**Reprinted from
July 2013**

The journal of record for public-private partnerships and infrastructure finance, since 1988.

PUBLIC WORKS FINANCING™

A PWF Interview with Rep. John Delaney

Repatriated Profits For Infrastructure

As *Public Works Financing* reported in May, a business-friendly Democrat from Maryland is quickly gathering bipartisan support for a bill (H.R. 2084) that would create a $50-billion nonprofit infrastructure investment fund to provide bond guarantees and low-interest loans to various types of projects selected by state and local governments.

Rep. John Delaney's central idea—and political challenge—is to capitalize an infrastructure bank by allowing corporations to repatriate offshore profits tax free as long as about 25% of the funds are invested in the bank's 50-year, 1% bonds. That approach results in a 10% effective tax rate on those profits, which will attract an army of business lobbyists and infrastructure/jobs supporters. But it may not fit plans by the White House for overall tax reform or for funding infrastructure. Also, Sen. Mark Warner (D-Va.), Ron Wyden (D-Ore.) and others have their own well-developed plans for using tax credits and incentives to address the infrastructure/jobs issue. Combining forces with either of their efforts would improve the prospects for Delaney's bill.

Among other things, Delaney has designed his American Infrastructure Fund (AIF) to perform the same credit enhancement role as muni-bond insurers like AMBAC, except with a lower cost of capital and on a much bigger scale.

Delaney's bank is the first to answer a recent call by former President Bill Clinton to bring private capital and expertise more directly to bear in addressing public works financing needs. But it does that indirectly. Delaney would offer financial incentives for states to adopt the PPP project delivery model. But PPP capital raising would be supported only indirectly—by reducing the cost of state and local debt used as the public contribution to hybrid financings. Private developers would not be able to access the loan pool directly. And by lowering the cost of public borrowing, the bill would further skew value-for-money analyses to traditional delivery with cheap public debt. P3 advocates are hoping to convince Delaney to level the playing field.

Rep. Delaney graduated from Columbia University and Georgetown Law School. He is the only member of Congress to have created a business and taken it public. He has worked closely with stakeholder groups and believes his nonprofit American Infrastructure Fund will survive the budget-scoring process.

Rep. Delaney agreed to speak with *Public Works Financing* early last month and then generously answered a number of follow-up questions for this month's issue. Because his bill, "The Partnership to Build America Act," has the real promise of bringing new money into state and local public works projects, and because 25% of that money is aimed at PPPs, *PWF* has dedicated considerable space to his response to questions posed by Editor William G. Reinhardt:

Legislative Strategy

Public Works Financing – Please talk about legislative strategy.

John Delaney – The bill has been filed. Right now we have 15 Republicans and 15 Democratic co-sponsors. In the next 30 days I expect that number will go to 25 and 25. That is the first step – to have something that really presents as bipartisan within the Hill.

Second step is to build a strong coalition outside the Hill, and I think we've done that. We've got about 20 letters of support now from business groups, trade groups and labor. The third component is to get some of the think tanks behind it and we're doing that now.

We've got bipartisanship among the outside groups and then we have bipartisanship from all the think tanks.

The next step after that is to get a Senate companion bill filed and we're working on that. I'm hopeful that in the next month we can get that done. That is an important step. And then the step after that is to have it taken up in the relevant committees.

Public Works Financing – How have you gotten support from Republicans for what seems to be another federal corporation?

Infrastructure investment is a bipartisan issue. Unlike other proposals, we've attracted bipartisan support by finding a vehicle for increased infrastructure investment that doesn't use federal taxpayer dollars and that pushes decision-making down to the state and local level.

Public Works Financing – I assume this has to go through the tax committees. Is that treacherous water?

John Delaney – I wouldn't call it treacherous water; I would call it tricky water. Meaning you have to navigate it right, but if you do navigate it right, there is a path. There are a couple of things going on.

First there is a push for comprehensive tax reform. And there is a really good case for this bill fitting nicely into comprehensive tax reform. There is also a reasonable probability that comprehensive tax reform doesn't happen, and then I think there is a good case for this bill being an attractive piece of legislation on its own.

