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Public-Private Partnerships: Addressing Our Infrastructure Needs

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LAI Minnesota
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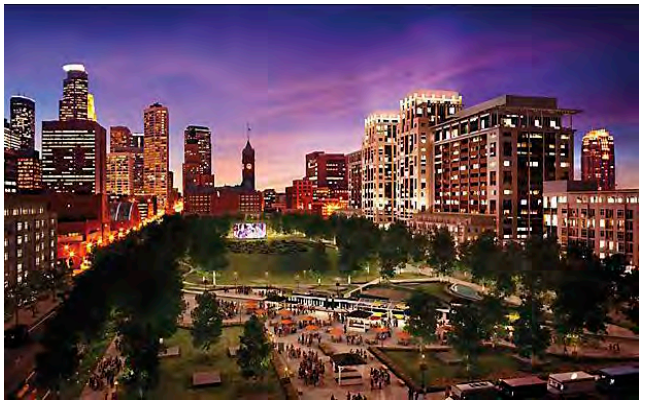
Goals for this Session

- **Intro — “Old Challenges, New Financing Tools”**
- **What is “P3I?”**
- **What is “P3D?”**
- **P3D Case Study**
- **P3I Structure**
- **P3I Risk Shifting**

But… First things first…

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

A Solution

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

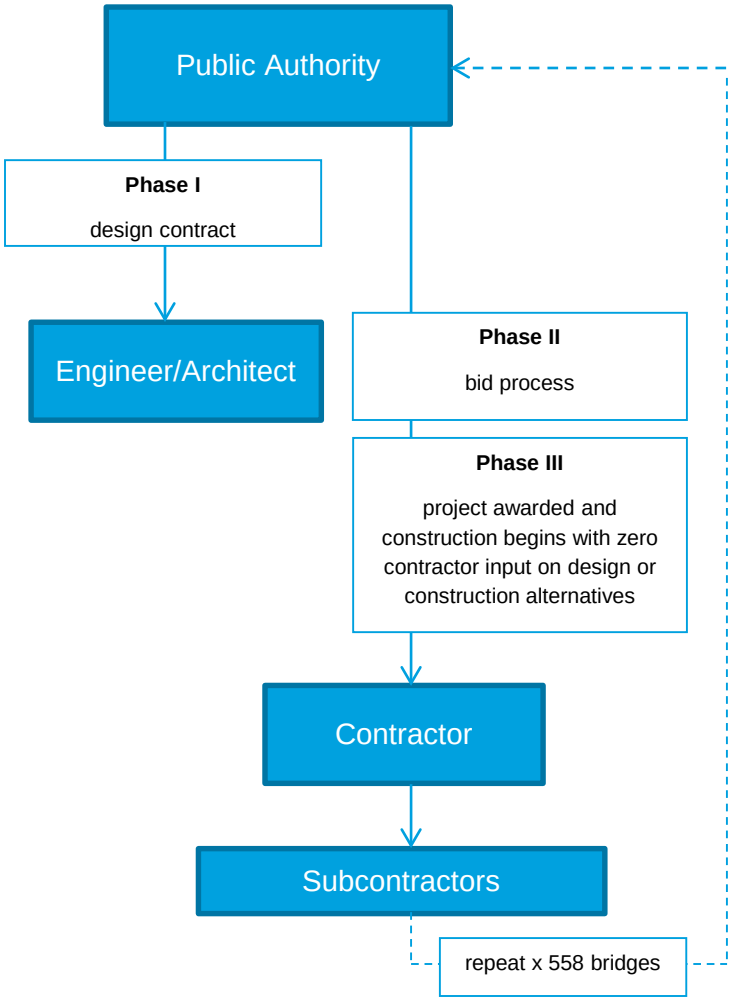
Design-Bid-Build Construction Approach

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

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P3I at a Glance:
("Public-Private Partnerships for Infrastructure")

