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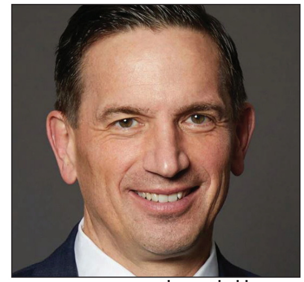
Industry Voices

# Commentary: Let private capital heal public infrastructure


Joseph Harvey

**By Joseph Harvey**

Fixing America's aging infrastructure shouldn't be this hard for the world's largest and most innovative economy, especially with a vast pool of private capital ready to share the load with taxpayers.

Infrastructure spending has been one of the most efficient ways to drive economic growth and create jobs. It helped fuel U.S. post-World War II expansion and was a key part of the recovery plan after the 2008 financial crisis. Yet, U.S. public investment now sits near an all-time low as a share of the economy — at 1.7% of GDP, down from 3% in 1967.

That could finally be changing. Momentum is building at both the state and federal levels for infrastructure spending programs that could provide jobs and pull the U.S. out of recession. In an election year, a lot is at stake to make sure this investment happens.

But a glaring omission in many of the current bills is that they focus exclusively on direct public spending, failing to cut down on complexities that could create pathways for putting private capital to work. In our view, this is a major miss.

The fact that U.S. government debt now exceeds the nation's yearly output would seem to create ripe conditions for opening the gates to the private sector. It's an opportunity for that rarest of social outcomes: a potential triple win. Consumers get better service quality. Politicians can claim credit for more jobs and an economic lift for the districts they serve. And investors gain the potential for attractive returns and predictable cash flows in a low-yield environment.

The issue: Before infrastructure investors can deploy capital to fix America's water system or make transportation infrastructure safer and more reliable, the government must create pathways for putting private money to work. Excessive red tape and political gridlock have made this a glacial process, contributing to the capital backlog in private infrastructure markets we see today.

Simply put, private-sector investors can provide much of the capital needed if given the opportunity and pathway to deploy capital.

For example, listed water utilities like American Water have been consolidating municipally owned water assets, helping to fund the sector's much needed pipeline replacement programs. A lot of these municipally owned assets are nearing the end of their useful lifespans and are gradually being sold to publicly traded utilities.

Listed infrastructure companies can use their access to capital to modernize water systems and enhance customer safety, typically without excessive rate increases. Municipalities can then use the funds from the sale to invest in other initiatives, like education and public safety. With 86% of U.S. water utility assets still municipally owned, we believe the potential for further acquisitions by listed companies remains substantial.

It's an example of "asset recycling," where government-owned fixed assets are sold or leased to private owners, with the proceeds used to improve other public infrastructure assets.

This approach has been used with great success around the world. Australia's Asset Recycling Fund provided incentives for $5 billion in asset sales, funding more than $6 billion in new development without increasing Australian public debt. The lease to operate and manage Canada's Highway 407 was sold to a private consortium 20 years ago, supporting nearly $16 billion in economic benefits and saving motorists 23 million driving hours a year due to improved efficiency.

We believe passenger railroads could be one example of asset recycling opportunity in America. Amtrak holds a de facto monopoly on U.S. train travel, but it lives off government subsidies, losing money on most of its lines. An exception is the normally heavily trafficked Northeast Corridor, which could be monetized through an initial public offering, with the proceeds reinvested to improve service quality and efficiency across Amtrak's service lines.

To get the ball rolling, what's needed is a push from the federal government to bring transaction and ownership structures for infrastructure into the American mainstream.

We are already seeing such a push to drive change in U.S. airports, where service quality lags many other parts of the world. The government has set up a pilot program to allow up to 10 airports across the country to be privatized.

Communications infrastructure, which includes cell towers and data centers, has been entirely funded by private enterprise in many countries, serving a critical role in the race to build out 5G networks. Speed to 5G development will create competitive advantages for those economies on the leading edge.

In energy infrastructure, tax-advantaged organizational structures have provided critical investment incentives that have helped to underwrite America's emergence as a major global energy producer. Designed well, we believe a pass-through structure for other types of infrastructure could be a game-changer. In fact, China is introducing the real estate investment trust structure to fund public infrastructure projects through its capital markets.

For those who doubt the imperative, the cost of doing nothing could be disastrous.

A public reckoning for the current spending shortfall is inevitable and may come sooner than we think. At a time when the government has a primary responsibility to allocate resources in support of pandemic relief, the need for the private sector to fund infrastructure has never been more imperative. The time to act is now.

***Joseph Harvey is president of Cohen & Steers, based in New York. This content represents the views of the author. It was submitted and edited under Pensions & Investments guidelines but is not a product of P&I's editorial team.***

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