What’s Next on Obama’s List?  
Infrastructure and Energy

LAYING A NEW FOUNDATION
Task List
1. SALVAGE BANKS
2. AVOID GREAT DEPRESSION #2
3. ENSURE HEALTH CARE FOR ALL
4. EXPORT-LED GROWTH PLAN
5. REFORM FINANCIAL ORDER
6. INVEST IN INFRASTRUCTURE
7. SHIFT TO CLEAN ENERGY

Congresswoman DeLauro on an Infrastructure Bank
California I-Bank Head Hazelroth
Cuomo Calls for a NY Infrastructure Bank
Furloughs as Counter-Stimulative?
Bringing Transparency to Banker Fees
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President Barack Obama came to office promising to address our financial crisis by redirecting ‘billions of dollars a week trying to put Iraq back together’ toward reinvesting in ‘putting America back together instead.’ From the broken levees of New Orleans to the I-35 bridge collapse in Minnesota to unsafe drinking water coming out of the faucets of many Americans, we face daunting infrastructure needs. The American Society of Civil Engineers awarded the nation a cumulative ‘D’ on its 2009 Report Card and called for $2.2 trillion in essential upgrades. To address these needs in a time of severe budgetary crisis, Obama is actively pursuing a range of traditional and innovative financing solutions including grants, loans, bonds, public-private-partnerships (PPPs), a National Infrastructure Bank, and a Clean Energy Bank. Here government is to play a role not only as regulator, but also as an investor in merit-based projects that lay a sound foundation for growth and promote equal opportunity.

Unlike President Ronald Reagan who charged that ‘government is the problem,’ Obama instead promises a government that works, one that ‘make[s] sure that we are investing in what’s required for long term growth.’ The stimulus act puts this investor-oriented approach into practice. The act mandates that the president -- and heads of federal agencies and departments -- abide by a prudent management standard when investing its $787 billion in funds. The prudent management standard requires that officials focus not simply on the performance of individual investments. Instead, officials must look to the act’s portfolio as a whole as well as to its impact upon intended beneficiaries.

Importantly, the stimulus act has two parts: appropriations and tax provisions. The tax provisions include a range of bond vehicles and inducements including the Build America Bond program, school bonds, recovery zone bonds, tribal bonds, Non-AMT Private Activity Bonds, High Speed Rail Bonds, low income housing credits, and an expanded Industrial Development Bond. It also includes related vehicles for clean energy, such as Clean Renewable Energy Bonds, an expansion of the Qualified Energy Construction Bonds, the Financial Institution Partnership Program, and also credits for renewable energy production, investments, expansion projects, home improvements, and alternative fuels.

While the shovel ready projects in the appropriations part of the bill have dominated the debates, we must also pay attention to the bond and other innovative vehicles. The shovel ready projects stimulate a short term business cycle and helped retain large numbers of jobs. The bond vehicles are clearly did this. For instance, the Build America Bonds unfroze the municipal bond market ensuring the retention of both public and private sector jobs.

At the same time, a main purpose of the bond vehicles is to provide long-term economic benefits through strategic investment in infrastructure and energy projects. Just as the Liberty Bonds during the Second World War were essential to financing victory in Normandy, so too are these reinvestment bonds key to delivering a sound foundation for an equitable America. For this reason, a full assessment of the bonds is premature.

Importantly, because the bond programs can finance long term public works projects -- the average Build America Bond issuance is between 20-30 years - they allow the government and private firms to make longer term economic plans and commitments than do shovel ready projects which will wind up and down quickly. As a result of the longer term business cycle that the bonds finance, we are likely to see firms start hiring for more ambitious projects that will last a number of years.

All this means taking a more holistic view toward the stimulus act, and a longer term one. We are a year and a half into American Recovery and Reinvestment Act and many Build America Bond projects will last for a number of years.

Equally importantly, the ability of these programs to contribute to reinvesting in America depends on reinforcing their successors. President Obama has proposed the extension of several of these programs including Build America Bonds and the Non-AMT Private Activity Bonds, as well as the creation of a national infrastructure bank to ensure that we choose public works projects on the merits. The House of Representatives passed the bond extensions, and the national infrastructure bank is being deliberated upon within Congressional committees.

Despite disasters, distractions and obstructions, President Obama along with Congressional allies continues to move steadily through his agenda to increase competitiveness, ensure national security and expand opportunity by laying a new foundation for growth. Once financial regulation is passed, we will next turn to energy and infrastructure investment. We face astounding infrastructure needs. In a time of constrained budgets, it is essential for the public and private sector to work together to stretch dollars and achieve public value.

This inaugural double issue devotes itself to our reinvestment in America, focusing on a number of pressing innovative financing issues now on the table. We are pleased to have public officials such as Congresswoman Rosa DeLauro and California Infrastructure Bank Executive Director Stanton Hazelroth offer their insights into not only why we need a national infrastructure bank, but also how it would work in practice.