Design-Bid-Finance-Operate-Maintain Contracts

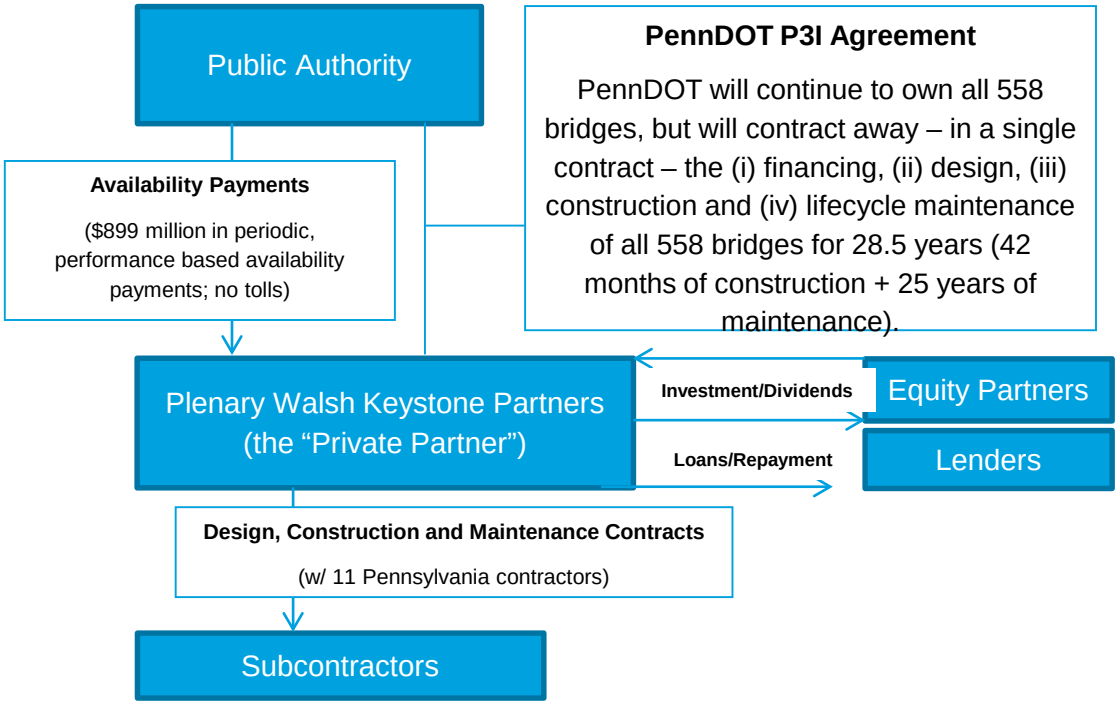
Publicly-owned projects (throughout or at end of contract-period)

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

P3I Approach



- 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.

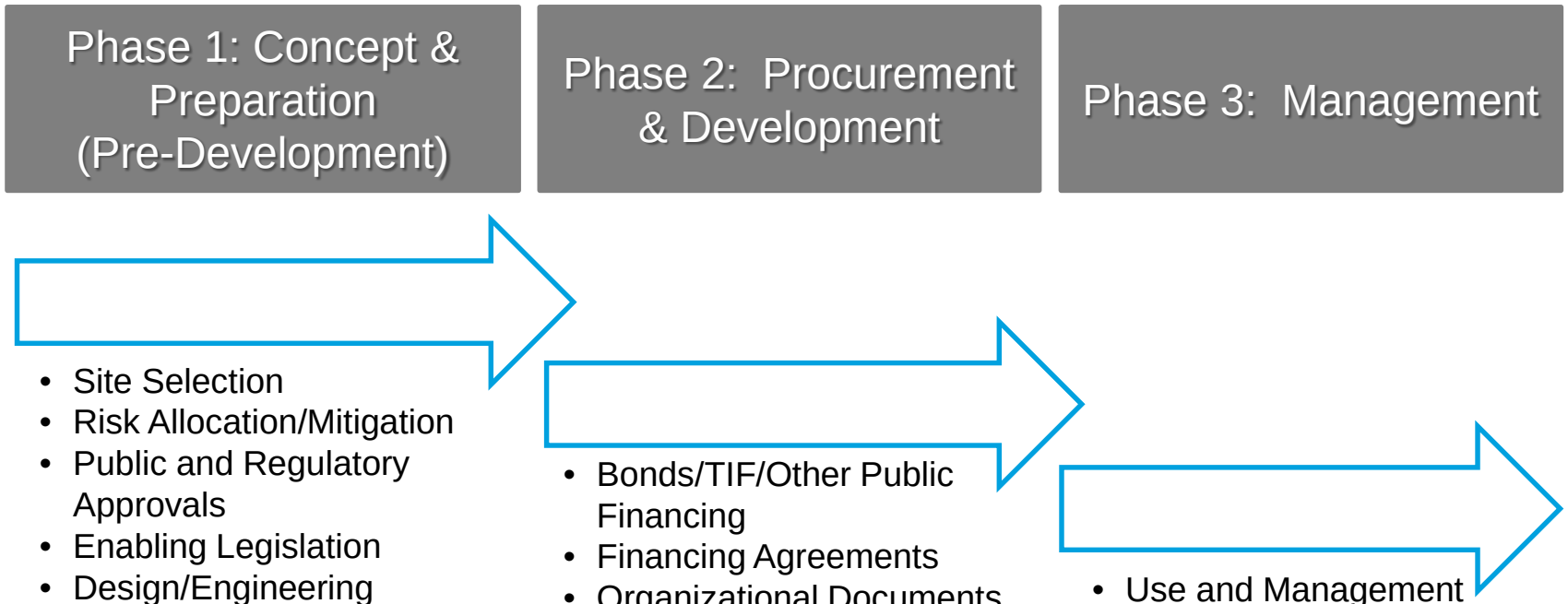
P3Ds are typically viewed as job/tax base – creating economic development initiatives or projects tied to a public need/benefit.

