SENATE COMMITTEE ON COMMERCE, SCIENCE, AND

TRANSPORTATION HEARING

TESTIMONY
OF
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Good morning, Mr. Chairman, Senator Hutchison and members of the Committee. It is my pleasure to be here this morning.

My name is Perry Offutt. I am a Managing Director in the Investment Banking Division of Morgan Stanley and am the Head of Infrastructure Investment Banking for the Americas. My group focuses on innovative transaction structures to utilize private capital to invest in infrastructure projects. Many of the transportation projects on which I work are structured as public-private partnerships (defined below). I work with both public and private sector clients. For example, I recently advised on the following transactions:

1. OHL Concesiones / Morgan Stanley Infrastructure Partners on their bid for the concession of Puerto Rico's PR-22 and PR-5 toll roads (public-private partnership bid submitted in May 2011)
2. City of Indianapolis on concession of City metered parking system (public-private partnership closed in 2010)
3. City of Pittsburgh on $452 million proposal for concession of City parking system (public-private partnership suspended after a city council vote in 2010)
4. Citizens Energy Group on $1.9 billion acquisition of Indianapolis water and wastewater system (approved by regulators and scheduled to close in Q3 2011)
5. Morgan Stanley Infrastructure Partners on its acquisition of NStar's district energy operations (closed in 2010)

As a financial advisor focused on public-private partnerships, I appreciate the opportunity to share my perspective on how federal funds can be used to leverage and partner with private investment to supplement current transportation funding and increase overall investment into transportation infrastructure projects.

Public-Private Partnerships

A Public-Private Partnership ("P3") involves a long-term lease (not a sale) of municipal assets (the "Concession"). The specific terms regarding how the asset is operated and maintained are included in a contract between the public agency/government and a private sector entity (the "Concession Agreement"). The government retains ownership with a right to reclaim the assets if the private operator does not meet certain standards. Under such an arrangement, some degree of risk and responsibility is transferred from the public to the private entity.

Due to the many safety and security concerns associated with transportation assets, it is essential that all potential private partners undergo an extensive evaluation of their qualifications. Such an evaluation is typical in P3 processes. Traditionally, the procuring government entity will issue a Request for Qualifications ("RFQ") that requires private operators to submit a response listing their qualifications in the areas of design, construction, operations and maintenance, as well as describing their ability to finance construction and improvements as necessary. In order to be considered as a bidder for a P3, a private party needs to pass all criteria in this qualifications phase. Consequently, the government can screen which private bidding groups are able to submit a final bid for a P3 project.

Private Capital Available for P3s

Morgan Stanley estimates that over $300 billion of private capital has been raised to invest in infrastructure projects. This capital is attracted to these investment opportunities given the potential to achieve long-term stable cash flows and attractive risk-adjusted returns for the project. Many of these funds (typically pension or infrastructure funds) have the ability to invest in various geographies around the world and across various infrastructure verticals (e.g., transportation, regulated utilities and energy). In order to mitigate some of the macro risks, investors tend to focus on jurisdictions with stable economic and regulatory environments.

Attracting the private sector as a partner can both leverage public funds and deliver a superior outcome for the project. For example, the private sector can often build a project more quickly and at a lower cost; drive efficiencies over time by introducing technology solutions; and develop incremental revenue sources by delivering additional services.

Given that private capital can focus on a variety of areas outside US transportation infrastructure, it is important to demonstrate that a project is commercially/financially viable and has political support. Because of certain return expectations and the desire for stable cash flows, some projects do not lend themselves to P3s. For example, a typical transit project is only a strong P3 candidate if it is secured by some form of "availability payment." The following is an example of a P3 transaction that utilized an availability payment structure:

In October 2009, the Florida Department of Transportation ("FDOT"), in conjunction with the City of Miami and US DOT, reached financial close for the Port of Miami Tunnel and Access Improvement Project. This P3 project involves the construction of a tunnel under the Port of Miami at an estimated project cost of approximately $900 million (financed with public and private capital). The winning bidder (Meridiam and Bouygues) proposed providing $80 million in equity upfront plus helped arrange $342 million of senior financing with project finance banks. Other funding was provided by a TIFIA loan. In addition, FDOT pledged to make "milestone" payments throughout the construction process, followed by availability payments following completion. These payments from FDOT helped provide the winning bidder with comfort that, despite uncertainty around the total traffic in the tunnel, the government was willing to serve as a 'buffer' for future traffic risks. Depending on the specific projected cash flows of the project, this may or may not be needed.