We also would like to express our gratitude to the Ford Foundation for its generous support in making this publication possible. Comments, story ideas, newsworthy items, and letters welcome: michael.likosky@nyu.edu.

’Let’s make sure that we are investing in what is required for long-term growth‘
- President Obama

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On February 13, 2008, then-Senator Barack Obama delivered a speech that marked a turning point in his candidacy and that would define much of his presidency. On the factory floor of the General Motors assembly plant in Janesville, Wisconsin, Obama pivoted away from being the sole candidate to have opposed the Iraq War and toward positioning himself as the forceful champion of America’s economic recovery. In this landmark speech, Obama argued for redirecting our energies away from reconstructing Iraq and toward reinvesting in America. This approach would be a cornerstone of the American Recovery and Reinvestment Act. Importantly, Obama also proposed creating a national infrastructure reinvestment bank to direct these efforts.

By the time Obama took office as president roughly a year later, our national ailment had become synonymous with a financial contagion originating in the subprime mortgage sector. In line with this diagnosis, our economy was undergoing a course of capital injections initiated under the previous administration into blue chip financial institutions and the market-dominant insurance firm AIG. Obama’s apparent decision not to disrupt this treatment predominated the twenty-four-hour news cycle. However, despite the expenditure caused by bipartisan bailouts, non-performance-based bonuses, and Washington–Wall Street teamwork, it is nonetheless useful to take a Copernican view of things. The subprime mortgage crisis, although disastrous, is a symptom of a much larger, graver chronic illness.

The Obama capital infusion was a stimulus package, not an extension of the Bush administration bailouts. It marked a sharp break. Viewed through the lens of the Janesville speech, which would create two million new jobs, which could not be outsourced. The spirit of the Infrastructure Bank—forward-looking, merit-based investment decisions—in multiply into almost half a trillion dollars of additional infrastructure spending. Importantly, the bank would choose projects ‘not by politics’ but instead ‘by what will maximize our safety and homeland security; what will keep our environment clean and economy strong.’ In other words, the bank would choose projects ‘not by politics’ but instead ‘by what will maximize our security and homeland security; what will keep our environment clean and economy strong.’

For this reason, the bank and AIG stimulus should not be dismissed outright as restoring the pre-crisis Wall Street status quo. Instead, we should be engaging in a debate over the public policies that actually underpin them with an eye toward whether the capital infusion itself is the appropriate means to accomplish the intended aim. In other words, we must determine what these policies actually are and also ensure that public and private tools are in place that are tailored to advancing them. This is a prerequisite to devising appropriate accountability measures.

The Janesville Plan set forth the basic axioms of the Obama administration’s approach to recovery and reinvestment. Obama prefaced his Janesville speech by stating, ‘What I really want to do is talk from the heart about where I want to take this country.’ Thus, one might look to Janesville to give definition to that enigmatic Obama principle of empathy.

Obama began by telling the audience not to expect the rousing speech delivered a day earlier to a full-capacity audience of nearly twenty thousand in Madison, the capitol city of Wisconsin and a university town, at the Kohl Center, the University of Wisconsin’s sports stadium, which was named for the state’s U.S. senator and department store magnate. Instead, Obama would ‘take it down a notch,’ giving ‘a little more detail.’ On Hardball that night, Chris Matthews described the speech this way: ‘He’s saying: I better move from the great speechmaking to the nuts and bolts to show the beef here to mix the metaphor.’ It was no accident that Obama chose to deliver his speech, assessing our economic predicament and proposing a policy agenda to lead us out of it, on a factory floor in the Rustbelt. In fact, his competitor at the time, then-Senator Hillary Rodham Clinton, on the day before, waved boxing gloves above her head on the factory floor of another General Motors assembly plant a couple states over in Lordstown, Ohio, saying, ‘We need a fighter and a champion in the White House again for the American people.’ With sports utility vehicles behind him, Obama spoke to an audience of around six hundred autoworkers.

Obama dispelled the still-persistent and prevalent myth that the subprime mortgage meltdown caused the crisis. Instead it was ‘the straw that broke the camel’s back.’ In fact, the crisis was ‘the culmination of decades of decisions that were made or put off without regard to the realities of a global economy and the growing inequality it has produced.’ As a result, the central job of government was to restore equal opportunity. Obama spoke compellingly about how the root of our crisis lay in government decisions to advance domestic and international policies that privileged corporate profits and the interests of the wealthy over worker jobs and fair wages. In other words, the crisis was not caused by the government passivity associated with the commonplace idea that it was the absence of government, its retreat through deregulation, that alone allowed the market to grow out of control. Moreover, it was not simply a banking crisis, arising in the financial sector and destined to be solved there. Instead, the government actively promoted policies driving a form of globalization that advantaged the few over the many. The Janesville speech explained how government policies driving both domestic and foreign commercial investment are inextricably entwined. The Council on Foreign Affairs included Obama’s Janesville speech in its Essential Documents collection, devoted to seminal foreign policy pieces.