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.**

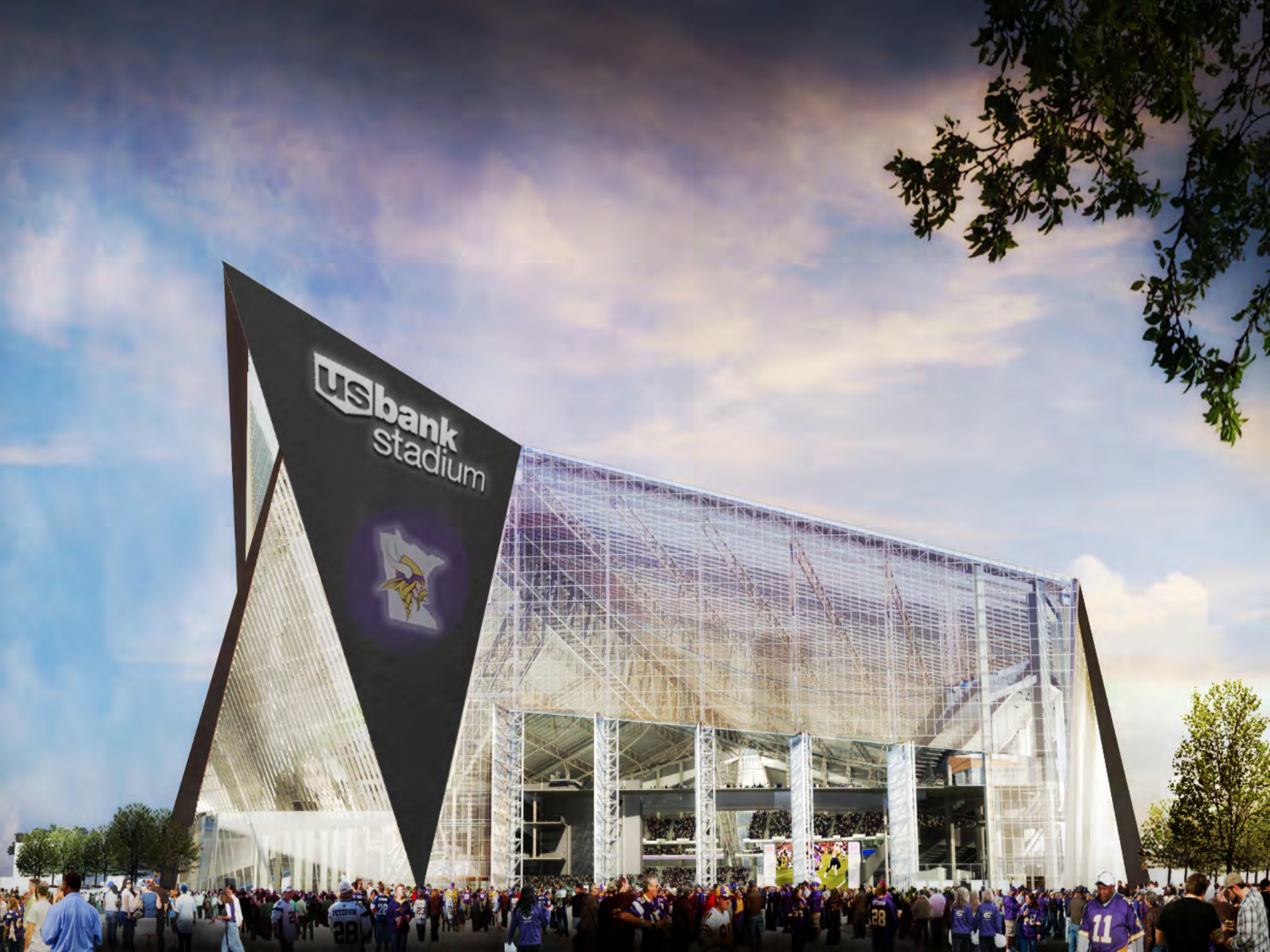
P3D

Project Lifecycle



P3D Example:

A multi-purpose facility


usbank
stadium


MINNESOTA
SPORTS FACILITIES
AUTHORITY

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 (2/3 rd'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

Public Private Partnerships

General

- Concession Company is the Client
- Contractual Relationships of the 'Parties'

Advantages

