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New Routes for Funding and Financing Highways and Transit
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Chairman Wyden, Ranking Member Hatch and members of the Committee, my name is Jay Dhru, Senior Managing Director with Standard & Poor's (S&P), a leading provider of credit ratings, research and analytics. In the infrastructure space, our teams of analysts assess risk and assign credit ratings to public-private partnership projects, or P3s, such as the I-95 Express Lanes managed lanes project in Virginia, the Goethals Bridge replacement in New York, and the Ohio River Bridges project.

Thank you for the chance to share our views on the challenges and opportunities towards addressing what we believe to be a $200 billion annual gap in funding the repair and new construction of critical U.S. infrastructure. How will America pay to build, and in many instances rebuild, the physical infrastructure needed to underpin economic growth for the future? This is one of the most important questions facing policymakers, yet one of the most intractable.

We can all agree that transportation infrastructure, reliably moving people and goods, is essential to reaching any nation's economic potential, and which faces a crisis in terms of the reality and scale in the previously mentioned funding gap. My testimony before the Committee today will outline several straightforward, private and public sector actions that would unlock substantially more private capital to shoulder some of the funding burden. More importantly, it will focus on how the needs of infrastructure can be financed through a range of investment sources, including the government and private sectors.

State of National Infrastructure

According to the Federal Reserve Bank of St. Louis, overall government spending on U.S. public infrastructure has fallen to a 20-year low of 1.7% of GDP. This is substantially lower than we see in most developed countries and more than five times lower in relative terms to what is spent in Canada. This figure underscores the conventional wisdom that the U.S. is falling behind on its infrastructure needs and that the funding gap continues to grow.

The World Economic Forum's Global Competitiveness Report for 2012-13 ranks the quality of U.S. roads as 20th in the world. The American Society of Civil Engineers rates U.S. roads and transit a 'D', our ports a 'C', and our bridges a 'C+'. The National Bridge Inventory released in March 2013 by the Federal Highway Administration indicated that 10% of the country's more than 600,000 bridges are structurally deficient.

Further, the National Surface Transportation Infrastructure Financing Commission suggests that just maintaining the existing conditions and performance of U.S. roads and transit would require a 50% increase in current funding levels. But with governments tightening their belts and banks, the traditional mainstay of private sector funding for big projects, repairing their balance sheets, this task is daunting.

At the same time, providers of public infrastructure spending – federal, state and local governments– have pulled back due to budgetary pressures. From 2008 to 2010, states cut spending as revenues declined by 12% in order to balance their budgets. In 2011 capital spending, of which transportation is the largest driver, dropped by nearly 3%. Similarly, new debt issuance by state and local governments declined by $64 billion over the last five years, more than 60% of which was used to refinance existing bonds, not to fund new projects.

The Role of Institutional Investors

While transportation funding has largely been left to the government, public funds for new projects and existing infrastructure repair are decidedly under pressure. This begs the question, who fills that void? Our analysis has found that institutional investors such as insurance companies, pension funds, and other non-bank lenders are well positioned to fill that void. In fact, infrastructure has many advantages for investors, including higher yields, the tolerance for long-term investment, and diversification. S&P has estimated that institutional investors would like to target about 4 percent of their portfolio to infrastructure, higher than their current levels of 2%. If achieved, this would provide an estimated $200 billion in additional infrastructure funding each year – nearly $3.2 trillion by 2030. We believe policymakers can take two important steps towards unlocking this investment:

1. Standardize project finance and enhance transparency, information, market visibility and predictability. The success of P3s in the United Kingdom, Canada and within certain U.S. states has grown in recent years due to just these types of reforms.
2. Minimize political and regulatory risk. Institutional investment thrives on certainty and having a clear vision of how expenditures are recovered, is vital to increased investor participation.

Public-Private Partnerships (P3)

In a P3, a group of private investors comes together to design, build and operate public infrastructure, lending their expertise and sharing in the risk of delivering transportation projects on time and within budget. Take for example the I-595 expansion project in Florida, the state's first P3 project financed with a Transportation Infrastructure Finance and Innovation Act (TIFIA) loan from the U.S. Department of Transportation, a bank facility and private equity. The $1.8 billion project was completed in 5 years, 15 years ahead of the state's schedule and at a cost of $275 million lower than state estimates.

P3 Financing

As for the public benefits of P3, governments are able to replace dangerously aging infrastructure or build new infrastructure to support economic growth much sooner than would otherwise be the case, while offering an opportunity to shift substantial risks over to private investors. It is the private investors in most P3s who absorb the risk of construction delays and cost overruns. Investors face steep penalties or even removal if not able to keep the projects on time and in operating condition.

In the U.S., P3s are still relatively new, being deployed in only a handful of states and principally for road transportation projects. Elsewhere in the world, the P3 model is being used more extensively to build schools, hospitals, public transit, court houses, prisons, and airports. According to the European Public-Private Partnership Expertise Centre, 80 European P3 transactions closed in 2013 totaling $16.3 billion.

The challenge in the U.S. is how to increase P3 accessibility. We put forward the following steps that would encourage P3 growth:

1) Establish mechanisms for the federal government to help states adopt best practices and innovation standards. Although 33 states and Puerto Rico have enabled P3, only a handful of states, notably Virginia, Texas, Florida, Indiana, and Colorado, have used them in a significant way. As an example, standardization of the P3 procurement and documentation process has been a major driver of high volumes of activity in Canada, where contract forms are consistent across provinces.

2) Expand the use of federal "magnet" and bond programs such as the TIFIA program and Private Activity Bonds (PAB). These funding sources attract private capital by lowering overall project costs and TIFIA offers favorable repayment terms.
3) Provide near-term funding certainty and predictability. A true partnership involves a long-term commitment and risk sharing on both sides of the public-private relationship. The current surface transportation and transit funding program, MAP-21, is a two-year program - an insufficient time horizon for the planning, design and construction of large-scale projects and programs that often take years to plan, build and manage.
4) Increase the transparency and availability of construction and performance data. This will enable the public and private sector to gain a better understanding of the costs and benefits to private investment in public assets from construction through the end of any given project.

In summary, we believe the actions outlined here could greatly reduce the funding gap through incentivizing and strengthening private investment. If nothing else, it is important to emphasize the importance of institutional investors in infrastructure financing.

Thank you for the opportunity to speak before you today on this important topic and I look forward to answering any questions you may have.