And what I mean by that is the issue we are using on the bill is the repatriation issue**.** We effectively create a path for people to repatriate money by giving them an opportunity to buy these bonds that are very attractive from the perspective of the issuer, the American Infrastructure Fund, but not very attractive for a buyer because no one would buy these things. But by buying them they get the ability to repatriate profits.

What we think they'll do is buy these bonds and then sell them instantaneously because the banks will make a market in these securities. If someone buys a bond for a dollar and then sells it right away for 30 or 40 cents, they take a loss. But then they can bring back $4 of foreign-held profits tax-free for every dollar, and that means it's about a 10% tax on those repatriated profits.

We think there's an attractive, thick, rich vein of repatriation interest at about a 10% tax rate, and so if they do comprehensive tax reform and they change the tax code going forward so we don't have this repatriation problem in the future, we still need a way to get some of the money over there back. Those are two different issues, in other words, by fixing the tax code going forward you don't necessarily fix the problem of all the cash over there.

I'm interested in creating a pathway for the money to repatriate in a positive way. There is a way to do it where people put a spotlight on jobs being created as part of repatriation. I think it's within the tax-reform environment that we're in.

Smart Politics

Rep. John Delaney's "The Partnership to Build America Act" neatly weaves a path through the political thicket on repatriation, and also addresses criticisms made of other infrastructure bank bills:

> It's not a "bank."

> It's potentially not a Washington bureaucracy.

> Taxpayers aren't on the hook directly for the downside risk.

> It's not "picking winners" and simply underwrites projects selected by state & local governments that meet the bank's creditworthiness criteria.

> And it is potentially P3 friendly, albeit indirectly.

Budget Scoring

John Delaney – We believe we've structured it in such a way that it is not on the budget. That's why it has a majority of outside directors.

Public Works Financing – The CBO aggressively counts all possible revenue impacts, which could result in your bill being scored for some portion of the foregone taxes on repatriated profits. Do you see that as an issue?

John Delaney – There will be scoring; we haven't done that yet. (All major bills get scored before coming to the House floor, even if the scoring just says the bill will have no significant impact on the federal budget.)

Public Works Financing – Does that come after the Senate legislation?

John Delaney – That is the right time to score it. We will get a more responsive scoring effort and a more serious scoring effort when the legislation is in both bodies.

Public Works Financing – Is there a model for what you're trying to do? Would the AIF operate like the Ex-Im Bank?

John Delaney – A little bit. But the government backs up the Ex-Im, and, therefore, Congress controls it. This wouldn't be federally backed.

Public Works Financing – What about Davis Bacon, Buy America, and the various social goals attached to federal infrastructure spending programs?

John Delaney – The only thing that is explicitly in the bill is Davis-Bacon.

Capitalization

Public Works Financing – How would you deal with some of the more complex operational issues, getting into the weeds with this thing to make it actually happen?

John Delaney – Yes, I think what is interesting about it is the way it will get capitalized. It will have $50 billion in the bank, and its board will be established and the board will be a mix of government appointments and private sector. And it will be organized as a non-profit with a singular mandate just to do infrastructure.

And the nice thing about it is it won't need money from Congress ever. It's fully funded for 50 years and it's also not being launched with a specific set of products, unlike things like TIFIA, which is a specific kind of product that either works for them or doesn't. This enterprise will have the flexibility to talk to its customers, who are local governments, and to develop the financial products that are needed for that market.

It can have a [rampup period] volume-guarantee product, which we think the market needs for toll roads, where insurance companies write a contract for minimum-traffic guarantees. It would develop a portfolio of those investments across the country, which is the role of an insurance provider to diversify risk across the portfolio and deliver value to the market. Because th AIF entity has long-term capital, really cheap capital, flexible mandate and good governance structure, it can develop products to meet the needs of the market.

Tax-Exempt Bond Insurer

Public Works Financing – Would one of those products be credit enhancement and other services provided by bond guarantors?

John Delaney – We think that as long as local governments can issue debt on a tax-exempt basis, they are better off being the issuer and this thing being the guarantor.

We're thinking about how to create a re-insurance pool so this entity could relaunch a whole bunch of AMBACs and to basically reinsure what they are doing.