As Obama diagnosed our underlying illness, he turned to the infrastructure crisis, telling a story of neglect, decay, and a collapsed bridge in nearby Minneapolis. Although he made no mention of Katrina, the decision by the executive branch to ignore the human cost of infrastructure failure was still fresh. With this diagnosis, Obama proposed a solution that sought to redirect our foreign reconstruction agenda into domestic. ‘It’s time to stop spending billions of dollars a week trying to put Iraq back together and start spending the money on putting America back together instead,’ an effort organized through the Infrastructure Reinvestment Bank. Thus, the Obama Infrastructure Bank itself is the central institution for reenvisioning our domestic and foreign commercial policies in order to address the root causes of our financial crisis and to chart a durable twenty-first-century New Deal for America.

Through the bank, Obama would address the broken political system’s inability to devise policies that advance the public interest, moving decisions over infrastructure policy away from the earmark system and instead toward being made on the merits of the projects themselves. In other words, the bank would choose projects ‘not by politics’ but instead ‘by what will maximize our safety and homeland security; what will keep our environment clean and economy strong.’ In Janesville, Obama proposed that the bank be capitalized by sixty billion federal dollars over a ten-year period. This relatively modest sum in the face of astounding need, Obama asserted, ‘will multiply into almost half a trillion dollars of additional infrastructure spending.’ Importantly, the financial institution and insurance firm stimuli are key elements in this strategy. Speaking at a factory, which would not survive to see his inauguration, Obama presciently explained that the bank would create two million new jobs, which could not be outsourced.

The spirit of the Infrastructure Bank—forward-looking, merit-based investment decisions—influenced the American Recovery and Reinvestment Act with its portfolio-based approach to public
5 RECOMMENDATIONS FOR A NATIONAL INFRASTRUCTURE BANK

Infrastructure Banks and public-private-partnerships have a long history internationally and are also a staple of our foreign commercial policy. For this reason, our own National Infrastructure Bank should benefit from lessons learned. A central lesson from our experience with the innovative financing of public works abroad has been that banks and methods of project delivery evolve over time so as to be responsive to specific needs. For this reason, we should not view a National I-Bank as a static institution. Instead it should solve problems. Here are 5 Recommendations:

1. Offer capacity-building (e.g. feasibility studies, financing advisory, contract drafting assistance) to low and medium income cities and states as a cost-effective way of improving decision-making. Related, provide assistance to public pension fund fiduciaries seeking investments within the US.

2. Ensure a multi-sectored bank including traditional infrastructures and also alternative energy as well as broadband. Tied to this, devise internal capacity across sectors and in a number of subject areas such as finance, law, economic growth, accountability, and the environment.

3. Establish mechanisms for citizen participation in project decision-making. Ensure that structured participation is available throughout the project lifecycle including the early stages.

4. Consolidate federal innovative financing programs and administer them through the bank so as to increase leveraging and multiplying effects. Include also key American Recovery and Reinvestment Act bond and guarantees programs. The bank should also explore issuing its own bonds. It should also deepen existing bonds with the aim of advancing specific public purposes.

5. Canvass international best practices in infrastructure bank design and public-private-partnership delivery, focused on a range of topics including commercial, growth, and accountability aspects.

In other words, high-speed rail, like the Infrastructure Bank, combines a set of progressive public purposes with a partnership-based means to delivering them. The second half of the stimulus bill devotes itself mainly to this bond-driven, subsidy-based reconstruction, as does our clean energy strategy. The high-speed rail itself is such a partnership, aiming to create a new foundation of a clean energy economy, one that, in the words of Obama’s inaugural address stressing the importance of infrastructure, ‘binds us together.’

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its GDP in infrastructure and India 5 percent and rising, while the United States spends less than 2 percent of GDP on these critical investments. The concept of a National Infrastructure Bank has evolved so that a proposed U.S. development bank can properly seek to make investments in traditional infrastructure, such as roads and water systems, as well as the infrastructure of tomorrow, namely high-speed rail, energy and broadband. If our nation is to remain competitive in the global economy, it is vital that a strong national infrastructure policy that includes a National Infrastructure Development Bank is needed now more than ever.

ML: Within the debates over an Infrastructure Bank, disagreement exists over whether it should be limited to transportation or instead be broadly multi-sectored. All international infrastructure banks around the world are multi-sectored and include energy as well as infrastructure. You have been a strong proponent of a multi-sectored bank. What is at stake here? Why does it matter whether a bank is single or multi-sectored?

CDL: By limiting the scope of projects to be considered, a National Infrastructure Bank would not have the diversity of revenue streams, location and borrower types to achieve the greatest multiplier in leveraging of dollars available or the ability to take a holistic view of infrastructure development. It is important to note that the European Investment Bank, which is the model for the National Infrastructure Development Bank in my proposed legislation, was established over 50 years ago and has successfully made investments across a wide range of infrastructure sectors with the goal of enhancing European integration. It is critical that a U.S. National Infrastructure Bank take a similar view of the critical needs in the United States and invest in projects of regional and national significance, including those that cross jurisdictional lines. Such a Bank would give states and localities a single location to seek funding for projects that may have a combination of transportation, environmental, energy or telecommunications components.

