SPECIAL FEATURE

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Much hinging on US election

The winner of the upcoming US presidential contest could have a profound effect on the transport finance sector. Barry Parker reports from New York

All eyes are on the upcoming US presidential election, which will profoundly affect financial markets in the near term. Longer term, trade flows will be affected, which will influence the fortunes of transportation-related business and institutions financing the sector.

The outcome of the 2008 election will drive approaches to funding. The current line-up features three senators: Republican John McCain and Democrats Hillary Clinton and Barack Obama. Traditionally in the US system, Republican administrations, ostensibly supporting the free market, attempt to pare down the size of government. Democrats, on other hand, are typically more supportive of government involvement in financing and in the actual marketplace.

A series of current legislative efforts, sponsored by members of both parties, are aimed at jump-starting financing solutions in which the private sector would play a crucial role. Financing of US surface transportation infrastructure is at a crossroads, with funding needs greatly exceeding the ability of present mechanisms to generate required finance. Air transportation, likewise, contends with physical real estate constraints at the regional level, and with a national air traffic control system in need of modernisation.

On the maritime front, the Republican George W Bush administration has sharply cut back one programme that impacts ship finance: US government ship mortgage guarantees. During Bush's tenure, existing commitments have been maintained under the now moribund programme in which the tenor on guaranteed bonds can reach 25 years. Bush's stance, which has effectively precluded all new business, is in direct contrast to the previous (Democratic) regime, under President Bill Clinton, when this programme ballooned outwards, as the US government moved squarely behind US commercial shipbuilding.

However, early on Bush's watch, the programme saw a default of USD65 million, stemming from a politically motivated Clinton-era shipyard refurbishment of which approximately half was recovered by the US Maritime Administration (Marad). Title XI also made headlines with a payout, under a guarantee, of USD187 million in 2001 for an ill-fated US cruiseship project that subsequently found its way to a US sub¡sidiary of Norwegian Cruise Line (NCL).

Meagre request

In a late February budget request before a US congressional subcommittee, Sean Connaughton, Marad's administrator, requested a meagre USD3.5 million allocation to manage the existing portfolio of guarantees that totalled some USD2.9 billion in mid-2007. If the Republicans win, bankers should expect more of the same. John McCain, the likely Republican nominee, has been adamantly opposed to the Title XI programme, which was partially oversighted by the Senate Committee on Science, Commerce and Transportation, chaired by McCain. In railing against a proposed USD50 million appropriation for Title XI in 2003, McCain called it a "broken programme in dire need of reform". McCain and others have pointed to approved transactions that they maintain would not stand up to the rigours of private sector analysis.

If the Democrats emerge victorious under Obama or Clinton, the landscape could look much different. While speaking at a Wisconsin automotive factory in mid-February - deep in what some refer to as the "rust belt" because of the contraction of manufacturing employment in the region - presidential hopeful Obama, currently a US senator from the neighbouring state of Illinois, put forth a plan for a National Infrastructure Reinvestment Bank (NIRB). Obama's NIRB plan comes about a month after a contentious US Department of Transportation (DOT) examination of surface transport funding - primarily highways - through 2025. His plan would have the federal government redirect some USD60 billion to transport infrastructure over a decade.

In the true spirit of US politics, Clinton, Obama's rival for the Democratic nomination, has claimed that Obama is recycling an old Clinton idea. In fact, Obama's plan has direct antecedents in Senate legislation introduced in mid-2007 by Connecticut Senator Chris Dodd, an Obama supporter, and four other senate sponsors. The roster of co-sponsors for 'National Infrastructure Bank of 2007' (S 1926) included Hillary Clinton - but not Obama.

A number of similar bills were introduced in the US House of Representatives in August 2007. Policy analysts have also linked the Obama idea to another set of proposals - the National Investment Corporation (NIC) - prom¡ulgated in the 2004 'Commission on Public Infrastructure' report spearheaded by Warren Rudman, a Republican senator, and Felix Rohatyn, who devised a package so that New York City could avert bankruptcy in the mid-1970s when he was managing director of investment bank Lazard Freres.

Paradoxically, if the Democratic infrastructure finance initiatives gain traction, they could form a link to the very Republican bond markets. The language of S 1926 describes an independent bank with directors from both sides of the political aisle serving six-year terms, with expertise that includes passenger transit and road/bridge infrastructure. The bank would seek - in conjunction with other sources; for example, individual states - to fund projects of at least USD75 million in size, always with public borrowers. A wide range of funding mechanisms and instruments is contemplated, including direct subsidies, project-based bonds, direct debt financing at low interest rates and loan guarantees that are an¡alogous to Marad's Title XI scheme.

The analogous House of Representatives version of the bill closely reflects the visions of Rudman and Rohatyn. This version, H 3896, contemplates a self-sustaining National Infrastructure Development Corporation (NIDC) run by presidential appointees rather than a bank - not unlike various federal real estate financiers such as the Federal National Mortgage Association (Fannie Mae) programme. NIDC would provide direct financing of infrastructure facilities and would also issue bonds targeted specifically at pension funds - an investor class that has demonstrated its voracious appetite for infrastructure deals, offering steady predictable payouts over lengthy timelines.

