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Who Really Owns the Roads?

By Barbara Kiviat

Pennsylvanians had been clamoring for a new road between Philadelphia and Lancaster for years, but the government just couldn't afford it. So in 1792 the state chartered a company that would build the nation's first private turnpike--62 miles (100 km) of stone and gravel--in exchange for the right to collect tolls. Today Pennsylvania finds itself in a similar bind, with the money it needs for roads and bridges far outstripping the money it gets from the gas tax and other revenue streams. So Governor Ed Rendell is turning back the clock, proposing a slew of deals with the private sector, starting with a long-term lease of the 359-mile (578 km) Pennsylvania Turnpike, which could bring the state an estimated $12 billion to $18 billion up front. "We have to be as creative as heck to get out there and fund our infrastructure needs," says Rendell.

For states and cities looking to upgrade or replace aging infrastructure, partnering with private players is the biggest idea to come along since the interstate highway system started ribboning the country with asphalt in the 1950s. The appeal: governments can stop worrying about roads, bridges and tunnels, and companies get lucrative leases that allow them to collect money from drivers for generations. The craze is being driven by investors who crave the steady cash flow of decades' worth of tolls. There are 71 projects worth $104 billion being considered for private development by state and local governments, according to the publication Public Works Financing. The proposals are feeding a new pack of investment funds from the likes of Goldman Sachs, Morgan Stanley and the Carlyle Group--as well as controversy over how roads should be paid for.

The deals, common in Europe for decades, got jump-started in the U.S. in 2005 when Chicago enriched its treasury by $1.8 billion by selling a 99-year lease of the Chicago Skyway to Spanish roads operator Cintra and Australian bank Macquarie. At about the same time, Texas bagged $1.2 billion to let a Cintra-led consortium build the first part of the Trans-Texas Corridor and collect tolls on it for 50 years. In 2006 Indiana signed a 75-year lease for the 157-mile (253 km) Indiana Toll Road in exchange for $3.8 billion, funding the state's transportation needs for the next decade--and grabbing the attention of other budget-conscious states. "It was an earthquake in transportation," says Bob Poole, director of transportation studies at the Reason Foundation, a think tank.

But since the spring, a backlash has taken hold. Texas, a pioneer in privatization under the enthusiastic leadership of Governor Rick Perry, saw its legislature impose a two-year moratorium on new projects. The Pennsylvania legislature bounced Rendell's first attempt to privatize the turnpike, though now he's trying again in the wake of shifting state politics. The mother of all toll roads, the New Jersey Turnpike, is under review, but Governor Jon Corzine, a former Goldman chairman, disappointed eager bankers in June when he flatly stated, "We're not going to privatize."

The issue exploded last May when a letter was sent by the House Transportation Committee's James Oberstar of Minnesota and Peter DeFazio of Oregon to all 50 Governors, expressing concern that a flood of local deals might put "parochial and private interests" ahead of an "integrated national transportation network"--and threatening to undo any deals found not to be in the public's interest. That's pointedly at odds with the Department of Transportation (dot), which, following the lead of the Bush Administration, has been a huge supporter of privatization and helped pave the way by letting some companies issue debt with the same tax advantages as municipal bonds. The dot also drafted model legislation for states considering deals and in at least one case--when Texas backed off a deal with Cintra--threatened to withhold funds.

So what's not to love? The most common gripe is populist. Tolls often skyrocket under private owners, though with the blessing of elected officials, who avoid the political costs of raising tolls or taxes themselves. That's how privatized roads deliver double-digit returns for investors and often lead to upgrades like electronic tolling. But there are other devils lurking in the details, like noncompete clauses that may prevent transportation agencies from building new roads, or the inability to use roads for economic development by, say, adding a new exit to attract businesses. Some officials get queasy about locking themselves into long leases; Colorado officials already regret offering a 99-year lease for the Northwest Parkway. Others are turned off by the hard sell from investment bankers who advise states on some deals and bid on others. "This should be the last option," says Texas state senator John Carona, "not the first."

At the core of the debate is a fundamental issue: Is building roads one of those things, like trade policy, that only the Federal Government should steer, or is there a better way? Forty-five percent of the money spent on American roads comes to the states from the Federal Government, but Congress hasn't raised the gas tax, its main source of highway funds, since 1993. And that's just fine by people who find the free market efficient and earmark-free.

The debate is more than philosophical. Even before the recent Minnesota bridge collapse, commuters in crowded corridors from Atlanta to northern Virginia knew that our infrastructure needed investment and that capacity hadn't kept pace with demand. It hasn't helped that many state politicians have been just as reluctant as Congress to raise gas taxes. Or that thanks to the surging price of materials like petroleum and steel, the cost to build highways has jumped 43% since the beginning of 2004.

Money from the private sector could help fill that gap, but there is more than one way to get it. Deals like the Chicago Skyway and Indiana Toll Road, which lease existing assets, may tap the private sector's operating prowess and political immunity in raising tolls, but critics see them as long-term mortgages to solve short-term fiscal problems. "People are giving public-private partnership a bad name by running around the countryside trying to entice cash-strapped states and municipalities to participate in these monetizations," says Tim Carson, vice chairman of the Pennsylvania Turnpike commission and a public-finance lawyer.

Carson argues that the public sector can wring plenty of cash out of toll roads by essentially behaving like the private sector and charging market rates for usage. The express lanes of State Road 91 in Southern California, for example, carry some of the highest tolls in the nation--at peak hours, nearly a dollar a mile--which may annoy drivers but help pay for the state's transportation needs. The Pennsylvania Turnpike commission has produced a plan to raise turnpike tolls and attach tolls to other roads in the state.

Deals in which the private sector actually builds new infrastructure are usually a better bargain for the public. The state or city gets a new stretch of highway or a bridge or a tunnel, and it shifts risk to its private partner--a genuine benefit. If construction costs spike or expected traffic doesn't materialize, that's the company's problem. "We've had some governments say to us, 'I don't really need to be in that business,'" says Mark Florian, who oversees infrastructure deals for Goldman Sachs. These so-called greenfield projects are starting to catch on. And some states are getting savvy about how to structure the terms. The 50-year lease for Texas' State Highway 130, for example, includes a revenue-sharing clause that nets the state 4.6% of gross receipts at first and up to 50% as traffic increases--just in case the road proves more valuable than predicted.

And even though 2007 has placed a few speed bumps in their way, public-private partnerships are almost certainly here to stay. Many of the financiers who run infrastructure funds actively drum up deals--some states allow unsolicited bids, and bankers have fanned across the country in response--and the big global players in infrastructure have set up shop too. Worldwide, somewhere from $50 billion to $150 billion worth of equity is waiting to be invested in infrastructure of all stripes (including assets like airports and water systems), and much of that is trained on the U.S. "U.S. infrastructure needs lots and lots of capital, and it's not obvious where all that money is going to come from," says Murray Bleach, who runs U.S. operations for Macquarie. "The potential is huge." With all that cash waiting in the wings, other concerns may not stand a chance.