Public-Private Partnerships and Innovative Finance

Agenda

- Brief Overview of P3
  - Lowell Clary, President – Clary Consulting, LLC
- P3 and Innovative Finance 101
  - Lowell Clary
- Question/Answer Period

Clary Background

- Advise public and private sector clients
- Expert in transportation finance and P3s
- Former Assistant Secretary – FDOT
  - Led development of FDOT P3 Program
  - ARTBA P3 Innovator of the Year
  - Led development of innovative finance efforts
- Chair – TRB Revenue and Finance Committee

Background of P3s

- "Privately" provided transportation was first and foremost in the US beginning in the 1800s lasting into the early and mid 1900s
  - Rail Systems – private, but regulation evolved
  - Development/Toll Roads – private (50k miles), then public
  - Public Transit Systems – private, then public
  - Airlines – private, but regulation evolved

Background of P3s (cont)

- Government role grew dramatically early to mid 1900s in U.S., taking over many former private responsibilities
- "Privatization" was the buzzword in the 80s and early 90s in Europe, New Zealand, etc.
  - Rail Systems
  - Aviation Systems
  - Highways/Toll Roads
  - Water/Sewer
  - Others

P3s in Europe and Canada

- Moved from Privatization to P3s and PFIs in 1990s and 2000s; "partnership" is essential:
  - Long-Term Agreements
  - Proper Roles for both Partners
  - Infrastructure Essential to the Economy – Must be Operated Efficiently, Adequately Maintained
  - Compensation Must be Fair to Both Partners
  - Must Deal with Expansions

Past 20 plus Years "P3s" in U.S.

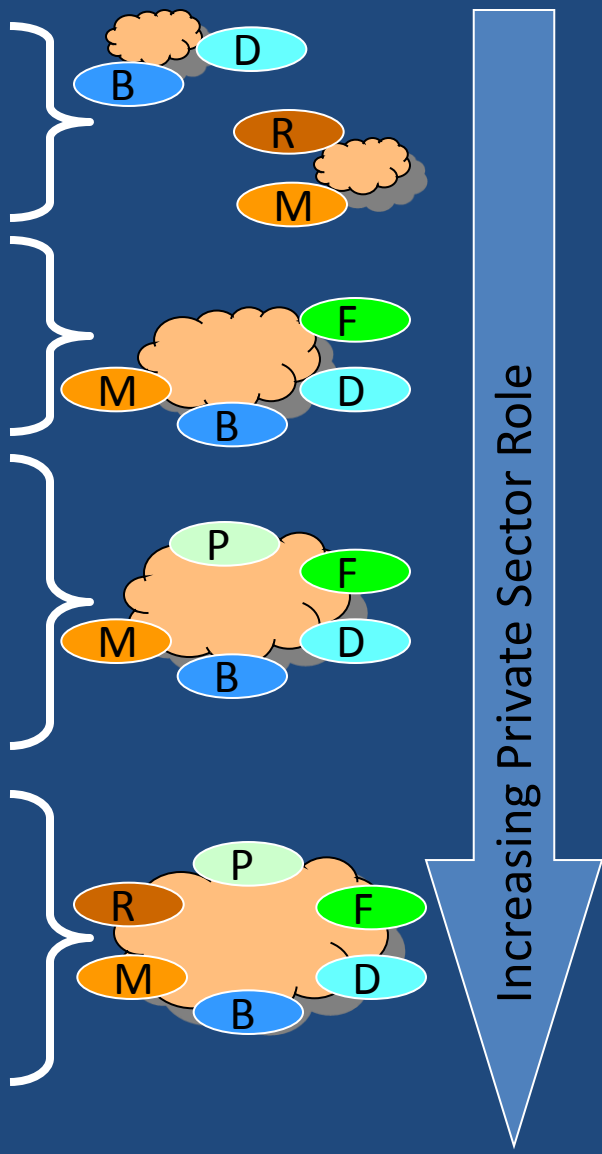
- Outsourcing Partnerships in Government
  - Construction
  - Engineering (varies greatly by govt. entity)
  - Operations and Maintenance (varies)
  - Major transit projects – DB or DBOM
- Periodic private sector "equity"
  - Land donations very common
  - Partial or Full Cash investment – expressway interchanges or transit stations

What is a P3?

- 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 section
  - Sharing of roles, responsibilities, risks and rewards
  - Possibility of Private Sector equity

Types of P3s

- Design-Build (DB)
- Asset Management Contract
- 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



Characteristics of a P3

- 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

What are the Benefits of P3?

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

What is Driving P3s?

- “Needs” far outweigh available resources
- Government purchasing power is eroding
- Cost certainty
- Changing financial markets/tools
- Legal authority for P3 opened up
- Ability to use user fees more acceptable
- Bottom line – P3 can advance projects

Facts vs. Fiction

- P3s increase funding for government?
- All P3s led by foreign firms?
- P3s “take away” work from U.S. based firms?
- P3s will replace “traditional” project delivery approaches?
- You need a PHD in P3s to understand this new tool?
- Expert advisors are essential for success?

Environment for Success

- Outside the Box Thinking
- Political Support
- Project Champions
- Understanding/willingness to take risk
- P3 “owner” processes
- Select the right projects

"Types" of P3s in Transportation

- Lease of Existing Asset
  - Asset "Owner" leases the facility such as toll road for extended term for payment from private entity
- Availability Payment
  - Private entity provides DBFOM receives periodic payment from "Owner" for availability of facility
- Revenue Risk
  - Private entity provides DBFOM and assumes risk of revenue stream for payment
- Developer – CDD/TOD Type Approach

Design-Build-Finance

- Tool to advance medium to large projects when available funds are spread over time such as five to ten years
- Private Team borrows the “gap” needed to advance the project and is paid back over time
- Florida DOT has advanced twelve projects between 3 to 6 years totaling over $2.4 billion
- All projects at or below the estimated cost and available funding.