Most interesting in H 3896 is contemplation of a subsidiary that would provide insurance on infrastructure projects. The well publicised travails of monoline municipal bond insurers, such as Ambac and MBIA, emerged months after the August 2007 introduction of H 3896. In retrospect, the House bill suddenly appears extraordinarily prescient as bond insurance now moves under the microscope of regulators and potential investors.

The criteria constituting eligible transit projects or road/bridge projects under S 1926 include projects that would promote economic growth, mitigate congestion and pollution, and projects of regional and national significance. Criteria for ranking suitable projects would be hammered out after the bank was established, but the bill specifies "a preference for projects which leverage private financing, including public-private partnerships [PPPs]" among expected criteria - including a standard benefit-to-cost analysis.

Wider view

The House bill takes a far more expansive view of eligible projects, with a long list that includes "a road, highway, bridge, tunnel, airport, mass transportation vehicle system, passenger or freight rail vehicle or system, inter-modal transportation facility, waterway or commercial port" that could be "owned, leased or operated by a public entity or a private entity or by a combination of such entities", with financing tied to user fees or "other dedicated revenue sources".

Analysts have described the US infrastructure situation as dire. The NIDC structure evokes the Reconstruction Finance Corporation (RFC) created in the early 1930s as the US struggled to build its way out of the Great Depression. The RFC played an important role in jump-starting economic activity throughout the 1930s, analagous to current activities of the European Investment Bank (EIB) and European Bank for Reconstruction and Development (EBRD).

The bank envisioned in S 1926 would issue up to USD60 billion of both bonds, and/or 'coupon notes' (interest rate strips), supported with the full faith and credit of the federal government.

There is also a provision for issuing strips of coupons. Bonds would be tax-exempt at the local level, similar to municipal bonds. The government-chartered corporation contemplated in H 3896 could issue debt and equity to fund activities that could include capital market instruments issued by public or private sponsors of infrastructure projects. Rudman and Rohatyn's vision contemplated debt of a 50-year duration to match the long-lived nature of projects.

The corporation's architecture supports ownership transfer to the private sector, similar to Fannie Mae in the mortgage sector. Unlike a bank, the corporation's bonds - with a preference for debt convertible into equity - would not be backed by the full faith and credit of the government. The corporation's board of directors would be political appointees drawn mainly from the private sector.

In practice, the Senate and House versions of potential bills are melded together, emerging as actual laws through a Byzantine political process. The fact that Obama has suddenly injected infrastructure - and, by inference, transport - funding into the mainstream is significant.

Logistics commentators in the trade media and in the increasingly influential 'blogosphere' have described Obama's endorsement of the NIRB as a tipping point in which a particular idea suddenly takes on a life of its own.

If either the NIRB or the NIDC, or some amalgamation of the two, emerges, ideological conflicts will run rampant. Both S 1926 and H 3896 give a great deal of lip service to PPPs. A commonality of PPP structures, which can vary widely, is that a private sector operator or concessionaire recoups its investment through tolls or user fees. Yet, at a campaign rally in Texas at the end of February - days before a crucial primary vote - Obama said that his plan could, ideally, reduce the need for tolling, especially on new highways, which is a major concern in Texas and other states hoping to maintain and augment existing capacity.

Political wrangling would also come with the territory. Project acceptance criteria in the Senate proposal includes an "understanding of the importance of diverse investment in infrastructure in all regions of the country". And, politicians would gain headlines railing against the likely securitisation packages that would be fashioned from NIRB or NIDC debt.

From the nuts-and-bolts perspective a critical aspect of any plan would be the support of pre-construction finance. Construction risk is often anathema and sometimes a deal-breaker for private sector participation in infrastructure projects. As contemplated, protection on up to half of such development risk could be underwritten by the NIDC's insurance subsidiary.

Political gridlock

Stephen E Flynn, senior fellow for national security studies at think-tank the Council of Foreign Relations, who has worked closely with Rudman, says: "We once had a transportation system that was the envy of the world. Now we are better known for our congested highways, second-rate ports, third-rate passenger trains and a primitive air traffic control system." Like the RFC that helped overcome the 1930s economic depression in the US, government infrastructure finance circa 2008 might instead overcome the political gridlock that has stymied efforts to fix the country's broken infrastructure.

The investor marketplace has demonstrated an appetite for infrastructure investment with powerhouses such as Macquarie Bank and Deutsche Bank promoting the asset class as a viable alternative investment class.

David Kerr, managing director and portfolio manager at Deutsche Bank's 'RReef' Infrastructure fund unit, stresses the "critical" role of government in structuring successful PPPs. He tells *Jane's*: "We have seen in Europe and Australia how the federal government taking leadership in establishing a predictable framework for these partnerships has kick-started a new era in infrastructure improvement and development."

Kerr, who worked on RReef's 2007 acquisition of the Maher Terminals business, adds: "The role that the European and Australian governments have taken has tended to be in establishing a framework that makes it more attractive for private sector debt and equity to fund infrastructure projects, rather than the government itself providing the funding."

In responding to the question posed by *Jane's* about his view of the Obama plan, he adds: "The US federal government providing the right kind of leadership in attracting long-term investors into the sector could be an important move in establishing a new source of funding for the United States' infrastructure needs".

However, one might hope that, if Obama becomes a catalyst for bringing transportation finance to the legislative agenda, the US government learns from its Title XI missteps.