ML: One of the main purposes of an Infrastructure Bank is to take advantage of a very strong interest in the US market among central banks, sovereign wealth funds, pension funds, and insurance companies. It is a way of stimulating investment in our public works and creating jobs in a time of severe budgetary constraints. In what ways can we ensure that private participation forms a genuine partnership?

CDL: In my view, the central function of a National Infrastructure Bank would be to issue federal bonds allowing these investors to invest in projects through the Bank. As an example, the City of Los Angeles is seeking to expand the L.A. rail system using revenues from a half cent sales tax increase approved by the voters. Currently, it will take Los Angeles 30 years to complete the estimated $40 billion project as the revenues come in, but with a Bank offering a loan to be paid back with the sales tax down the road, the project could be done, perhaps at a lower cost, in 10 years. Such a public-private partnership involves the private sector investing in bonds to help pay for the infrastructure project, but not taking ownership of or privatizing a project. Of course there are other types of public-private partnerships that the Bank can facilitate. For any project, in my proposed legislation the Bank is explicitly directed to ensure that we are engaged in projects that maximize the level of private investment while providing the greatest public benefit.

SH: The I-Bank received a General Fund appropriation of $181 million in 1999. Most of those funds have been used in the Infrastructure State Revolving Fund Program where the Bank made loans to eligible cities, counties and other local governmental entities for one of the sixteen categories of infrastructure listed in our statute. The I-Bank made loans to eligible cities, counties and other local governmental entities for one of the sixteen categories of infrastructure listed in our statute. When we had sufficient revenue returning in the form of loan repayments from initial borrowers, we pledged a portion of those revenues to a bond issue and borrowed more money to make more loans. By utilizing this revolving fund program approach, and selling approximately $50 million of bonds in three separate series since the creation of the program, the Bank has been able to commit to about $400 million in loans to local governments. The Bank also ‘buys down’ the interest rate to the borrower by 1/3. The interest rate is based on the cost of the average ‘A’ rated bond determined on the date of board approval of each loan. The Bank also charges ‘fees’ for making each loan and an annual monitoring fee. Similar fees are charged for issuing and monitoring each bond the Bank issues for non-profits, manufacturers and processors, state government entities and the like. The Bank finances its annual operations from the fees charged to borrowers and interest received with loan repayments.

ML: Is it a challenge to develop the internal expertise to assess and monitor projects in diverse sectors?

ML: Is a national infrastructure bank a campaign promise of President Obama? It is now being discussed in Congress where a debate is happening over whether it should be transportation-oriented or multi-sectored. California’s I-Bank covers many sectors. What advantages are tied to this?

SH: Michael, I recently testified before the House Ways and Means Committee on Select Revenue Measures on this very topic. There are several reasons I stressed a multi-sectored approach. The most obvious is that there is a variety of needs that can all be addressed by a National Infrastructure Bank. Even more important is that the core of our I-Bank, as would be the case at the national level, is a highly trained team of finance experts familiar with the whole range of financing tools available. Once this team is assembled, moving from transportation to water is not difficult. The fundamentals are very much the same. Recruiting a financing entity for each subject matter area is a waste of resources and, I believe, dulls the creativity of the team. Operating in several arenas also allows the Bank to develop a larger, more diverse, portfolio. This is helpful in leveraging and ratings.

ML: Is it a challenge to develop the internal expertise to assess and monitor projects in diverse sectors?

SL: Yes. In the California civil service there is no category of employment that allows one to easily assemble the high level team of financing experts necessary to operate a bank. We have been fortunate to find many people from the private sector that we could hire into this creative and fascinating work, we have trained some talented folks within the system, and acquired high level Career Executive Assignment Positions that gave me the flexibility to hire uniquely experienced and talented people. I strongly recommend that the National Infrastructure Bank be equipped with a number of positions, either appointed by the President or the Board, without pre-qualification through a civil service system. This Bank will not have a need for dozens of clerks with the same abilities, but rather individual high level finance professionals as described in the DeLauro Bill. While I think it is helpful to describe the positions needed as the Bill does, I would suggest that all those positions be hired by and report to one Executive Director in the traditional corporate format.
Opposition

OPINION

LESIONS FOR GREECE: AMERICA’S ANSWER - WE INVEST

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The Greek government and one of its bankers, Gold-

 Sachs, are coming under fire for risking the

Euro solvency. Pressured to abide by the European Union’s debt ceilings, the government simply
moved its obligations off the balance sheet. They bonded the rights to airport landing fees and
lottery revenues in return for cash up-front. Although the book keeping changed, the liabilities
remained. Like an exploding subprime mortgage, the Wall Street techniques dug Greece into an
even deeper hole. The bills have now come due. Europe and perhaps the global economy will be
forced to foot the bill.