- Effective Risk Transfer
- Schedule and Cost certainty
- Opportunity for integration functions of P3 and overall lower cost
- Team working relationship

Disadvantages

- Risks must be mitigated and priced accordingly at the bid phase

Traditional Construction Management

General

- Authority is the Client
- Fewer parties to interface with

Advantages

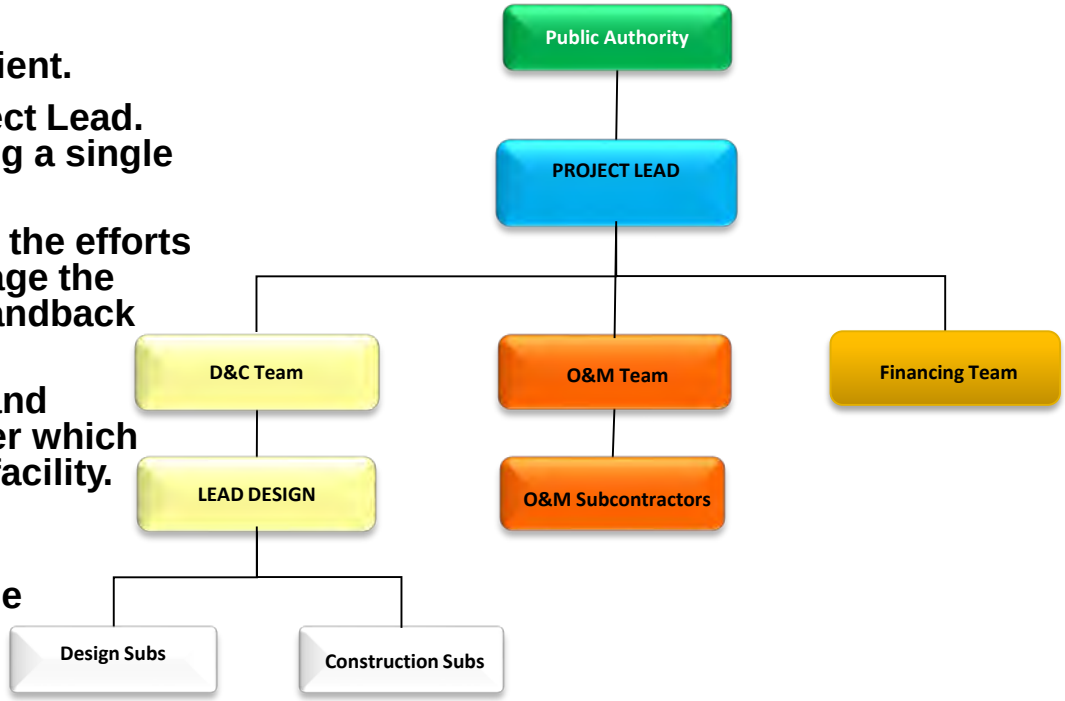
- Less risk for DB
- Less onerous security package requirements