Characteristics of a P3

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Term of Agreements

- Some early P3s were too short and there was not adequate time for the private entity to recoup their investment
- A term “financial equilibrium” developed that helps define the point where the private sector and public sector financial interest intersect
- Led to longer-term P3s, generally 20 years and longer

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

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

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
  - Developments like TOD – YES, where the project pencils out

Sharing of Risk

- The sharing of risk is a key benefit of P3s.
- The key is to balance the risk to the partner that can best manage/mitigate the risk.
  - Design/Construction – private
  - Environmental Clearances – public
  - Permits – generally shared, but project specific
  - Right-of-Way – generally public, but can be private
  - Operations/Maintenance – private or public, depending on the goals of the project

Risk Considerations

- P3s are about allocating and managing risk
- There must be key people with the ability and "stomach" to analyze risk, discuss it with the private teams and make decisions that protect the public interest while ensuring the private teams are treated fairly
- These are "big decisions" that can mean millions of dollars in future savings or higher cost depending on the outcome

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Private Sector Expertise

- Bottom Line Leads to Innovation
- Linking DB Saves Time, Sometimes Cost too
- Long-Term O&M Drives Quality DB
- Excellent Financial Modeling
- Lenders Watch Private Team Closely – same interest as owner
  - Closely examine technical/financial plans
  - Approve DB progress payments
  - Make sure asset is properly maintained

P3 Compared to Public

- Independent Studies on varied types of government and P3 projects in U.K. and Australia
  - PPP projects normally delivered on time and within budget
  - Traditional projects normally late and significantly over budget
  - 2008 Australia study on completed projects
    - $4.9B in PPP, overrun - 1.2%, ahead of schedule 3.4%
    - $4.5B in Traditional, overrun – 15%, behind schedule 23.5%

"Types" of P3s in Transportation

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- Availability Payment
  - Private entity provides DBFOM receives periodic payment from "Owner" for availability of facility
- Revenue Risk
  - Private entity provides DBFOM and assumes risk of revenue stream (usually tolls) for payment
- Developer – CDD/TOD Type Approach

Major P3 Project Examples

- **Leases of Existing Assets** (Toll Facilities) Examples:
  - Chicago Skyway raised $1.8 billion (www.chicagoskyway.org)
  - Indiana Turnpike raised $3.8 billion (www.getizoom.com)
  - Pocahontas Parkway to restructure a challenged financial situation (www.pocahontas895.com)
  - PR-22 and PR-5 – Puerto Rico raised $1.4 billion (www.p3.gov.pr/?page_id=119?page_id=925&lang=en)

Major P3 Project Examples (cont)

- **Availability Payment** Project examples:
  - Port of Miami Tunnel (www.portofmiamitunnel.com)
  - I-595 FL (www.i-595.com)
  - Eagle P3 – Denver Commuter Rail (www.rtd-fastracks.com/main_126)
  - Presidio Parkway CA (presidioparkway.org/contractors/publicprivate_partnership_overview.aspx)
  - Under review in Maryland, Los Angles and other areas for possible use on major transit improvements

Major P3 Project Examples (cont)

- **Revenue Risk** Project Examples
  - I-495 VA DC area Hotlines (www.vamegaprojects.com/about-megaprojects/i495-hot-lanes/)
  - North Tarrant Express TX (www.txdot.gov/project_information/projects/fort_worth/north_tarrant_express/default.htm)
  - LBJ Managed Lanes TX (www.newlbj.com/default.asp?p=1)
  - South Bay Expressway CA (www.southbayexpressway.com/)

Partnering with Growth

- Development Driven
  - Over 200 “development districts” in Florida
  - Numerous community redevelopment areas
  - Tax Increment financing common
  - Impact Fees and Related Fees
  - Developer contributions and partnerships
- Total amount generated not easy to discern – likely billions for infrastructure improvements

Transit Oriented Development/Economic Development

- TOD's/EOD's are a great opportunity for P3s
- Foster environment for private sector investment
- Solid process to accept/vet/select proposals
- **Public components are critical, but private development must pencil out**
- Harness "value" where appropriate to the benefit of the public benefit

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Design-Build-Finance

- Traditional Design-Build – adds gap financing by the design-build team
- Generally used for “medium size to large” projects - $20M to $500M
- Banks – loans may be debts of the contractor and creates challenges with Surety company
- New Bond Approach – tax-exempt bonds, open to Surety and not a debt of contractor

State Infrastructure Bank

- Implemented in Florida in 1997. Two "Accounts" for the Florida SIB:
  - Federal Account – projects must meet Federal highway and transit program criteria:
    - $352 million in loans supported $1.15 billion in projects
  - State Account – all transportation modes eligible:
    - $753 million in loans supported $7.2 billion in projects
    - Bonded the repayment stream portfolio
    - Flexible repayment terms and can be subordinate to senior debt

SIB Transit Examples

- Types of Uses
  - Vehicle Purchases
  - Vehicle Maintenance Facilities
  - Intermodal/Transit Centers
- Transit Users - FDOT (MIC); HART; City of Gainesville; Lee County; LYNX; PalmTran
- Advantages
  - Low interest rates
  - Flexible repayment schedules
  - Can be subordinate to other debt

Fad or Long-Term Trend?

- Needs are not going away
- Stresses on funding sources in government
- P3 market well developed internationally
- Further consolidation of U.S. construction industry with increasing foreign ownership
- Major capital raised for P3 market
- Success breeds further P3s

Questions

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