The take away lesson is not that Goldman hoodwinked Greece into signing on to a disadvanta-
geous deal. The solution is not just to rebuke Goldman and re-bond the country’s debt. Greece has
not been the only government to adopt Wall Street financing schemes. American state and local
governments have been securitizing public works and public revenue streams for decades. Does
this experience have any lessons for Greece and other European countries, such as Italy, that have
aggressively securitized state assets?

In financial crises governments look for innovative financing schemes, such as Public Private
Partnerships or P3s to limit the damage. However, P3s only make policy sense if the capital raised
leads to the creation of a valuable public asset. If, as in the case of Greece, they are simply a way
to avoid debt limits and generate off-balance-sheet cash, they have no underlying economic value.
In practice, the first generation of P3s in the US included many such efforts at short-term budget
balance, and they have imposed too much risk on governments. Under tax-driven sale-leaseback
deals, the private buyer has an incentive to under-invest in the asset or even to allow its degrada-
tion for tax purposes. The private investors are only concerned with repayment, not with service
quality. As the Greek case illustrates, this is the wrong way to encourage private innovation in
infrastructure.

Beginning in the 1980s, often at the urging of the US Department of Transportation, cash-strapped
public authorities raised quick up-front money through tax-sheltered deals. For example, they sold
and then leased back assets, such as rail cars, to financial institutions that benefited from the depre-
ciation write-offs. In 2004, the IRS and Congress reviewed these deals and found them potentially
abusive, putting an end to the practice. However, cities had already locked themselves into over
$16 billion of deals, many backed by AIG.

Sale-leaseback deals are an extreme form of P3 where the investor is essentially a passive finan-
cier. Other more defensible P3s provide financing and private sector expertise on advantageous
terms that give the investor a stake in the on-going success of the investment. However, in times of
financial crisis, even these deals may lock governments into contracts that could distort public
sector priorities. They may lack the flexibility of in-house projects that can be delayed, speeded up
or redirected in response to changing circumstances. Of course, contracts can be renegotiated, but
this is a costly and time consuming option.

The solution is not to quarantine private finance and to steer clear of Wall Street innovations,
preventing them from aiding our recovery. However, the tail should not wag the dog. Politicians
often look no further than the next election, even when they make long-term financial commit-
ments. Benefits occur right away, but the costs are borne in the future and can be hidden in obscure
contract terms that may be difficult to watchdog groups and political opponents to decipher.

At their best, P3s forge a genuine partnership with incentives to produce and maintain quality pub-
lic assets. However, these benefits will not occur without informed public debates over such issues
as contract types, tax code incentives, and financing decisions.

Unfortunately, there is reason to worry. The first P3 projects in the US have not released even de
mimms project documentation. This is true throughout the country from California to Texas and
Pennsylvania and across to Florida. Particularly in the Midwest, the contractual models in use are
widely associated with failures to manage risks effectively—creating accountability deficits, and
inviting renegotiations.

In America, despite the lack of public discussion and transparency, P3 deals are hardly hidden from
regulators and sophisticated investors. The same was true in Greece, where deals were wide-
ly reported and celebrated within financial circles. The European Union was well-aware of the way
these transactions were used to evade its debt ceilings. Moreover, Greece was not alone within
Europe in pursuing these schemes with the help not only of Wall Street but also with assistance
from UK and European banks. One analyst quoted in the Wall Street Journal on October 22, 2001,
stated that securitized debt in Greece ‘enables them to raise cash in a difficult environment’—‘The
report went on to note that ‘Analysts warn, however, that despite clever financial engineering this
is still debt, whether it appears on the balance sheet or not.’

Growing one’s way out of crisis requires both traditional and innovative financing schemes.
However, governments must have the capacity and the incentives not only to assess the long-term
effects of leveraged projects but also to bargain effectively for favorable terms that add value. For
example, the national infrastructure bank now under consideration in Congress must play this role
by including safeguards and provisions for public participation and accountability. It can provide
incentives to state and local governments to avoid the worst abuses of P3s and develop productive
projects.

ON THE CAMPAIGN TRAIL:
CUOMO PROPOSES AN I-BANK FOR NY STATE

Andrew Cuomo recently announced his run for NY Governor. To lead the state out of severe budgetary crisis, Cuomo issued a New NY Agenda - an action plan to clean up Albany, rightsize government and restore its fiscal
health, and also advance individual rights. Notably, Cuomo has a strategy for getting the economy out of crisis, creating a State Infrastructure Bank. Given the state’s finances and the need to maintain public services,
an infrastructure bank will not itself bankroll large expensive projects.

Instead, the bank will play a catalytic role. Congresswoman DeLauro in her interview spoke about
the existing appetite among investors — private equity funds, sovereign wealth funds, investment
banks, hedge funds, and pension funds—for public infrastructure. The Build America Bond pro-
gram itself provided a vehicle for this class of investors to finance projects in NY. A Cuomo bank must make use of this money now sitting on the sidelines. It should appear across the political spectrum as it does not involve taxes or significant direct spending.

