Public-Private Partnerships: Addressing Our Infrastructure Needs

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LAI Minnesota
May 15, 2018
Goals for this Session

• Intro — “Old Challenges, New Financing Tools”
• What is “P3I?”
• What is “P3D?”
• P3D Case Study
• P3I Structure
• P3I Risk Shifting
But… First things first…

LAI Minnesota Luncheon

Public-Private Partnerships: Addressing Our Infrastructure Needs

Jay Lindgren, Partner, Dorsey & Whitney

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Midland Hills Country Club | 2001 Fulham Street

By all accounts, America has fallen way behind in providing the infrastructure that adds value to our communities, expanding the infrastructure that adds value to our country productive. There is no easy answer to this problem; simply must do "whatever we can, whenever we can." This presentation will provide an overview of the so-called "P3" model and its development and finance – both horizontal and vertical. P3 is not a solution for every i
Old Challenges, New Financing Tools
Public-Private Partnerships (P3)

In the broadest sense, public-private partnerships represent any form of new or innovative cooperation and funding between the public and private sectors — including traditional P3 models.

Even classic public financing tools can be used more creatively to foster stronger and more productive cooperation between the public and private sectors.

Whatever form a public-private partnership takes, the partnership must be carefully structured to:

– allocate risks;
– create value for each party;
– maximize the impact of public investment; and
– drive economic growth farther and faster.
The Evolution of a Community

- Economics, demographics, industries and consumer preferences, evolve over time.
- The real estate, land use, infrastructure, livability, sustainability and identities of our communities must also evolve to facilitate progress and catalyze economic development.

Source: Rochester Convention & Visitors Bureau
Leverage

What distinguishes these new and innovative forms of cooperation from traditional public or private project finance is the concept of leverage.

Effective public-private partnerships use public money as more than an incentive to attract development and private resources and capabilities as more than a service to be bid at the lowest cost.

leverage public investment to attract private capital; and

leverage private investment, experience and expertise.
The Problem

The need for revitalization and new development are evident, but transformative projects are complex and difficult to get off the ground

- Tight economic conditions and reduced budgets
- Informed, demanding and skeptical communities
- Increasing regulation and public involvement
- High design and construction costs
- Unstable performance across industries/sectors
- Strict private financing underwriting requirements
- Escalating pre-development costs and risk
- Lengthy entitlement processes
- Complex environmental and legal issues
- Infrastructure challenges
- Extensive site reconfiguration and assembly
Public-private partnerships offer an effective solution for addressing the challenges of development while capturing critically important public benefits — including economic development and job creation.

- Public benefits are inherently incorporated into projects
- Economic and delivery risks are allocated
- Private investment creates opportunities
- Non-project related resources can enhance project viability
- Project value can be increased before development
- Public inefficiencies can be contracted away
- Site assembly can be facilitated
- Co-development opportunities increase
- Service costs can be integrated into project economics

Effectively structured P3s allow the public and private sectors to create value for each other.
Traditional Public Infrastructure at a Glance:

Publicly-owned project
Design-Bid-Build Construction Approach
Examples: County government center, State office building, public school

• Public authority contracts for designs
• Public authority bids out construction based on detailed specs
• Public authority builds
• Public authority finances
• Public authority operates and maintains

Risk → primarily on public sector
Traditional Approach (Design-Bid-Build)

**Pennsylvania DOT example:**
- 15 years to complete 558 bridges (versus 42 months under P3 approach)
- Pressures may be exerted on the design and construction teams due to competing interests (e.g., economy versus quality), which may lead to disputes and associated delays.

**Total Cost:** $1,171,800,000.00
P3I at a Glance:
(“Public-Private Partnerships for Infrastructure”)

Design-Bid-Finance-Operate-Maintain Contracts
Publicly-owned projects (throughout or at end of contract-period)

Examples: State bridges, highways, university housing

- Public authority enters into long term contract with a private partner
- Private party may design, build, finance, operate, maintain
- Public authority makes availability payments over term of contract

Risk → allocated between public and private parties
PennDOT P3I Agreement

PennDOT will continue to own all 558 bridges, but will contract away – in a single contract – the (i) financing, (ii) design, (iii) construction and (iv) lifecycle maintenance of all 558 bridges for 28.5 years (42 months of construction + 25 years of maintenance).

