

Infrastructure: Crisis and Opportunity



*John Adler
Director, Private Equity
Service Employees International Union
Capital Stewardship Program*

Infrastructure Crisis



Our current infrastructure is
deteriorating

Collapse of I-35 bridge in Minnesota, August 1, 2007.

Infrastructure Crisis

- In 1956 infrastructure spending as a share of the federal budget was 10%; since the late 1980's it has been about 3%, or \$77.3Bn in 2007¹
- Condition of US infrastructure rated "D"; required investment need estimated at \$1.6Bn 2005 - 2010²
- Gap between current federal spending on surface transportation and level required to maintain good repair, modernize existing facilities and build new; estimated cost is between \$140 billion and \$252 billion *annually* thru 2055³

1. Congressional Budget Office, "Trends in Public Spending on Transportation and Water Infrastructure, 1956-2004", August 2007 p. 4

2. American Society of Civil Engineers, "report Card for America's Infrastructure, 2005",

3. "Report of the National Surface Transportation Policy and Revenue Study Commission: Transportation for Tomorrow", December 2007, p.6

Infrastructure Needs

- 400 new power plants and 100,000 miles of electric transmission lines needed by 2020; average cost: \$35 billion per year¹
- In 2000 the National Education Association reported that \$268 billion would be needed to bring school facilities to a state of good repair and to accommodate population growth²
- US currently spends \$21 billion a year on capital improvements to our water systems and up to an additional \$19 billion a year will be needed over the next 20 years³

1. Morgan Stanley Investment Management, "Investing in Infrastructure: A Primer", Infrastructure Paper Series No. 2, May 2007 p. 12

2. American Society of Civil Engineers, "Report Card for America's Infrastructure"

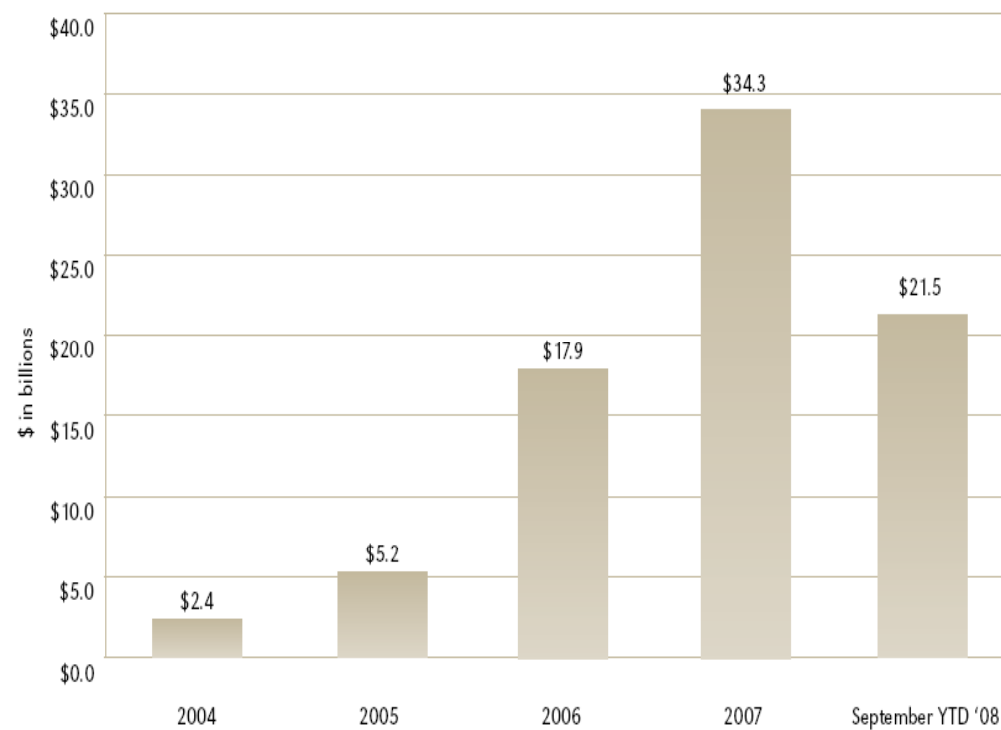
3. Estimates using 2001 dollars by Water Infrastructure Network, reported by Congressional Budget Office, "Future Investment in Drinking Water and Wastewater Infrastructure," November 2002.

Increased Needs Decreased Funding

- Traditional sources of funding for infrastructure are constrained
 - Tax-exempt bonds
 - Increased taxes
 - Increased user fees

Emergence of Private Infrastructure Investment Funds

Chart I Global Infrastructure Fundraising



Source: Probitas Partners

Reasons to Invest in Infrastructure

- High yields
- Low volatility
- Stable, inflation-linked cash flow
- Portfolio diversification
- Low correlation with other asset classes
- Long term hold

→ Ideally matched to long-term pension fund liabilities

Issues with current funds

- Private equity fees and fund structure:
 - High management and incentive fees (20% carry)
 - Closed-end fund with limited duration does not match life of infrastructure assets
 - Returns driven by exits and use of leverage
- Many funds have limited track records

Investment Risks

- Liquidity
- Construction
- Risks associated with leverage:
interest rate, credit,
mismatched maturities,
counterparty
- Inflation
- Diversification
- Political

SEIU Infrastructure Concept

- Public pension funds together invest \$10 billion to form a low-fee, evergreen investment vehicle to generate sustainable, long-term returns above actuarial assumed rates (7-8% annually)
- Help meet infrastructure capital needs
- Help create good jobs, in both construction and operations
- Create a model for private capital operating in the public interest

Obstacles and Opportunities

- Pension funds have suffered massive losses this year, creating short-term liquidity and asset allocation issues for many
- Pension funds have little experience or history with this kind of collaboration
- Federal stimulus bill may change the infrastructure finance playing field
- Threading the needle of having low fees but paying enough to attract experienced managers

Next Steps

- Legislation enabling pension fund infrastructure investment, public private partnerships
- Pension funds:
 - Make infrastructure part of their investment plan
 - Adopt investment policy, including responsible contractor policy
- Line up support: elected officials, public and private sector unions, business, advocates