It could be capitalized with Build America Bonds. As California I-Bank head Hazelroth noted in
his interview within this publication, initial seed money cannot only launch a bank but also facili-
tate a revolving fund. An I-Bank can become self-financing.

Importantly, as Cuomo stresses, New York now foregoes favorable federal streams of financing,
because it lacks a receptive regulatory environment. States with enabling legislation and adaptive
agencies disproportionately secure this money. An infrastructure bank can address this issue. To
do so, it must be multi-sectored to take advantage of the Obama administration’s increased focus
on inter-modality and coordinated planning.
FORMER DIRECTOR OF NY STATE ASSET COMMISSION BAREND

ML: As Executive Director of the New York Commission on State Asset Maximization, you assessed the state’s infrastructure needs and explored workable ways of financing them. What surprised you most?

SB: I was most surprised by the widespread misperceptions and varied, sometimes completely inaccurate, definitions of public-private partnerships. For nearly two decades NYS has tried to pass alternative delivery legislation and it has consistently failed. In each instance, legislation was introduced that overlooked labor concerns, offered an unclear process for project oversight, and the bills did not provide a rationale for when and why such projects would or would not be advanced. Labor unions, for instance, viewed these projects as a means to bring the state’s cost savings at their expense, to reduce the use of in-house engineers, and to scale back their hard fought wage protections. Worse, legislators viewed these deals as windfalls for the private sector on the backs of taxpayers. A public entity with PPP oversight authority would obviate many of these issues.

Through the Commission’s work, however, we uncovered that PPPs can be a powerful tool in our toolbox to stretch taxpayer dollars. Alternative delivery can be a win-win for everyone if a consistent framework is put in place to assess the merits of proposed projects with the private sector. If value for money exists and public policy imperatives are protected, then there is a real space for alternative delivery procurement.

Canada and the UK have had incredible success utilizing PPPs to generate real cost savings through innovation and efficient infrastructure delivery. With these savings they have undertaken more projects, in less time, and with more accountability to taxpayers. That means more jobs, increased economic activity, and better infrastructure all delivered faster to taxpayers.

ML: One of the most debated issues in NY and elsewhere has been how to pay for projects. P3s or public-private partnerships have been widely discussed. What do you see as the main advantages and risks of using P3s?

SB: The main benefit of a PPP is the opportunity to efficiently allocate risk and reward between the public and private sector to deliver a service or facility for the benefit of citizens. This ability to allocate risks enables the government to assume the risks it can properly manage while the private sector takes on risks it is better suited to manage. The outcome is that you have certainty a project will be finished on-time, on-budget and you have assurance that the asset will be maintained properly for a set time period. If for some reason that asset is not up to standards established in the contract with the private party then the State does not pay. Since the private sector is taking long-term financial risk it is more accountable and will design and construct a structure that will last for the long-run.

The main risk of using P3s is that these projects are complex, require considerable public sector knowledge and capacity to implement over a long-term. There is also a maze of federal, state, local and public authority resolutions and statutes that can at times bring unforeseen regulatory challenges to bear on projects.

States have tripped up in their well-intentioned efforts to advance PPPs due to lack of technical, legal, and financial knowledge in how to structure the procurement process and proceed through financial close. Most public agencies have no experience allocating risk and do not have the in-house knowledge to successfully advance PPP projects. Without a budget to build internal capacity and hire outside advisors, states may not gather the most value for money from PPP projects. Further, responding to PPP RFPs is a multimillion dollar proposition for firms, so if there is not a credible procurement process in place the level of competition from the private sector will be minimized. Governments need to acknowledge what they know and don’t know, work with the industry to do capacity building in-house, so the procurement process inures to their benefit.

AN INTERVIEW WITH STANDARD & POOR'S GABRIEL PETEK, DIRECTOR OF STATE AND LOCAL GOVERNMENT

ML: You have taken the position that furloughing introduces a de-stimulative impact into the economy. Can you say something about the logic behind this view that furloughing can adversely impact on a state like California’s credit rating?

GP: Sure, it’s not so much furloughing per se, but any action that the state is taking to make spending or service cuts in order to lower its expenditure to achieve fiscal balance. We realize that the state has very little flexibility on the revenue raising side. On the other hand, when the state makes cuts to programs, furloughs and lays off, or reduces programs in a way that leads to layoffs, or even delays capital spending like CA did last year through ROUs, these actions basically take cash out of the state’s economy. It can compress economic activity in California and have negative multiplying effects. When California makes cuts or furloughs, in this case it was two days a month for something approaching 200,000 state employees, it’s basically resulted in a 10 percent pay reduction for the state’s employees. So, when you talk about that number of employees, it can have a negative effect on spending throughout the state.

ML: Does the impact that furloughing can have become magnified when we shift to talk about layoffs? Is this a sensible way for states to prioritize how they balance their budgets?