Disadvantages

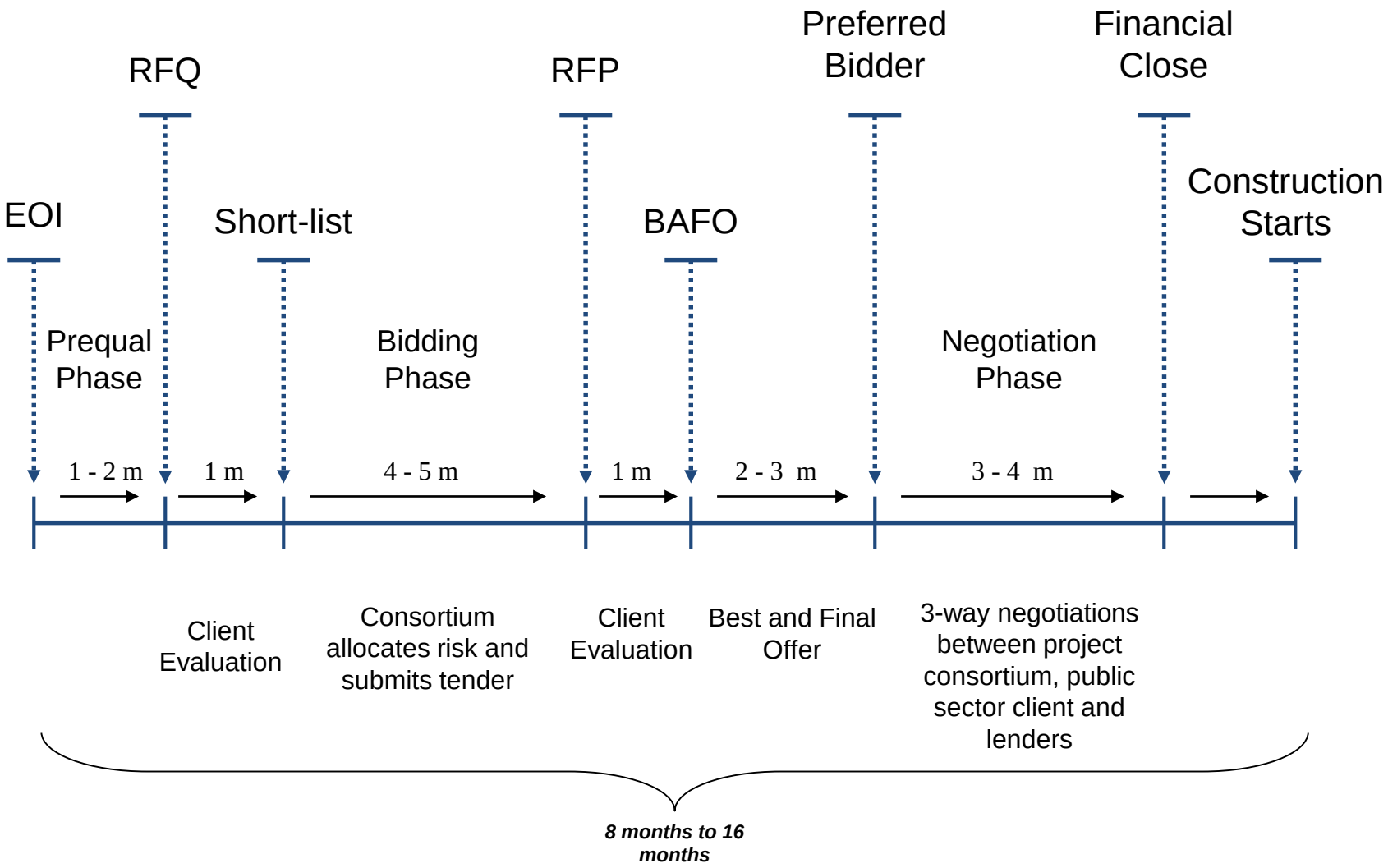
- No Risk Transfer for Authority
- Uncertainty in cost and schedule

