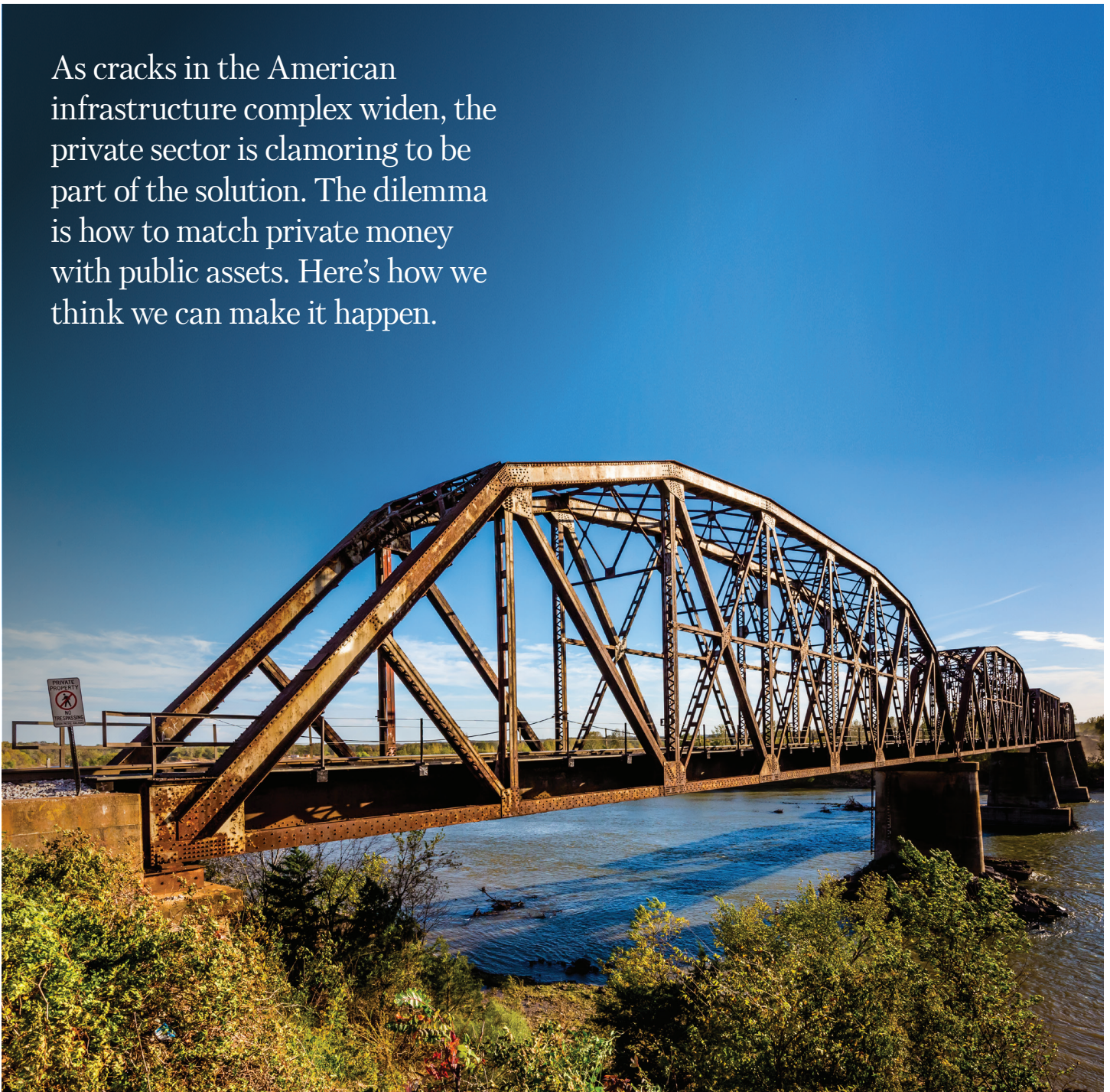


Let Private Capital Heal What Ails Public Infrastructure

Benjamin Morton, Head of Global Infrastructure and Senior Portfolio Manager

As cracks in the American infrastructure complex widen, the private sector is clamoring to be part of the solution. The dilemma is how to match private money with public assets. Here's how we think we can make it happen.



Let Private Capital Heal What Ails Public Infrastructure

Private sector capital can often solve problems that government actors cannot. As investors, we accept this premise as self-evident, having staked our livelihoods on the ability of the public markets to allocate capital efficiently.

Today, our country faces a problem so glaring that we believe it is derelict to ignore the private sector's capacity to help solve it.

Critical upgrades to American infrastructure are urgently needed at a time when federal, state and municipal balance sheets—the traditional funding source for these services—are already stretched to capacity. Service quality has deteriorated in recent years to a state of public health crisis: from dangerous lead levels in city water supplies to derailments involving freight and passenger trains in multiple parts of the country.