As reinsurers, the entity basically says these are the products we'll let you underwrite and we get to approve them of course, and you reinsurers have to put in 5% into every deal. But we'll delegate underwriting to you and you let other people go rev up the marketing engine.

It will be a little hard out of the block for this AIF entity to really cover all the local governments and get in front of them and educate them as to what's available here, whereas if we create a reinsurance product then you can leverage all the infrastructure that's out there with other providers of insurance and financing.

The bottom line is if you have a large portfolio, and you have good diversification, and you have good analytics, you can come up with a way of guaranteeing almost anything. And that's where this thing can really add a lot of value.

Public Works Financing – Can a federal government corporation provide a guarantee of tax-exempt state and local debt?

John Delaney – The AIF bonds and guarantees will not carry with them the Full Faith and Credit of the United States, nor does the capital come from the U.S. Treasury. The AIF will be independent and not part of annual appropriations.

Bond Guaranty Benefits?

Public Works Financing – In 2006, before they went bankrupt, Ambac/FGIC and other AA/AAA bond insurers together insured about half of all tax-exempt issues, taking minimal risk and providing a 10-20 basis point reduction in borrowing costs. Very few public revenue bond issuers or P3 sponsors were able to obtain insurance because there were so many GO bond issuers willing to pay for a 0.1-0.2% reduction in their cost of capital.

How would your entity operate differently and obtain a better result?

John Delaney – Firstly, the AIF would also guarantee bonds for issuers with sub-AA ratings. Secondly, the pricing offered by the AIF will be much cheaper than that offered by the monolines, which will make the AIF guarantee more attractive to municipal borrowers.

Public Works Financing – Have you considered using your 1% money to make 2% loans? In this case, there would be no leverage but there would be deep benefit in the capital structures of proposed projects—a greater benefit to fewer projects.

John Delaney – We think the majority of the AIF's portfolio will be in bond guarantees, but it certainly has the ability to provide low-cost loans. We gave it that flexibility to respond to changing market conditions.

Public Works Financing – So, back to basics: the traffic and revenue studies would be a state responsibility?

John Delaney – And we would have a team of people to rip them apart to make sure they were good.

Public Works Financing – Who would staff the AIF?

John Delaney – We want to make sure in the legislation that this thing isn't held to government salaries. I'm not criticizing people in government, but if you want to get the best people against this challenge, it's easier to do that when you're not held to a government pay scale.

Enterprise Mandate

Public Works Financing – What is AIF's mandate?

John Delaney – The enterprise mandate is very simple—it can only be for infrastructure and has to run itself in a way that it is viable so that it can pay off its 1% bonds in 50 years. Other than that it can do anything it wants.

So just imagine you are on the board of this non-profit with a limited charter to only provide infrastructure financings to local governments and states, municipalities or special purpose authorities. And you have $50 billion in capital, which would allow you to get a AA+ independent rating in the markets.

This gives you $750 billion of guarantee or lending power [15:1 leverage]. And you could hire a team of people to run the business and those people weren't limited to government-regulated hiring requirements.

Federal Infrastructure Czar?

Public Works Financing – That's a lot of spending power in one place. You'd be creating the infrastructure czar of America. Can you get away with that in Washington?

John Delaney – You'd have a really good fiduciary structure here. You'd have this 11-person board, four of whom are appointed by the President, and seven are appointed effectively by the private sector. The way those seven are appointed is the seven biggest AIF bond purchasers, companies like Apple, GE and Boeing, are required to appoint someone to the nonprofit board and that person can have no financial interest in the company.

The whole Board has to be subject to New York Stock Exchange Governance requirements around conflicts, around fiduciary responsibilities, etc. You'll have an 11-person board that is going to be held to a high fiduciary standard by law to do what's in the best interest of the enterprise to fulfill its mission. Its mission is to finance infrastructure and to do it in a way that is sustainable for the enterprise, which as a nonprofit won't pile up profits.

Public Works Financing – How would the interest rate be set on the bank's loans?

John Delaney – That will be determined by the AIF board and the management team. The main product will be bond guarantees. It will price its services to cover its costs as a nonprofit. The AIF will have capital, which is the $50 billion, at a 1% cost—this is very important, because if this were a private company it would have a 20-25% cost of capital.

