Testimony in Support of HB956

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Maryland has just had two unhappy experiences with P3s on major infrastructure projects: the Purple Line and the I-270/Beltway toll lanes. We need to learn from them. HB 956 gives us the opportunity to do so.

While the specific circumstances of these two projects are different, the problems arise from the same underlying issues.

One issue has to do with the basic bargain in a P3. The theory behind P3s is that the private investors earn a profit in exchange for taking on risk that the government would otherwise bear. This does not work on major infrastructure projects because full risk transfer is impossible. The private sector won't and can't take on these risks. And the government can't avoid them. The big risks always fall on the taxpayers.

Second, the P3 structure puts a layer of investors and lenders between the government and the construction contractor. Along with that layer comes a web of contractual rights and responsibilities. All those extra hands in the pot make it harder to fix problems when they arise.

The P3 contract is suppposed to incentivize the concessionaire to control its contractors and make them deliver on time and on budget. But as we have seen with both the Purple Line and the toll lanes, things don't always work out that way.

Two groups of intermediaries, money managers and construction managers, stand between the source of the money and the transportation. They face incentives of their own, which are not necessarily the same as those of travelers and investors.

Money managers, in particular, tend to concern themselves with the next quarterly bonus. They earn large fees when the deal first goes through, whether or not it is a good one. During the 2000s-era housing bubble, Wall Street bankers issued bad loans with abandon and joked about the "toxic waste" they were passing on to clients.

In the P3 structure, it is the job of equity investors and lenders to look out for the long term. How well do they do that? The equity investors, who expect a high rate of return in exchange for standing first in line to absorb losses, may not care that much about the long term. If the business pays dividends for fifteen or twenty years and then goes bust, they will have already pocketed a substantial profit. Behind them stand the lenders – but we learned in the crash of 2008 that large financial institutions can do a poor job of oversight.

The construction managers, too, have incentives of their own. We saw with the Purple Line how this can backfire. The construction contract passed the risk of legal delay back to the concessionaire. Nor were the concessionaire's lenders willing to absorb that risk. Ultimately, the cost fell on Maryland's future taxpayers – a cost that was unnecessarily high as a result of the Hogan administration's mismanagement, but even if handled better would have still been in 9 figures.

Buried in the toll lane P3 contract were similar lessons, which we fortunately will not have to learn the hard way. The P3 concession was awarded to a team that lacked a construction contractor, based on a promise to find one that would work for a low rate of profit. The construction contractor that was subsequently chosen has a reputation for "change-order scheming." What might have happened once lanes were shut down for construction on the American Legion Bridge, we can only imagine.

If the P3 structure is ever again used for giant infrastructure projects, additional oversight is urgently needed. We urge you to give HB956 a positive report.