Research

Asset Recycling and its Potential for Infrastructure Savings

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Summary

- Asset recycling is a measure that enables the government to fund necessary infrastructure investments through proceeds made from the sale or lease of public assets, typically fixed assets, to the private sector.
- While asset recycling could be a viable strategy for state and local governments to adopt, a federal asset recycling initiative would be difficult to implement as part of the administration's anticipated infrastructure bill. The U.S. government has only $267.6 billion in non-defense fixed assets, also known as property, plant, and equipment (PP&E), for potential recycle, with many assets unlikely to attract permanent or temporary private sector operation.
- Given the immediate need for infrastructure investment, the administration should not rely substantially on asset recycling to achieve $1 trillion in investment, as the measure may not have as large a market as hoped.

Introduction

President Trump has promoted a goal of $1 trillion to invest in America's infrastructure over the next 10 years, with the private sector being the primary source of funding. With only $200 billion in government spending dedicated to President Trump's infrastructure initiative, policymakers are looking to infrastructure investment models in other countries for guidance. Vice President Pence has praised Australia's infrastructure financing model known as asset recycling, suggesting the administration may include asset recycling in its upcoming infrastructure proposal.

Asset recycling provided Australia with some quick cash to make necessary infrastructure investments, including improvements to the Sydney Metro. Given the lack of dedicated revenue funds available for infrastructure investment, the United States needs to explore new innovative measures for securing reliable infrastructure funding. To estimate the viability of asset recycling for producing such funding , The American Action Forum (AAF) analyzed the potential value of asset recycling and the likely private sector interest.

What is Asset Recycling?

While there is no definitive model for asset recycling, it is understood as a way for governments to fund new assets or revitalize existing assets using proceeds from the sale or lease of preexisting public assets. Asset recycling has primarily been advertised as a measure to fund infrastructure at no cost to taxpayers—and no additional government debt.

Private entities pay governments an up-front payment to lease existing public infrastructure, known as fixed assets. During this leasing period, the government retains ownership of the asset while the private entity maintains and operates the asset in exchange for the asset's revenues from user fees and taxes. Thus, assets that are most sought for recycling are those with established revenue streams, such as toll roads, airports, and electric utilities. The government then uses the lump-sum payment to fund infrastructure projects. Proceeds from these assets are typically invested in non-revenue generating assets, which have difficulty obtaining funding, such as transit systems, schools, and other public buildings.

Australia's Asset Recycling Initiative

Asset recycling models have been adopted in other countries to finance infrastructure projects, with the Australian government popularizing the measure. In 2014, the Australian government included an Asset Recycling Initiative measure in its 2014-2015 budget. The initiative provided incentive payments to states and territories that sold their assets and reinvested the proceeds to fund infrastructure projects. The incentive payments were financial contributions worth 15 percent of the assessed sale value of the sold asset. Australia created an Asset Recycling Fund (ARF), made up entirely of the uncommitted funds from the Building Australia Fund and the Education Investment Fund, to fund the incentive payments. Subsequent funds for the ARF would come from the privatization of Commonwealth assets. The initiative ultimately failed due to its inability to secure consistent funding for the ARF through the sale of Commonwealth assets.

The Government of New South Wales (NSW) profited the most from the short-lived Asset Recycling Initiative. Under the initiative NSW was able to invest about $8 billion into infrastructure projects, including the Sydney Metro, by leasing its high voltage electricity transmission network, Transgrid, to the private sector. Transgrid was leased to a consortium for 99 years in exchange for $10.26 billion. Three billion dollars went to debt attached to Transgrid, leaving about $7 billion in net profit. NSW also received roughly $1 billion from the Australian Government as the 15 percent incentive payment. Although asset recycling was halted in Australia, the success stories of NSW have the Trump Administration eager to make asset recycling work in the United States.

Could Asset Recycling Work Nationally?

With little context on how the Trump Administration plans to incorporate asset recycling, it is unclear whether such a model could work in the United States. If asset recycling is part of President Trump's infrastructure bill, then it is necessary to assess whether asset recycling is both nationally viable and has the potential to generate the necessary funds. To estimate the potential value, AAF looked at the Treasury Department's Financial Report of the United States Government to gauge the magnitude of the federal government's fixed assets. Table 1 shows the federal government's net PP&E.