Private infrastructure funds raised \$85 billion in 2018... even with more than \$220 billion of uninvested capital sitting on the sidelines. The shortage is not in available capital, but in suitable assets.

Meanwhile, investor appetite for the investment attributes of infrastructure is stronger than ever. In a low-yield environment, investors are piling in to infrastructure vehicles in search of predictable cash flows and attractive return and diversification potential. According to Preqin, private infrastructure funds raised \$85 billion in 2018, up from \$30 billion in 2012, even with more than \$220 billion of uninvested capital sitting on the sidelines. The shortage is not in available capital, but in suitable assets.

In the listed market, global institutional allocations to infrastructure strategies have grown to more than \$105 billion as of the second quarter of 2019, up from just under \$21 billion in 2011, as interest spreads among institutional investors worldwide.⁽¹⁾

Innovative and case-supported privatization programs can provide a mechanism to correct this mismatch. One such approach is asset recycling, a circular funding program in which public fixed assets are sold or leased to private owners and the proceeds used to upgrade or build other infrastructure assets. Once these assets are stabilized and profitable, they can be sold to the private market, and the cycle repeats.

Here in the U.S., government-run assets—including 50 million miles of transmission assets and the entire Tennessee Valley Authority (TVA)—could be sold to private buyers and recycled for public use through more efficient management.

What's needed is a push from the federal government to bring transaction and ownership structures into the American mainstream.

This model has been successfully deployed abroad. Australia's Asset Recycling Fund (ARF) has executed the sale of 12 public assets to a mix of global pension funds, sovereign wealth funds and private fund managers. The project incentivized \$5 billion in asset sales and funded \$6.6 billion in new development without increasing Australian public debt.⁽²⁾

Privatization of traditional transportation infrastructure assets in the U.S. is a recent—but still rare—phenomenon. But more effective efforts must be made.

In Canada, Toronto's Highway 407 was sold to a private equity consortium 20 years ago, supporting nearly \$16 billion in economic benefits in Ontario alone from highway network decongestion and increased productivity. The benefits of the 23 million driving hours that Canadian motorists have saved each year⁽³⁾ since privatization may be harder to quantify, but easier to understand in terms of road safety, efficiency and enhanced quality of life for residents who regularly rely on the Highway 407 corridor.

Despite these positive precedents, privatization of traditional transportation infrastructure assets in the U.S. is a recent—but still rare—phenomenon. But more effective efforts must be made.

The Federal Aviation Administration (FAA) Airport Privatization Pilot Program, established through an Act of Congress in 2012, has authorized the ownership, management, leasing and development of up to 10 U.S. airports, with Lambert International Airport in St. Louis on track to become the next major hub to line up private capital. Other U.S. states have introduced private-public partnership (P3) legislation for the development of toll roads through private concessions. For example, Australian road builder Transurban operates multiple express lanes in the Washington D.C. area.

(1) eVestment Alliance; 2019.

(2) Government Asset Recycling: Making more achievable. Deloitte; 2014.

(3) Economic Impacts of Highway 407 ETR: Implications for Travelers, Transportation and Prosperity. Canadian Centre for Economic Analysis (CANCEA); July 2019.

We believe passenger railroads could be a prime target for asset recycling in the United States. Amtrak, which has held a de facto monopoly on U.S. train travel since its founding in 1970, lives off government subsidies and loses money on most of its lines. An exception is the heavily trafficked Northeast Corridor, which could be monetized through privatization (potentially through an initial public offering) and the proceeds reinvested into the Northeast Corridor and its other lines to improve service quality and efficiency.

We know from experience that private sector capital can be drawn to this type of investment. Master limited partnerships (MLPs) are a sterling example of how tax pass-through structures have incentivized capital formation in the energy infrastructure asset class: gas and oil pipelines and processing facilities. Today, the total market capitalization of midstream MLPs is approximately \$740 billion⁽⁴⁾ and has essentially underwritten the U.S. energy renaissance. If this works for pipelines, it can work for other forms of infrastructure as well.

Another approach would be to utilize the REIT structure (or something very similar) more broadly for infrastructure, expanding the types of assets that could benefit from its uniquely beneficial tax status—as has already been done to great effect for digital infrastructure, such as cell towers and data centers. This would potentially remove challenges to investment by providing tax efficiency to owner-operators and investors alike.

The federal government could further engage the private sector by developing income support plans to create cash flow streams for new-build (greenfield) assets until they become profitable.

Yes, there are challenges.