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


EOI
RFQ
Short-list
RFP
BAFO
Preferred Bidder
Financial Close
Construction Starts
Prequal Phase
Bidding Phase
Negotiation Phase
1 - 2 m
1 m
4 - 5 m
1 m
2 - 3 m
3 - 4 m
Client Evaluation
Consortium allocates risk and submits tender
Client Evaluation
Best and Final Offer
3-way negotiations between project consortium, public sector client and lenders
8 months to 16 months

Risk Sharing

√: **Primary Risk Taker** √: **Secondary Risk Taker**

Risk Allocation / Categories	Government	Concessionaire	DB Contractor	Operator
Finance	√	√		
Design / Engineering			√	
Construction			√	
Operating Cost		√		√
Major Refurbishment – Lifecycle Costs		√		√
Public Support	√	√	√	
Government Commitment		√		

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.

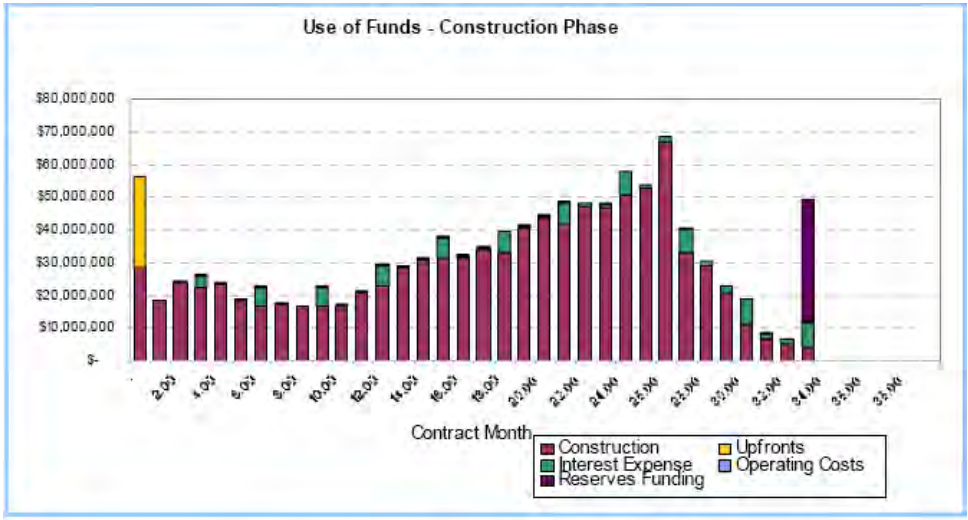
Sources & Uses of Funds

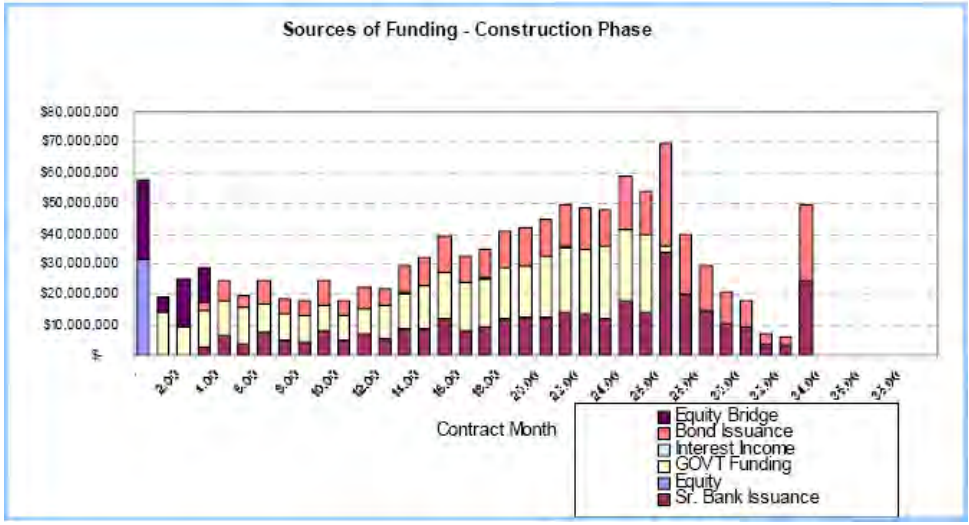
During the construction phase, the Project Company will incur costs. These costs will include:

