Public Private Partnerships Benefit Texas

A policy white paper

Texas Conservative Coalition Research Institute
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Public-Private Partnerships (P3s) Benefit Texas

Texas' Transportation Needs

Transportation financing remains an urgent concern for state lawmakers. The All-Funds budget for the Texas Department of Transportation for 2012-2013 was nearly $20 billion, with about half going to planning, right-of-way acquisition and construction.[i] It is not enough. The Texas Department of Transportation (TxDOT) Legislative Appropriations Request for the 2014-2015 biennium, notes: "There is no question that Texas has a transportation funding challenge. Our traditional sources of funding have proven no longer reliable, making it difficult to meet the mobility needs of our rapidly growing state."[ii]

The Texas State Data Center projects our state's population to be as high as 55 million people by 2050. Furthermore, a recent Census Bureau report highlights Texas as the recipient of net internal migration: people leaving other states and moving to Texas. As population grows, so do the demands on infrastructure.

Public-Private Partnerships (P3s)

Amid competing state budget priorities and growing concern over public debt and general opposition to increased taxes, both the state and federal governments have explored new and innovate ways to fund costly infrastructure projects. Over the last two decades, public-private partnerships (P3s) have emerged as a viable and important tool. P3s involve contracts between a public agency and a private investor to build and operate public infrastructure. These partnerships allow for the sharing of both resources and risks in order to maximize efficiency and provide the highest value for taxpayer dollars. Such projects have been used to finance of variety of needs such as roads, bridges, and facilities for water treatment, energy generation, and even recreation.

P3s generally work as collaboration between a public agency and a private investment consortium. The private group provides the design, financing, development, construction and operation of the project. The public agency will retain ownership of the project, oversee its operation, and manage the private group's involvement, often involving a decades-long contract. Projects are financed though combinations of state contributions, private activity bonds (PABs), equity investment by the private developers, and loans from the Transportation Infrastructure Finance and Innovation Act (TIFIA) loan program at the U.S. Department of Transportation. Over the course of the project term, the private partner's investment is repaid through tolls, designated revenues, cost savings, or lease agreements. Additional revenue that is accrued can either go directly to the private partner or be split between the private and public partners, depending on the terms of the contract.

Texas has been utilizing P3s to help finance public projects for several years, and the Legislature recently provided new and additional authority to govern these agreements. The 82nd Legislature passed the

Public Private Facilities Infrastructure bill (SB 1048) allowing the use of P3s for infrastructure development projects at the state, county, city, and school-district levels. While transportation projects were not included in SB 1048, legislative action in 2007 (SB 792, 80R) authorized the limited use of private sector investment in these arenas, and Senate Bill 19 (82R) established a streamlined process for local toll projects.

Alleviating Transportation Debt

The value of these partnerships is especially acute in the area of transportation. Texas has historically used a pay-as-you-go approach for transportation funding, building roads as money is available from vehicle registrations fees and taxes on motor fuels. However, in recent years these fees have not been able to sustain the state's roads and construction needs due to increases in population, cost of construction, increased fuel efficiency and other factors that impact revenue for road building.[iii] As a result, Texas taxpayers have been forced to make sizable investments in the state's transportation infrastructure, mostly through increased debt.

Texas debt service payments have doubled since 2007, and in the most recent state budget, debt service payments total more than spending on the judiciary and the Department of Public Safety, combined.[iv] Transportation-related bonds are among the chief contributors to increases in state debt, accounting for more than one-third of all outstanding state debt. Transportation debt accounts for 57.6 percent of the debt that the Bond Review Board anticipates will be issued in fiscal year 2013.[v]

Faced with such costs, it is important that the state continue to utilize private financing – among other transportation financing options – in order to mitigate costs that would otherwise be borne exclusively by taxpayers through the cost of long-term debt, higher taxes, and/or increased fees.

Use of P3s for Existing Transportation Projects

The Texas Department of Transportation (TXDOT) uses a version of P3s called Comprehensive Development Agreements (CDAs) to partner with private companies to design, finance, and maintain tolled highways.[vi] A variety of CDA arrangements are underway throughout the state, including the construction, financing, and eventual maintenance of the 13-mile LBJ-635 corridor expansion in Dallas. In addition, a CDA allowed for the development of State Highway 130 (Segments 5 & 6) from Austin to Seguin.

