Future of Funding and Innovative Finance Tools

An Overview

October 2013

CLARY CONSULTING, LLC

Key Challenges

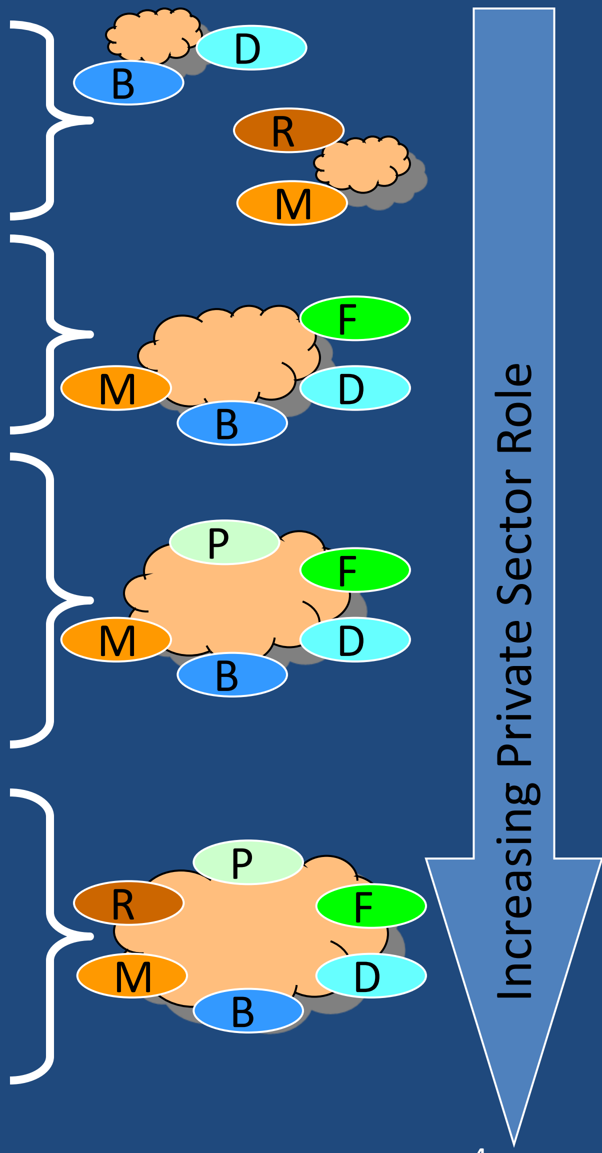
- Transportation funding sources are stressed at all levels of government
- Needs continue to grow
  – new/expanded facilities
  – major rehabilitation of existing facilities
- Difficult to fund middle size to large projects “Pay-As-You-Go”
- Requires all “tools” for innovative finance

Opportunities

- ✓Enhancing User Fees
- ✓Public-Public Partnerships
- ✓Financing Major Projects
- ✓Leveraging Private Sector
- ✓Be open to all available tools

Types of P3s

- Design-Build (DB)
- Asset Management Contract
- **Design-Build-Finance (DBF)**
- Design-Build-Operate-Maintain (DBOM)
- Design-Build-Finance-Operate (DBFO)
- Build-Operate-Transfer (BOT)
- Build-Transfer-Operate (BTO)
- Joint Development Agreement (JDA)
- Concession
- Asset Lease/Sale



What is Design-Build-Finance?

- Design-Build, can be Design-Bid-Build
- Public Owner
  - Funds “programmed” in the future, subject to annual appropriation
  - Procurement process for DBF/BF
- Private Team
  - builds the project now
  - borrows the “gap” needed to advance project
  - paid when funds available from public owner

Example Cash Flows

Two Projects Combined	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Total
Public Owner Funds	$39,411,794	$26,845,048	$12,523,824	$0	$11,942,894	$17,204,448	$12,611,028	$120,539,036
Contractor Draws	$2,308,860	$27,706,314	$58,875,917	$24,243,025	$2,308,860	$0	$0	$115,442,975
Net Cash Flow	**$37,102,935**	**$35,741,669**	**-$10,860,425**	**-$24,243,024**	**$9,634,034**	**$17,204,448**	**$12,611,028**	**$5,096,061**
Financing	-$500,000	-$250,000	$10,860,425	$24,243,024	-$9,634,034	-$17,204,448	-$11,900,000	-$4,385,033
Cash Flow	$36,602,935	$35,491,669	$0	$0	$0	$0	$711,028	$711,028

Advance Project	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Total
Public Owner Funds	$0	$0	$0	$12,300,000	$40,000,000	$40,000,000	$12,326,300	$104,626,300
Contractor Draws	$9,518,804	$38,075,216	$38,075,216	$9,518,804	$0	$0	$0	$95,188,041
Gap Cash Flow	**-$9,518,804**	**-$47,594,021**	**-$85,669,237**	**-$82,888,041**	**-$42,888,041**	**-$2,888,041**	$9,438,259	$9,438,259
Financing	$91,300,000	-$2,375,000	-$2,375,000	-$2,375,000	-$40,600,000	-$40,600,000	-$11,700,000	-$8,725,000
Cash Flow	$81,781,196	$41,330,980	$880,763	$1,286,959	$686,959	$86,959	$713,259	$713,259

What are the Benefits of DBF?

