

Infrastructure: The Global Dilemma and its Potential Impact on Real Estate

Private investors may end up allocating some of the capital and expertise required to rebuild and develop new US infrastructure, says one real estate leader

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NEW YORK, NY – January 9, 2005 – Commercial real estate expertise – and perhaps even US institutional real estate capital – may provide both capital and creative solutions for the growing global issue of infrastructure development and rebuilding, according to the global leader of Ernst & Young’s real estate group.

Dale Anne Reiss, New York-based leader of Ernst & Young’s global real estate practice, says that infrastructure issues are so important in the U.S. and other major economies, they could end up dominating real estate planning and investment decision making for years to come. As evidence of this, she points to work now underway in New Orleans, as well as the \$222 billion plan proposed last week by Governor Arnold Schwarzenegger to upgrade California’s aging infrastructure over the next 10 years.

“Commercial real estate lives – and dies – by the quality of the infrastructure supporting it, just ask the citizens and businesses of New Orleans,” said Reiss. “In the U.S., we are on the cusp of what may prove to be the biggest wave of infrastructure spending since Roosevelt’s New Deal. California’s proposed plan is just the tip of the iceberg.” Infrastructure issues, says Reiss, play out just as importantly in India, China, Russia, Europe and South America. “All this means is that real estate investors and developers from Bangalore to Burbank could witness tremendous opportunities from infrastructure-related investment in the next few years,” she said.

Reiss cited a host of recent infrastructure catastrophes in the U.S., including the major after effects of the hurricane season, the failure of levees in Northern California overwhelmed this past week during winter rainstorms, and the recent breach of the Tam Sauk Reservoir in Missouri. “Catastrophic events, combined with the aging of key transportation infrastructure such as the NY subway, the federal highway system and major dams and bridges, are creating a wake up call we cannot ignore if the U.S. is to remain competitive in global markets,” Reiss said.

“There is a growing realization that much of our infrastructure is aged and brittle, and my bet is the public purse strings are going to be opened far more for major infrastructure building and re-building over the next ten years, and well beyond what is currently planned for hurricane ravaged Gulf states,” Reiss predicts.

The trend line, she says, is already headed up. In this year's November elections, voters in New York State approved a \$2.9Bn plan for transportation upgrades and last month, officials in Northern California's Contra Costa County announced plans for a \$10Bn bond issue to finance upgrades in and around the county's

transportation infrastructure hubs such as rapid transit stations. "These initiatives are likely to produce billions of dollars in ripple-effect commercial development and investment opportunities over the next 10 to 20 years for the private sector, especially in housing, mixed-use and retail development."

Reiss said a good example of infrastructure investment producing new private investment opportunities is the \$2 billion Trans Bay Terminal project in San Francisco. Local experts say the rebuilding and conversion of this outdated bus terminal into an inter-modal public transit complex could spur \$10 to \$20 billion in commercial and mixed-use development in the immediate neighborhood over the next ten years. "Duplicate this in the 50 major U.S. metro markets and it is not hard to see what impetus commercial development could receive from infrastructure-related investments," said Reiss. Other examples nationally include plans to rebuild New Orleans, for which the federal government just this week designated \$3Bn for levee reconstruction and upgrades alone, Boston's "Big Dig" and New York City's \$6Bn program to upgrade its water delivery system via City Water Tunnel No. 3.

Reiss emphasized that the dollars needed for most infrastructure projects are huge and that the strains posed on the federal government, the states and municipalities may lead to more public-private partnerships in the future.

"Estimates suggest that the U.S. needs \$1.6 trillion over the next five years just to repair and build highways, bridges, dams, airports, railroads and other infrastructure. The annual tab to maintain the nation's 50-year old highway system is \$176 billion alone. With real estate capital flows at their highest levels ever, I would not be surprised to see more pension funds and other long term investors move into private funding of key infrastructure developments, especially those with the greatest potential for commercial development such as transit hubs," Reiss said. In ten years or so, she expects to see a very active infrastructure-financing sector emerge from private capital flows.

Reiss also feels that systemic streamlining is needed to facilitate infrastructure investment in the U.S. As an example, she says, private funding of infrastructure projects is in crisis right now as engineering and contracting firms charged with building such projects have diminishing economic strength to cover their risk.

Mike Lucki, head of Ernst & Young's Construction practice in North America, feels that many major infrastructure projects are taking longer to complete, and are costing more, due to the onerous bonding and surety requirements placed on

contractors. “Contractors can’t get enough bonding to cover projects. Some are getting around this by joint venturing larger deals, but the fact remains that insufficient coverage is adversely affecting infrastructure development,” he says. Private financing, said Lucki, would help if only by attracting more insurers into the sector.

“Infrastructure provides the fabric for America’s commercial real estate and housing markets. The real estate sector has always been skilled at visionary utilization of public infrastructure to create places to live, shop and work. As the infrastructure is replaced and expanded, the real estate industry will lend its expertise and capital to maximize the value of these necessary improvements and solidify the country’s global economic position,” says Reiss.

“If the U.S. is to remain the investment market of choice in the world, we will need a concerted effort from both the public and private sectors to stay competitive,” she warns.

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