Table 1: Property, Plant, and Equipment, Net, FY 2016

[number in billions]

Property, Plant, and Equipment	National Defense	Non-Defense
Buildings, structures, and facilities	154.0	124.5
Furniture, fixtures, and equipment	414.8	59.4
Construction in progress	118.1	46.5
Land	10.7	13.0
Internal use software	3.5	12.4
Asset under capital lease	0.2	2.4
Leasehold improvements	0.3	4.1
Other property, plant, and equipment	10.3	5.3
Subtotal	711.9	267.6
Total property, plant, and equipment, net	979.5	

Source: Department of the Treasury

The balance sheet for fiscal year 2016 reported $979.5 billion net in PP&E for the U.S. government.[1] However, national defense makes up nearly 73 percent of the federal government's reported PP&E, net, which would be contentious to recycle. This leaves only 23 percent of its PP&E for possible recycling. Buildings, structures, and facilities – assets that are most attractive to the private sector – account for slightly less than 50 percent of PP&E, further reducing the scope of federal assets that are likely feasible to recycle.

Regarding the potential payout to the federal government, upfront payments made by private consortiums may over-value or under-value an asset. This makes it difficult to predict the potential payout the federal government would receive for selling or leasing its assets. The federal government held an estimated $268 billion in fixed assets. However, upfront payouts are dependent on the estimated net-present value of the asset revenue to the private concessionaire over the lease term.

Unfortunately, very few federal fixed assets have profitable revenue streams and therefore are unlikely to pique the interest of the private sector to purchase or lease. The Department of Defense, Department of Energy, Department of Veterans Affairs, Department of Interior, Department of State, and Department of Transportation, along with the Tennessee Valley Authority (TVA), General Services Administration, and the United States Postal Service comprise 95 percent of the federal government's related PP&E net. TVA is the only entity with earned revenues exceeding gross costs. And while privatization of an asset may help to increase efficiency and reduce operating costs, the underwhelming revenue streams of PP&E in these entities may deter private sector interest.

A Viable Option for State Governments

Due to the likely limited private interest in operating federal fixed assets, political leaders may argue there is a greater market for state and local public assets. While a national asset recycling initiative may not work nationally, asset recycling could benefit certain states. In 2005 Indiana was able to fund then- Governor Mitch Daniels' 10-year transportation plan, "Major Moves," through the lease of the Indiana Toll Road . Indiana received $3.85 billion to lease the toll road   for 75 years to the consortium Indiana Toll Road Concession Company . Under the deal the consortium was required to implement electronic tolling and invest in upgrading and widening portions of the toll road. It was also required to maintain certain levels of service in rural and urban areas. In return, the consortium collected the revenues from the road and increased the price of tolls.

The recycling deal proved beneficial for Indiana's surface transportation. Since 2006, the Indiana Department of Transportation (INDOT) leveraged Major Moves funding into a more than $11 billion program through 2015. In 2012 INDOT estimated that Major Moves will have funded 413 miles of new highway, rehabbed or replaced 6,350 miles of highway and 1,070 bridges, and completed 87 corridors.

The Indiana Toll Road is a prime example of how asset recycling can benefit states. More important, asset recycling does not need to be incentivized through federal payments for states to sell or lease their assets. While incentive payments, as in Australia's initiative, would lead to more states selling off their assets, there is still uncertainty regarding how the payments would be funded. The federal government has limited resources to allocate to the payments, and President Trump's budget allots only $200 billion over 10 years for infrastructure. Furthermore, AAF's analysis of federal assets shows there are few federal assets to sell or lease to the private sector to fund the payments, which was the primary reason the initiative failed in Australia.

Conclusion

On paper, asset recycling appears a promising means for reducing America's infrastructure investment gap. However, in practice asset recycling may be impractical as a federal initiative. This is not to say that the Trump Administration should abandon asset recycling altogether. Many states are already looking into asset recycling, and while incentive payments would likely lead to an increase in asset recycling, the specifics of incentive payments need to be ironed out. If the administration plans to meet its goal of $1 trillion in infrastructure investment, it should look beyond asset recycling.

[1] For financial reporting purposes, stewardship assets are not recorded as port of PP&E. Stewardship assets consist of public domain land (Stewardship Land) and Heritage Assets.