- Accelerate High Profile Projects
- Economic Stimulus/Jobs
- Private Sector Expertise
- Use “Others” Money to Advance Project
- Promote Innovation in Project Development and Delivery – Profit Motive

What is Driving DBFs?

- Putting people to work!
- Strong industry competition – good prices
- Funding challenges for medium to larger projects
- Changing financial markets/tools
- Legal authority for P3 opened up
- Bottom line – DBF can advance projects

DBF Challenges

- New approach for DOT, industry, Surety
- Banks “qualify” contractors, can eliminate some prequalified contractors
- Bank loans may not be available to Surety
- Conflicts over “cure/step-in” rights in the case of default between Surety and Bank
- Timing of funds for added work/valid claims
- Directing payment from public owner
- “Offset” provisions

Market Forces Solve Challenges

- DOT made changes to make the "gap financing" more "bankable"
- Alternative finance option developed – tax-exempt bond method
- Surety companies partnering with industry on DBF/BF projects
- Industry getting "smarter" on DBF/BF

DBF Conclusion

- DBF/BF is a new tool to added to the tool box
- Don’t reinvent the wheel
- Pick the “right” projects
- Have industry “sounding sessions”
- Solid procurement process
- Public owner be flexible where possible
- Market responds to DBF/BF approach

What is a P3 "Concession"?

- An agreement between public and private sector partners which allows more private sector participation than is traditional:
  - Private sector may design, construct, finance, operate, maintain, renovate and / or manage a facility or system
  - Public sector usually "owns" the asset and leases it to the private sector
  - Sharing of roles, responsibilities, risks and rewards
  - **Possibility of Private Sector equity**

Characteristics of a P3 Concession

- Project Champion
- Longer-Term Agreements
- **Private sector funding (equity and debt)**
- Private sector operates multiple major project elements (design-build, plus operate-maintain, etc.)
- **Sharing of risk between private sector and public owner**

Uses Other People's Money

- **Private equity partners, several types:**
  - Developer, higher risk, generally first money in and first money out – lose it all or larger return
  - Equity partner, covers riskier time of project, generally early years
  - Longer-Term Equity Partner – patient investor
- Lenders, much like typical mortgage/bond financing from banks and public bond market

Private Sector Funding

- "Skin in the Game" – meaning the private sector puts funding into the project - **Equity funding that is at risk**, not just debt
- Many areas of "at risk" - examples:
  – Cost/schedule guarantees where the private firm must cover all or selected overruns and/or delays;
  – shortfalls in estimated user fees;
  – Asset availability, with payment reductions if the facility is not open to use

Why is Private Equity Critical?

- Traditional approaches for government debt have been damaged by financial crisis
  - Bond Insurance limited availability
  - Need for stronger credit structures, cutting ability for 100 percent project debt financing
- **Private equity strengths**
  - At risk funding – focused on success
  - Subordinated to project debt – “coverage factor”
  - Private firms delivering the project invest in effort

Is Equity Really Available?

- “It Depends!” – For example:
  - Availability Payment – YES for entities with solid credit ratings
  - Lease of Assets – YES where asset have marketable value like priced parking
  - Revenue Risk – MAYBE – this is tough, but within very limited situations equity may take some revenue risk
  - Development supported projects – YES, where the project pencils out

TIFIA Uses

- Loans or Guarantees – NO grants
- Project must be Federal eligible and follow Federal requirements
- Law – loan up to 50% of Project, but 33% likely
- Loans are flexible
  - Deferral periods such as no payments during D-B
  - Subordinated to senior debt, except in bankruptcy
  - Low Federal Interest Rate
  - Senior Debt rated “BBB” or higher

Key TIFIA Take-Away

- TIFIA is a powerful finance tool
- Usually for larger projects – Federal eligible
- Project readiness is critical
- Loans not Grants
- Requires investment grade repayment source
- Most P3s since 2008 included TIFIA loans
- TIFIA Process takes time – assume six months or longer to close on TIFIA agreement

Questions

Lowell Clary, President – Clary Consulting, LLC

– Lowell.clary@claryconsulting.com
– 850-212-7772
– www.claryconsulting.com