Another challenge facing some US P3s is convincing the private sector that there is political will to complete the P3. Given the high costs to reach a binding bid (i.e., significant due diligence costs), private capital focuses early on the regulatory/political approval process. Any additional Federal support (both monetary and political) would be very helpful to minimize this risk.

Current Need for Significant Infrastructure Investment

In 2009, the American Society of Civil Engineers (ASCE) reported that $2.2 trillion would be needed over the next five years to raise America's infrastructure from its current "poor" rating to a "good" rating, which is required to ensure reliable transportation, energy and water/wastewater systems. For example, approximately $930 billion would need to be spent on bridges and roads alone, and the ASCE estimates that only 40% of this amount will be deployed. Such projected shortfalls are quite troubling. No one wants another bridge to collapse, as did the I-35W Mississippi River Bridge, so the time for Federal leadership on this topic is now.

When you compare the percentage of GDP that the US is spending on infrastructure relative to emerging markets, the ASCE's conclusion is not surprising. For example, between 2000 and 2006, the total public spending on infrastructure in the US was less than 2.5% of GDP versus China, which spent almost 10%.

Unfortunately, the current proposed infrastructure initiatives do not address the magnitude or the immediate urgency of this problem. Leadership from the Federal government (as has been done in Canada, Australia and the UK) could help attract significantly more private capital to a greater number of key infrastructure projects.

While many states and local governments are focusing on these matters, top-down leadership is also needed that includes a vision for the country and common P3 principles. Currently, no standard or government entity exists to share best practices across states and localities. In addition, states and municipalities need capital to support critical projects. Unfortunately, given (1) ongoing stresses on the global banking system; (2) large budget deficits projected for states and municipalities; and (3) limited additional debt capacity at state and local levels given current debt loads and large pension liabilities, the Federal government's presence is critical to support essential projects.

Ideas to Consider

Various types of infrastructure projects need to be funded, ranging from improvements of high cash generating "brownfield" projects (i.e., existing operating assets) to investments in social services that are not focused on profitability (e.g., public transit). In order for the nation to finance such a wide range of projects, sponsors need to have access to a large variety of public and/or private financing alternatives. Therefore, I personally see the benefits of providing a greater number of grants and low-cost loans (e.g., TIFIA and RRIF loans) as well as taking steps to promote competitive capital market alternatives (e.g., a healthy tax-exempt bond market). In many cases, public capital from Federal, state and/or local sources can be leveraged with additional capital from the private sector.

While states and local governments are pursuing initiatives to address the US infrastructure crisis such as implementing P3 legislation, the Federal government should develop a long-term plan for development and maintenance of the country's infrastructure as has been done successfully by other countries. A National Infrastructure Bank would be a key part of such a plan. However, other ways exist by which the Federal government can facilitate project development of national significance and help ensure that projects do not get stalled or terminated due to local issues. From the private market's perspective, ensuring political will is just as important as ensuring access to capital for a project; a project will not succeed without both of these critical components.

Various parties at Morgan Stanley have discussed the concept of creating a non-partisan infrastructure commission to serve as a repository of best practices and help inform and empower local governments to utilize all available tools, including private capital. While there are several non-partisan groups acting as "think tanks" on this topic, no "national infrastructure commission" exists. Sadek Wahba, Global Head and Chief Investment Officer for Morgan Stanley Infrastructure Partners, has written on this topic. He calls for a National Infrastructure Commission similar to Infrastructure Australia, a statutory body established in 2008 to advise governments and investors.

Examples in Other Countries

Canada, Australia and the U.K. took strong steps to promote public-private partnerships and have seen the benefits of their efforts. For example, the Building Canada program, which began in 2007, and the U.K.'s National Infrastructure Plan announced in October 2010 both focus on public policy and decision-making initiatives. Britain's plan calls for creating "the optimum environment for investment," improving the "quality of data to inform decision-taking," "efficient and effective funding models," and "addressing regulatory failures." Most importantly, it calls for delivering "transformational, large-scale projects that are part of a clear, long-term strategy."

The Building Canada program is also a comprehensive plan that aims to assist municipalities in addressing their needs. It complements PPP Canada, a program created to serve as a center of excellence for P3s. PPP Canada has increased visibility of P3s as a procurement solution and is consistent with efforts done at the provincial level such as British Columbia's Partnerships BC. Programs such as PPP Canada help demystify and depoliticize the use of P3s as a financing alternative. The absence of this in the US is a key reason that it is taking longer for P3s to be widely accepted as a viable financing alternative relative to traditional sources such as tax-exempt debt.

Thank you very much for the opportunity to testify here this morning on this very important topic. I would be glad to answer any questions that you may have.