So it will cover its cost of capital, it will have to build up reserves for future losses, it will have to pay its overhead, and then price its guarantees and loans to cover those things, but again, since it is a non-profit it won't price to put profit into it.

So let's do a hypothetical. Let's say the business has $500 billion of loans and guarantees outstanding. And let's say your expense structure is you have $500 million of interest on your bonds—that's your big expense. Your second big expense is your overhead. So let's say you have 500 people and your average cost is $100,000 /person. So that's another $50 million, and you're expected to lose a quarter of a percent on your assets every year—so you have $500 billion of assets and costs of $1.5 billion a year.

In terms of your revenues: First you have $50 billion you're investing, insurance companies invest their capital in the market. So if you're making 5% on your capital you're probably making $2.5 billion in revenues just there, before you have to charge for your guarantees and interest.

You see that having one percent capital really allows it to charge very, very little for its services.

Public Works Financing – And the secondary market? What do you foresee there?

John Delaney – 30 cents on the dollar. So the math works: If you're the CFO of Apple you put in an order for $2.5 billion of these bonds, you probably have an offer to buy the bonds the next day from an investment bank for a billion dollars. JP Morgan then sells them its customers.

So in that scenario Apple has lost a billion and a half dollars, which they're not happy about obviously, but then since they've bought $2.5 billion of these bonds, they can bring back $10 billion tax-free. So they've saved $3.5 billion in that transaction.

It looks like we're taking the tax rate on the repatriation from 35 to 15%, but it's actually a little lower than that because they get a tax deduction on the loss of the bonds. So that takes it down to 10%.

Public Works Financing – Where would you locate the AIF?

John Delaney – We really hope its not located in Washington. There are three jurisdictions where this thing should be located. Connecticut, Wisconsin, or Nebraska. Or California, potentially. The reason is those are the states that have the most developed insurance law.

Riskiest Projects?

Public Works Financing– There is concern that the bank would get the risky, political projects that couldn't get done otherwise. How would you prevent that?

John Delaney – We put into the legislation that the Board has to develop allocation procedures so that the money is allocated fairly between the state and local governments, both on an annual and cumulative basis. For every state will basically have an allocation. We think that when you look at the size of this thing, we think the big challenge it will have is deploying all of the capital. What I mean by that is $750 billion on a revolving basis is a lot of capital to deploy. We think that for a long time all the projects that meet the AIF's standards will get approved.,

Montgomery County, Maryland is a really strong credit. If they want to build a glass-enclosed, elevated, two-lane bike path down the center of a major highway, and they are willing to stand behind it, this thing will give it a guarantee. Even though it's a stupid project. You are either in one business or the other—you're in the business of making qualitative decisions about the best projects, or you're in the credit business, and this thing is going to be in the credit business.

Some people have a hard time with that. I don't think you can ever set it up to make those qualitative judgments and ever be confident that you can consistently do it in a logical way.

PPP Incentives

Public Works Financing – What about incentives for PPPS?

John Delaney – Already in the bill are some incentives for PPPs; we set aside 25% nationally to go towards things that underlie PPPs. If you were an elected official in a state, you'd get up on the podium and say why doesn't our state have PPP legislation? Because as a result we're not allowed to get our full allocation from this thing.

We aren't telling them they have to do it, but we think it is good policy for them to do it, and we want to create a reward for those who do it.

Public Works Financing – Your bill includes a prohibition against for-profit borrowers. For a P3 project financing, how would the private borrowers obtain any benefit from your entity in their capital raising? What role would banks, insurance company lenders and other issuers of taxable debt have in your plan?

John Delaney – Many P3s include a public component for financing. Under our plan the public entity would clearly get a benefit in terms of lower-cost capital, while private entities would benefit from more projects and greater certainty about future investments.

Public Works Financing – Could governments sell their water systems, airports or parking systems to private investors with low-cost AIF financing?

John Delaney – You can build it, widen it, redo it. But the AIF is not going to be used for private companies to buy public infrastructure. That we want to stay away from. I don't think it's the highest public good. ■