GP: It does, it does. And the state is in a position that it doesn’t have a lot of good options. However, it doesn’t remove the fact that reducing work force and furloughs may have a negative effect on economic activity in the state. That’s the perspective we had on it.

Another thing is that when we looked into this, the Department of Finance had reported that furloughing of some of its staff within the Board of Equalization – which does tax collection -- would translate to roughly $800 million over two fiscal years in foregone revenue. They didn’t have the staff working hours to collect taxes and penalties by delinquent taxpayers. So, there’s a less theoretical element to this as well.

You can see that some of these actions over the course of several fiscal years could have a negative effect on the state economy if they undermine education services, the quality of infrastructure, and the workforce’s pay keeping up with inflation. That can ultimately have a downward pressure on the state of the economy.

ML: You speak of how these sorts of decisions can undermine the health of the economy by resulting in deteriorating assets and services. Do you see the leasing and sale of state-owned assets as potentially having the same impact as furloughing and workforce reduction?

GP: You’re referring to when the state securitizes the sale of publicly-owned assets. This is a slightly different issue. I view these as a one-shot option to balancing the budget. But, like furloughing, it’s not a step in the direction of a structurally balanced budget.

The revenue raised from selling off assets is gained up front for the fiscal year 2011. It is used for the budget of that year. Then, going forward, the state is going to be leasing the properties that before having sold them it owned. And, then they are going to be leasing out into the future. This is not really a step in the direction of structural best budget practice.

Coming out of a severe recession when the state has had a 19 percent decline in revenue between 2008 and 2009, it shows you how severe the downturn was. So that definitely translates into a long term fiscal liquidity problem that the state has been grappling with. So, this is one option the state has to alleviate the cash flow problem. For this reason, it’s an understandable alternative. But, if they do pursue this option, it’s important for the state to recognize that this option will not solve its budgetary deficit. Borrowing against assets that they already own through leasing devices is very much like taking out a second mortgage and then living off of it during a period of unemployment, hoping to pay it back later when your household income is where you want it to be.
Revenue Neutral Proposal

A National Clearinghouse for Banker Fees

The Build America Bond program created under the American Recovery and Reinvestment Act has caused a stir this year. Senator Charles Grassley called out Goldman Sachs for the high fees it charged connected to underwriting these bonds. By all accounts, the bankers have charged higher fees for issuances under this program than for traditional tax-exempt municipal bonds. A number of rationales have been put forward both justifying these fees as an understandable aspect of introducing a new bond vehicle in the midst of a financial crisis. Others point to the fact that the fees still seem disproportionate to the services rendered. Regardless, the fee rates seem on the wane. Nonetheless, the debates over fees are misguided. With the Build America Bond program now under consideration within Congress for extension until 2012, it is important not to indict the program itself based upon problems over fees.

Moreover, underwriting fees are a problem that stretches far beyond the Build America Bond program. Little transparency exists in the market. As a result, fees have been steadily escalating for a number of years. Also, when fees are pegged to the pricing of a project and its attendant capital raise, then larger projects mean netting bigger fees. It can become unclear whether the incentive here is to raise money for much needed projects or else to value assets so as to increase fee rates. That said, we rely upon bankers to move capital into much needed public works and energy projects. The function they serve in a time of financial crisis is all the more valuable. Our large scale investment banks will play a pivotal role in determining whether we can build the projects we desperately need and also forge the types of public-private partnerships akin to the Second World War ones that drove us to victory.

Bankers play a vital role in finding and bundling investors for our public works projects. However, as we pursue infrastructure and energy projects to ensure our national competitiveness, security and ability to deliver broad-based opportunity, we need to make certain that fees do not distort the structure of projects or drain equity from them.

Many years ago, Justice Louis Brandeis set forth the structure of projects or drain equity from them.

All else is nothing more than a toll charge on the road to capital. To ensure that banker fees reflect these considerations, we propose creating a National Fees Clearinghouse. It would provide a real time one-stop repository of fees for a range of services, such as arranging public-private-partnerships, bond related activities, and advisory. The rationale for charges would be included.

Right now, not only is the underwriting fees market not transparent, but it is also balkanized. For instance, a city in Maryland does not always have access to the fees charged for a similar project in Florida by another town of roughly equal size and creditworthiness. At the same time, a local official is constrained, large investment banks operating throughout the country are not. For instance, the same investment bank may charge different fees to those Maryland and Florida projects. If good reasons exist for difference, then we should know them. Moreover, in the era of the Internet, fees can be published real time and circulated broadly.

In an era of skepticism about the motivations and operations of our large financial institutions, a little transparency can not only promote accountability but it can also provide a greater appreciation to the value that these institutions bring to the table.

Realignment planning and finance of public infrastructure and community development

Scale: The initial funding to create the HUD Sustainable Communities is under the Community Development Block Grant program. CDBG, long a favorite of mayors and other local politicians of all parties, has the somewhat undeserved reputation as federal block grants for locally directed pork. While probably not so widely used for political patronage as advertised, CDBG certainly gets spread around within a city – a little here, a little there. CDBG generally is not as coordinated nor as leveraged as it could be. So, as a more targeted carve-out of CDBG funds, Sustainable Communities encourages greater coordination and leveraging – all of which are intended to give the program impact on a larger (i.e., regional vs. local) scale.