- **Efficiencies of scale in the design, construction and maintenance phases.**
- **Future funding moved forward** (i.e., projects completed today at current costs instead of years or decades later at unknown costs).
- **Accelerated project schedule minimizes impact on travelling public**
- **Private Partner responsible for any failures or defects and expected maintenance over 25 year term (like an extended warranty).**
- **Private Partner responsible for structural maintenance, inspections, repaving, etc.**
- **Public Sponsor responsible for routine operations/maintenance** (i.e., snow removal, debris removal, mowing, etc.).
- **Private Partner to turn bridge over to Public Sponsor after 25 year term in predetermined “handback” condition that will guarantee continued performance.**

**Total P3 Cost: $899,000,000.00**
**Total P3 Savings: $272,800,000.00**
P3D at a Glance: ("Public-Private Project Development")

Publicly-owned or privately-owned project
Hybrid – typically economic development projects with public $

Examples:
Convention center, hotel, retail, sports facilities

- Public authority provides incentives for private projects (local option sales tax, tax abatement, value capture)
- Private cooperation for financing, use of public projects (sponsorships, naming rights, lease/use agreement)

Risk → allocated between public and private partners
What is P3D?

“Public-Private Project Development”

Definition:

In the broadest sense, public-private partnerships represent any form of new or innovative cooperation and funding between the public and private sectors.

P3Ds are typically viewed as job/tax base – creating economic development initiatives or projects tied to a public need/benefit.

Whatever form a public-private partnership takes, the partnership must be carefully structured to:

• allocate risks;
• create value for each party;
• maximize the impact of public investment; and
• drive economic growth farther and faster.
P3D
Project Lifecycle

Phase 1: Concept & Preparation (Pre-Development)
- Site Selection
- Risk Allocation/Mitigation
- Public and Regulatory Approvals
- Enabling Legislation
- Design/Engineering Agreements
- Bidding/Contract Award
- Environmental Planning
- Due Diligence
- Negotiation
- Strategic/Finance Plan

Phase 2: Procurement & Development
- Bonds/TIF/Other Public Financing
- Financing Agreements
- Organizational Documents
- Lease & Development Agreements
- Construction Agreements
- Insurance Agreements
- Naming Rights and Sponsorship
- Land Acquisition
- Insurance
- Tax Matters

Phase 3: Management
- Use and Management Contracts
- Dispute Resolution
- Amendments
- Post-Issuance Compliance
- Operations and Maintenance
- Public Reporting
P3D Example:

A multi-purpose facility
Downtown East-Project Components

- Office Towers (Blocks 2 & 3) - Developed by Ryan/Owned by Wells Fargo
- Parking Garage (Block 1) - Built by Ryan/Owned by MSFA
- Urban Park (2/3rd’s of Block 4 & Block 5) - Developed by Ryan/Owned by City
- Ryan Skyways - Built by Ryan/Maintained by Wells Fargo/Split Ownership
- Stadium Skyways - Built by Ryan/Owned and maintained by MSFA
- Ryan Development Parcel (1/3 of Block 4) - Owned by Ryan
- Air/Development Rights (Block 1) - Owned by the City/Potentially Developed by Ryan
- Other – Block 6 (DTE Ramp) – Owned by the MSFA
What is P3I?

Definition:
A long-term performance-based contract between public sector and private sector to deliver public infrastructure

A P3I Project has the following key elements:
• A long-term contract between a public-sector party and a private-sector party;
• for the design, construction, financing, and operations of a public infrastructure by the private-sector party;
• in exchange for payments over the life of the P3 Contract;
• with the facility remaining in public-sector ownership, or reverting to public-sector ownership at the end of the P3 Contract.
## Contrast between P3I and Traditional Infrastructure Construction Contracts

<table>
<thead>
<tr>
<th>Public Private Partnerships</th>
<th>Traditional Construction Management</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>General</strong></td>
<td><strong>General</strong></td>
</tr>
<tr>
<td>• Concession Company is the Client</td>
<td>• Authority is the Client</td>
</tr>
<tr>
<td>• Contractual Relationships of the ‘Parties’</td>
<td>• Fewer parties to interface with</td>
</tr>
<tr>
<td><strong>Advantages</strong></td>
<td><strong>Advantages</strong></td>
</tr>
<tr>
<td>• Effective Risk Transfer</td>
<td>• Less risk for DB</td>
</tr>
<tr>
<td>• Schedule and Cost certainty</td>
<td>• Less onerous security package requirements</td>
</tr>
<tr>
<td>• Opportunity for integration functions of P3 and overall lower cost</td>
<td><strong>Disadvantages</strong></td>
</tr>
<tr>
<td>• Team working relationship</td>
<td>• No Risk Transfer for Authority</td>
</tr>
<tr>
<td><strong>Disadvantages</strong></td>
<td>• Uncertainty in cost and schedule</td>
</tr>
<tr>
<td>• Risks must be mitigated and priced accordingly at the bid phase</td>
<td></td>
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</tbody>
</table>
P3I Structure

• The traditional organizational chart in a P3I Project has the following characteristics:
  – The Public Authority is the ultimate client.
  – Correspondence go through the Project Lead. The Authority usually insists on having a single point of contact.
  – The Project Lead will coordinate all of the efforts through the bid submission and manage the project through all phases until the handback period.
  – A Design-Build Contract (Fixed term and fixed price) will dictate the terms under which the Design-Builder will construct the facility. A security package will be pledged as collateral for the work performed.
  – A Maintenance Contract will dictate the terms under which the Operator (“O&M Provider”) will maintain (and sometimes rehabilitate) the facility during the Operations Period. A security package will be pledged as collateral for the work performed.
P3 Timeline