- **The construction costs of the Design-Builder 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.**





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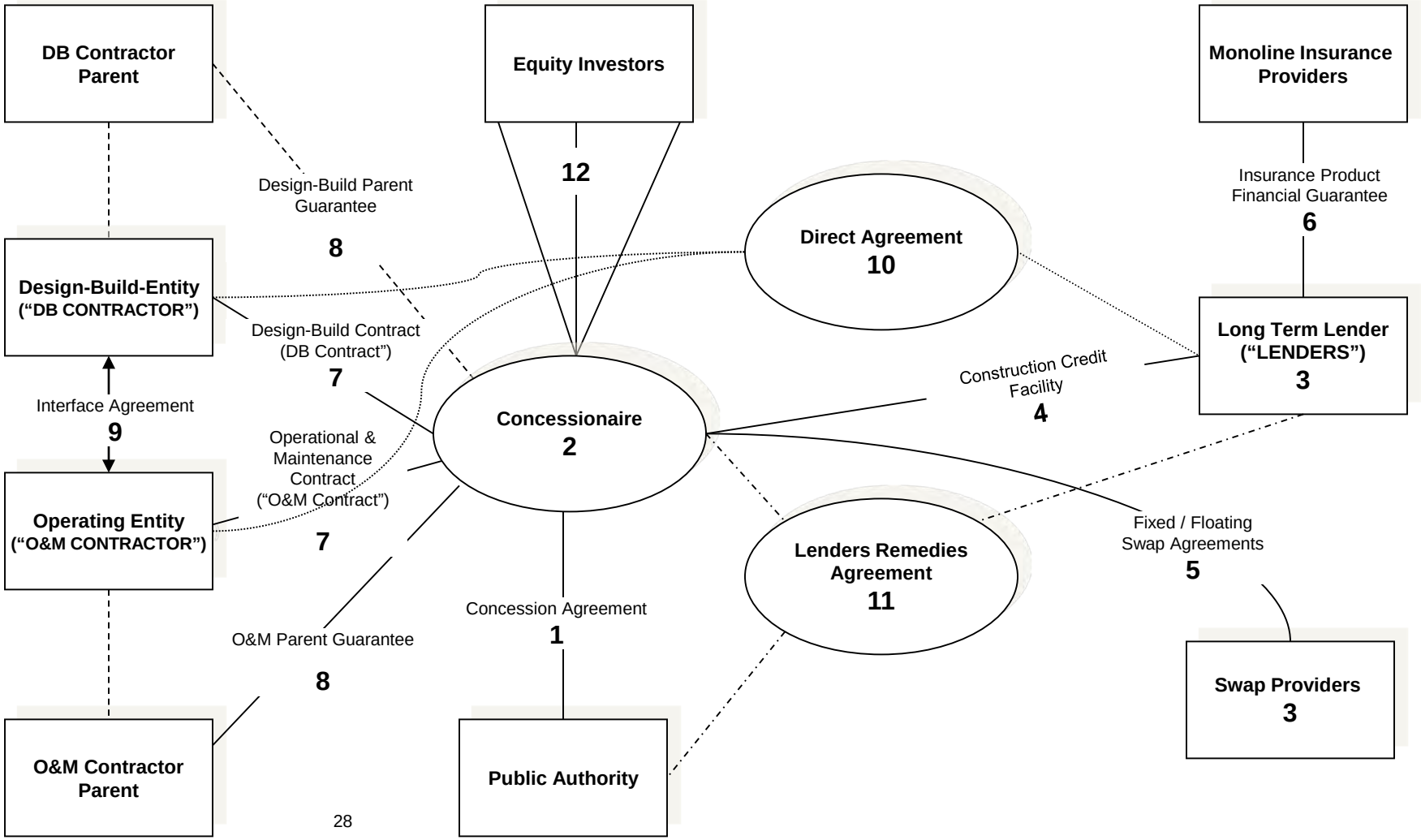
It Is All About Risk Allocation

- **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



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.

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Questions?

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