Silos-busting: HUD’s Sustainable Communities is part of the federal Sustainable Communities Initiative, a partnership between HUD, the US Department of Transportation and the Environmental Protection Agency under an interagency operating agreement that, as the Regional Planning Grants, seeks to coordinate housing, transportation and environmental policy. While it remains to be seen whether agencies with different cultures, different languages, different goals can work together in a meaningful way, the initiative illustrates that the Obama administration expects government bureaucracies to function differently (albeit in relatively modest ways) than ever before.

Leveraging Private Sector Resources, Private Actors: In these days of increasingly scarce public resources and growing economic need, governments have to do more with less. This means public private partnerships, tax incentives, tax credits, targeted grant programs and other subsidies and competitive programs – lots of innovative new programs like the Regional Planning Grants in attempts to use minimal public investment to leverage and direct maximal private investment for public purposes. Here the open issues have to do with whether profit motivated actors are appropriate, which activities are best suited to which types of actors, at what levels and with what control mechanisms and whether desperate, cash strapped jurisdictions are in the best position to make these assessments.

Equitable Process and Equitable Outcomes: With encouraging rhetoric about the value community participation and social equity but few concrete measures to guarantee such, the proof will be in the pudding as to how the program delivers.

Sustainable Communities

On June 24, 2010, the US Department of Housing and Urban Development announced the availability of Sustainable Communities Regional Planning Grants. Administered by the newly created HUD Office of Sustainable Housing and Communities, the funding is intended to support regional planning efforts that integrate transportation infrastructure and housing development with smart growth and sustainability principles. Consortia of local governments, transit authorities, regional planning agencies, businesses and nonprofit organizations will craft Regional Plans for Sustainable Development (RPSD) that address transit, water infrastructure, economic development, energy, open space, land use policies, social equity, access to opportunity for low-income people, inclusive planning processes, etc. While the amount of funding – $98 Million total with maximum individual grants of $5 Million – is modest relative to the program’s ambitions, Sustainable Communities offers an interesting window into the mind of the Obama Administration and the ways in which it seeks to realign planning and finance of public infrastructure and community development. Along these lines, we highlight the following aspects of the program:

Building the Green Economy: Alternative energy tax credits, subsidies for mass transit and transit oriented development, carbon trading, etc. – the Sustainable Communities planning grants are another Obama Administration strategy to use economic incentives to spur development of green industries and otherwise push Americans towards more sustainable life practices. And if saving the environment wasn’t enough, these measures carry the extra burden of rebooting our economy and weaning us off of foreign oil.

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INNOVATION TO WATCH

PROJECTS IN THE PIPELINE

Meridiam wins the competition for the Long Beach courthouse in California. Advisors include DLA Piper, Ernst & Young, Hawkins Delafield & Wood, and KPMG.

Florida’s First Coast Outer Beltway to tender, again.

Texas I-635 mega P3 closes.

South Bay Expressway, first TIFIA project, hits bankruptcy.

LEGISLATION WORTH NOTING

House of Representatives passes HR4213 with extensions of two stimulus bond vehicles, the Build America Bond program (to 2012) and Non-AMT Private Activity Bonds (to 2011). The Build America Bonds are well-known for unseizing the municipal bond market in the midst of the crisis. Although Non-AMT Private Activity Bonds have received less attention, in the airport sector alone well over $8 billion have been issued.

President Obama includes a version of the National Infrastructure Bank - the National Infrastructure Innovation Fund - in its budget. The House Ways and Means Committee holds hearings.

PEOPLE ON THE MOVE

Samara Barend from the Executive Director of NY State Commission on Asset Maximization to the Head of AECOM’s national P3 practice.

Former Mayor of Indianapolis Stephen Goldsmith moves into the Bloomberg Administration as Deputy Mayor of New York City.

Karen Hedlund moves from Chief Counsel of the Federal Highway Administration to the Federal Railroad Administration where she will serve as Chief Counsel.

Joyce Miller, the CEO of Tier One Public Strategies, has been appointed to the Board of the Empire State Development Corporation.

Joel Moser moves from Fulbright & Jaworski’s P3 practice area to Bingham McCutchen where he will continue his work on infrastructure.

THEY SAID IT WHEN

On October 22, 2001, the Wall Street Journal said about Greece’s efforts to reduce its debt burden in order to gain entry into the European Union: ‘Analysts warn, however, that despite clever financial engineering this is still debt, whether it appears on the balance sheet or not.’

Larry Summers, the Director of the President’s National Economic Council, announced an innovative financing proposal for student loans on September 8, 1988 as a chief advisor to Michael Dukakis: ‘People worry about having a low income and crushing debt,’ Summer said: ‘That can’t happen here.’