1. **Prequal Phase**
   - Client Evaluation
   - 1 - 2 months

2. **Bidding Phase**
   - Consortium allocates risk and submits tender
   - 4 - 5 months

3. **Negotiation Phase**
   - Preferred Bidder
   - 1 month
   - Best and Final Offer
   - 2 - 3 months

4. **Financial Close**
   - 3 - 4 months

5. **Construction Starts**

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**Notes**:
- 8 months to 16 months
- 3-way negotiations between project consortium, public sector client and lenders

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*Image and Text Source:* DORSEY always ahead
# Risk Sharing

<table>
<thead>
<tr>
<th>Risk Allocation Categories</th>
<th>Government</th>
<th>Concessionaire</th>
<th>DB Contractor</th>
<th>Operator</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Design / Engineering</td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Construction</td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Operating Cost</td>
<td>✓</td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Major Refurbishment – Lifecycle Costs</td>
<td>✓</td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Public Support</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Government Commitment</td>
<td></td>
<td></td>
<td>✓</td>
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</tbody>
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Compared to a traditional Design-Build project, a P3I Project results in significant risks relating to:

- The costs of design and construction for the Facility;
- Market demand for the Facility (if applicable);
- Service provided by the Facility (Usage risk); and
- The Facility's operation and maintenance costs.

...being transferred from the Public Authority to the Project Company.
Sources & Uses of Funds

During the construction phase, the Project Company will incur costs. These costs will include:

- The construction costs of the Design-Build which will be paid by the Project Company on a fixed periodicity (usually monthly).
- The Interest Expense on the Loans already outstanding;
- The funding of Reserves (i.e. DSRA, CoL)
- Operating Costs & Management Costs; and
- Upfront Costs (e.g., Fees to Lenders)

This money can come from a few sources:

- Receipt of Government Funding (if any);
- Issuance of Debt;
- Issuance of Equity;
- Receipt of revenue, if payment mechanism dictated by the Authority is phased through the construction period; and
- Receipt of interest income, if money are on deposits in the Project Accounts.
It Is All About Risk Allocation

• A P3I project is all about risk allocation

• The Concessionaire is a special purpose vehicle with no additional financial resources beyond the equity and debt contributed at financial close

• General rule: The party best able to handle the risk should assume it and price it

• The competitive process drives bidders and bid team members to be as precise as possible in pricing risks
P3I Structure

- DB Contractor Parent
- Design-Build-Entity ("DB CONTRACTOR")
- Concessionaire
- O&M Contractor Parent
- Operating Entity ("O&M CONTRACTOR")
- Equity Investors
- Monoline Insurance Providers
- Monoline Insurance Providers Providers
- Long Term Lender ("LENDERS")
- O&M Parent Guarantee
- Design-Build Contract (DB Contract")
- Design-Build Parent Guarantee
- O&M Parent Guarantee
- Operational & Maintenance Contract ("O&M Contract")
- Concession Agreement
- Direct Agreement
- Lenders Remedies Agreement
- Public Authority

Additional notes:
- Lenders Remedies Agreement 11
- Concession Agreement 1
- Direct Agreement 10
- Design-Build Contract (DB Contract") 7
- Design-Build Parent Guarantee 8
- O&M Parent Guarantee 8
- Operational & Maintenance Contract ("O&M Contract") 7
- Concession Agreement 1
- Direct Agreement 10
- Lenders Remedies Agreement 11
- Public Authority
- Monoline Insurance Providers
- Long Term Lender ("LENDERS")
- Insurance Product Financial Guarantee 6
- Fixed / Floating Swap Agreements 5
- Construction Credit Facility 4
- Interface Agreement 9
Risk Waterfall

The “risk waterfall” is as follows:
1. Risk retained by the Public Authority
2. All other risk is assumed by the Concessionaire. Each such risk is identified and addressed:
   (a) in the case of construction risk, by dropping down to the Design-Builder;
   (b) in the case of operating risk, by dropping down to the Operator;
   (c) in the case of insurable risk, by insurance solutions; and
   (d) in the case of any remaining risks, by the creation of reserves and contingencies
Stranded Risk Analysis

• Prior to “bid”, the lenders and the equity will undertake with their lawyers and consultants a “stranded risk analysis” to ensure that there are no risks which are the responsibility of the Concessionaire that have not been dropped down, insured against or reserved for.
P3I: Massive Infrastructure Needs

P3I

$454B: American Society of Engineers’ (ASE) estimate of annual investment to maintain the nation’s infrastructure.

Of the $454B, funding gap of $201B requires P3 financing.