The primary hurdle is political: getting state and local lawmakers to cede control of hotly contested or critical assets to private companies. Another is winning the trust of consumers (who vote), and who may assume that privatization equals higher prices and an unwelcome “profits-over-people” mentality in the management of public assets. We saw these contentious factors play out in blowback from state legislators in 2008 on a plan to lease the Pennsylvania Turnpike to an investment consortium led by Spain’s Abertis, a deal that would have triggered a 27% increase in toll rates in the first year, with inflation-indexed toll increases set to follow in every subsequent year. The bid was ultimately withdrawn due to staunch widespread legislative opposition. A lesson learned.

Yet another issue is how to attract investors to projects in less densely populated areas, where the need for infrastructure repair is acute, but where expected user fees may not present a feasible economic case for investment. Using asset bundling strategies and combining private and public funds within the asset recycling model could provide a way to get these kinds of deals done, enhancing project scale and improving overall credit quality.

Privatization of our public assets presents a clear path forward and that rarest of social outcomes: a potential triple win.

Despite these challenges, there are promising success stories, from state-level P3s to refurbish bridges to expanding efforts to grant concessions to private operators in U.S. airport projects.

Some of the solution may come down to an alignment of political and investment time horizons: while political priorities may rise and fall with election cycles, infrastructure investors are less motivated by short-term political expediency, and are willing to commit longer term for attractive returns on capital.

Once presented with a pattern of repeat successes funded through private sector capital, we believe that the U.S. electorate, traditionally unaccustomed to private ownership of public assets, will be ready and willing to embrace it.

Privatization of our public assets presents a clear path forward, as well as that rarest of social outcomes: a potential triple win. For consumers, better service quality. For politicians, happier constituents, more jobs and an economic boost for the districts they serve. And for investors, such as pension funds, the potential for improved investment portfolio returns.

For those who doubt the imperative, the cost of doing nothing could be disastrous.

A public reckoning for the current spending shortfall is inevitable and may come sooner than we think. Whether the cracks in our public structures are exposed by calamity—a bridge collapse, an airport mishap, or lethal lead levels in public drinking water—the risk of continued inaction is alarmingly clear. The time to act is now.

(4) Cohen & Steers estimate, as of June 30, 2019.

Important Disclosures

Data quoted represents past performance, which is no guarantee of future results. This commentary is for informational purposes, and reflects prevailing conditions and our judgment as of this date, which are subject to change without notice. The information presented in this commentary does not reflect information of any fund or other account managed or serviced by Cohen & Steers. There is no guarantee that any market forecast set forth in this commentary will be realized.

This material should not be relied upon as investment advice, does not constitute a recommendation to buy or sell a security or other investment and is not intended to predict or depict performance of any investment. This material is not being provided in a fiduciary capacity and is not intended to recommend any investment policy or investment strategy or take into account the specific objectives or circumstances of any investor. We consider the information in this commentary to be accurate, but we do not represent that it is complete or should be relied upon as the sole source of suitability for investment. Please consult with your investment, tax or legal adviser regarding your individual circumstances prior to investing.

Please consider the investment objectives, risks, charges and expenses of any Cohen & Steers fund carefully before investing. A summary prospectus and prospectus containing this and other information may be obtained by visiting cohenandsteers.com or by calling 800 330 7348. Please read the summary prospectus and prospectus carefully before investing.

Risks of Investing in Global Infrastructure Securities. Infrastructure issuers may be subject to regulation by various governmental authorities and may also be affected by governmental regulation of rates charged to customers, operational or other mishaps, tariffs, and changes in tax laws, regulatory policies, and accounting standards. Foreign securities involve special risks, including currency fluctuation and lower liquidity. Some global securities may represent small and medium-sized companies, which may be more susceptible to price volatility than larger companies. No representation or warranty is made as to the efficacy of any particular strategy or fund or the actual returns that may be achieved.

Cohen & Steers Capital Management, Inc. (Cohen & Steers) is a registered investment advisory firm that provides investment management services to corporate retirement, public and union retirement plans, endowments, foundations and mutual funds.

Cohen & Steers U.S. registered open-end funds are distributed by Cohen & Steers Securities, LLC, and are available only to U.S. residents.

Cohen & Steers UK Limited is authorized and regulated by the Financial Conduct Authority (FRN 458459).

Cohen & Steers Asia Limited is authorized and regulated by the Securities and Futures Commission of Hong Kong (ALZ 367).

Cohen & Steers Japan, LLC is a registered financial instruments operator (investment advisory and agency business with the Financial Services Agency of Japan and the Kanto Local Finance Bureau No. 2857) and is a member of the Japan Investment Advisers Association.

About Cohen & Steers

Cohen & Steers is a global investment manager specializing in liquid real assets, including real estate securities, listed infrastructure and natural resource equities, as well as preferred securities and other income solutions. Founded in 1986, the firm is headquartered in New York City, with offices in London, Hong Kong and Tokyo.

Publication Date: **September 2019**. Copyright © 2019 Cohen & Steers, Inc. All rights reserved.