The benefits to the state from these projects are significant. For the LBJ-635 project, the state contributed $445 million, but will ultimately receive a $2.7 billion investment in new road capacity for a one of the most congested areas of the DFW region.[vii] In the development of State Highway 130, Segments 5 & 6, no public dollars are involved and the entire cost of the $1.3 billion project is financed by the private investor. [viii] Both of these projects also create thousands of new construction and engineering jobs for Texans during the course of the construction phase.[ix]

P3s in Context

P3s offer valuable improvements to the transportation system by bringing private sector expertise to the public arena. Private companies often have substantial expertise in financing and asset management, thereby successfully leveraging billions of dollars for investment into public infrastructure. P3s are able to accelerate and guarantee the completion of large and complex projects in ways often superior to the delivery model of state and local governments. Additionally, the option to include long-term maintenance of the project in addition to the design and construction makes P3s a very appealing solution to public infrastructure needs.

Despite its advantages, the use of P3 projects nationwide is still limited. In fact, the P3 market share for national highway investment since 2008 is roughly 2 percent.[x] Opposition to tolling as well as opposition to private profits from operating public infrastructure have prevented many states from enacting legislation to accommodate and allow for P3 agreements. Union opposition has also derailed efforts in states such as New York and New Jersey.[xi] And while the use of P3s is increasing, many countries in Europe spend nearly five times as much as the U.S. in leveraging private sector dollars to fund public projects.[xii]

Many private international companies have significantly more experience with toll projects than do American companies, and there is no inherent risk to the State of Texas if its highways are funded with private capital. As Leonard Gilroy, a senior policy analyst at the Reason Foundation, noted in his 2007 testimony before the Texas Senate Committee on Transportation and Homeland Security:

> States want to deal with firms that have extensive experience as toll road providers. The simple fact is that the United States has no such industry, as yet, because we have used only public-sector agencies to build and operate toll roads. Thus, responsible governments, wanting to ensure that the toll road is in experienced, professional hands, will weigh prior experience very heavily in their selection criteria… Attracting billions of dollars in global capital (and expertise) to modernize America's vital highway infrastructure is a huge net gain for Texas.[xiii]

The folly of rejecting private equity is particularly stark in contrast to the fact that private companies build the cars, trucks, gas stations, street lights, traffic signals, and virtually every other item that is necessary for travel on the public highway. Private companies also extract and refine the petroleum and petro diesel that is used to fuel the vast majority of vehicles that use public highways. There would be no meaningful system of highway transportation without the investments made by private enterprise. Involving private equity in the construction of public highways remains an entirely logical approach to delivering an effective and efficient transportation network.

Conclusion and Recommendations

While Texas has been involved in a variety of efforts to involve private investment in public-sector projects, more could be done in the cash-strapped area of transportation infrastructure. As tax receipts continue to fall short and the ability to finance large construction initiatives through public funds alone diminishes, greater reliance on P3 agreements can help address the transportation infrastructure funding gap. CDA agreements at TXDOT provide only limited authority in certain types of transportation infrastructure. While not a panacea for every transportation infrastructure challenge, broader authority and oversight to partner with the private sector can help address many of these issues.

***Recommendation*: Develop a standard framework for procuring state highway construction projects using a P3 model that protects taxpayers, promotes transparency, and encourages private initiative and investment. Utilize the success achieved through this approach in Europe.**

***Recommendation*: Expand the use of CDAs at TXDOT beyond just local toll projects to include other types of transportation infrastructure, including maintaining and expanding the capacity of the Interstate Highway System.**

ENDNOTES

[i] Legislative Budget Board, "Fiscal Size Up,"
[ii] Texas Department of Transportation (TxDOT), Legislative Appropriations Request (2014-2015).
[iii] Legislative Budget Board, "Texas Highway Funding: A Legislative Primer," March 2013.
[iv] Texas Bond Review Board, Debt Affordability Study, February 2013.
[v] Texas Bond Review Board, Debt Affordability Study, February 2013.
[vi] See Texas Transportation Code, Chapters 223 and 228
[vii] See project plan of finance at: http://ftp.dot.state.tx.us/pub/txdot-info/dal/lbj_635/cda/book1_exhibits/05_0909.pdf
[viii] See project plan of finance at: http://ftp.dot.state.tx.us/pub/txdot-info/tta/sh130_cda/exhibit_5.pdf
[ix] Texas Department of Transportation, I-636 New LBJ Project Overview; available online at: http://www.newlbj.com/documents/I635ManagedLanes-ProjectOverview.pdf
[x] William Reinhardt, "The Role of Private Investment in Meeting U.S. Infrastructure Needs," American Road and Transportation Builders Association Transportation Development Foundation, June 2011.
[xi] The Heritage Foundation, "Can Public-Private Partnerships fill the Transportation Funding Gap?" by William Reinhardt and Ronald Utt, January 12, 2012.
[xii] *The Economist*, "A River Runs Through It: A Natural Experiment in Infrastructure," March 2, 2013.
[xiii] "Improving Mobility in Texas through Public Private Partnerships," Testimony of Leonard Gilroy before the Texas Senate Committee on Transportation and Homeland Security; March 21, 2007.