UNECE/UNOG Special Session on PPP

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Patton Boggs LLP
PPP Activity Global Snapshot

**Illinois and Virginia.** Market innovators in PPP

**British Columbia.** 20% of new infrastructure done through PPPs

**Ontario.** 30 hospital infrastructure PPPs over the next 5 years

**American Recovery and Reinvestment Act.** $120B in infrastructure funding

**Texas.** One of the world’s largest transportation PPP programs

**Brazil.** PPP investment opportunities – $6.3B of investment in transport, waste and water and prison

**Ireland.** Over 100 PPP projects in wastewater

**Portugal.** 31 hospitals to be privatized under PPP – value of $28B

**UK.** Largest schooling PPP program; more than 105 educational PFI deals with value of £3.6 billion. Transport accounts for 7% of PFI deals with 50% capital value of PFI projects. Defense accounts for 9% of signed PFI deals; 56 deals by 2005.

**Ireland.** Over 100 PPP projects in wastewater

**Netherlands.** World leader in PPP for social housing/urban regeneration

**France.** $1.25B in prison projects

**Italy.** 75% of PPP projects undertaken in transportation sector

**Spain.** $113B or 1/3 of investment in roads and rail to be done through PPPs by 2020

**India.** $35.5B in highway PPP projects

**Australia.** Transport sector – first to use PPP; 25% of PPPs are related to transport

**Africa.** 14% of energy, transport, and water projects, through private infrastructure firms during 1990-2004; higher than rest of developing world.

Key Features of Infrastructure Investments – An Asset Class for Today's Economic Turmoil

- **Long Term Investments**
  - Asset lives often exceed 30 years
  - Often long term support for off-take of output or service

- **Stable Cash Flows**
  - Low volatility and steady dividend streams arising from:
    - Regulated prices or long term off-take contracts
    - Essential services
    - Predictable operating and maintenance costs
    - Concessions often limit competition
    - High cost, physical and regulatory barriers to entry

- **Supplementary to Other Asset Classes**
  - Long term development and planning horizons
  - Expenditure by users is less discretionary
What is a Public-Private Partnership?

A public-private partnership (PPP) is usually defined as:

A form of collaboration or joint endeavor between the public and private sectors for the purpose of developing, constructing or operating an infrastructure project through a series of interrelated agreements between public and private participants which define their respective rights and responsibilities.
# Public-Private Partnership Options

<table>
<thead>
<tr>
<th>Form</th>
<th>Asset Ownership</th>
<th>Operations &amp; Maintenance</th>
<th>Capital Investment</th>
<th>Commercial Risk</th>
<th>Typical Duration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service Contract</td>
<td>Public</td>
<td>Public and Private</td>
<td>Public</td>
<td>Public</td>
<td>1–2 years</td>
</tr>
<tr>
<td>Management Contract</td>
<td>Public</td>
<td>Private</td>
<td>Public</td>
<td>Public</td>
<td>3–5 years</td>
</tr>
<tr>
<td>Lease</td>
<td>Public</td>
<td>Private</td>
<td>Public</td>
<td>Shared</td>
<td>8–25 years</td>
</tr>
<tr>
<td>Concession</td>
<td>Public</td>
<td>Private</td>
<td>Private</td>
<td>Private</td>
<td>25–30 years</td>
</tr>
<tr>
<td>BOT/BDO</td>
<td>Private and Public</td>
<td>Private</td>
<td>Private</td>
<td>Private</td>
<td>20–30 years</td>
</tr>
<tr>
<td>Divestiture/Privatization</td>
<td>Private or Private and Public</td>
<td>Private</td>
<td>Private</td>
<td>Private</td>
<td>Indefinite (may be limited by license)</td>
</tr>
</tbody>
</table>
Finance Elements: Private Capital Sources

- Equity from Concessionaires, Private Equity, Infrastructure Funds, High Net Worth Families, Finance Institutions—Lots of Money
- Debt from Lending Banks, Public Finance Markets, Hybrid Funds
- International Finance Institution Participation
- Equity from Subordinated Debt from Contractors
- Long-Term Capital Markets/Private Placements
- Structured Products Like Insurance Company Annuities and Sale-Leaseback Pension Funds
Capital funding is raised primarily through Government guaranteed or Governmental grants and investment, with private sector involvement limited to construction.
Typical Privatized Concession Approach

Private concessionaire is responsible for making equity investments and for designing, building, financing and operating the facility.

The concessionaire is usually subject to strict contractual requirements, as well as to governmental regulation.
A typical project takes a minimum of 18 months to financial closing. Basic phases of the overall project are:

- **Phase 1**: Project conceptualization
- **Phase 2**: Enabling framework
- **Phase 3**: Project development, bidding and negotiation
- **Phase 4**: Financing and financial closing
- **Phase 5**: Construction
- **Phase 6**: Operation & maintenance
Project Financing—
A Roller Coaster Event
The parties will need to consider the allocation of three principal kinds of risks:

- Government and Regulatory Risks
- Financial and Economic Risks
- Technical, Construction and Operational Risk
# Risk Perspectives of Participants

<table>
<thead>
<tr>
<th>Party</th>
<th>Goals</th>
<th>Seeks</th>
</tr>
</thead>
</table>
| Concessionaire| • Recover development expenses  
• Management fees  
• Cash returns on operations | • Low cost debt  
• Control of Contractor/Subcontractor Participation  
• Efficient use of tax benefits  
• Refinancing flexibility  
• Time and excuse for delays  
• Sufficient access to funding. |
| Operator      | • Fees                                                               | • Sufficient Funds  
• Limited Price Risk  
• Liability Protection  
• Host Government Support  
• Project as Part of System |
| Lender        | • Minimum Financial Risk  
• Timely Repayment of Principal and Interest  
• Fees                                      | • Reliable Sources of Revenue  
• Sufficient Equity  
• Sufficient capital to Finance Project  
• Senior Collateral Position and/or Control  
• Satisfactory Intercreditor Agreement  
• Limited Market Risk  
• Credit Support as Necessary |
<table>
<thead>
<tr>
<th>Party</th>
<th>Goals</th>
<th>Seeks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Host Government/Agency</td>
<td>• Well constructed road/airport at an affordable price</td>
<td>• Reliable concessionaire</td>
</tr>
<tr>
<td></td>
<td>• Balance of public and private interests</td>
<td>• Adequate and affordable financing</td>
</tr>
<tr>
<td></td>
<td>• Proper operation of road</td>
<td>• Performance guarantee</td>
</tr>
<tr>
<td></td>
<td>• Ultimate ownership of road</td>
<td>• Timely completion</td>
</tr>
<tr>
<td></td>
<td>• Integration of road into transit system</td>
<td>• Review and approval controls</td>
</tr>
<tr>
<td></td>
<td>• Security in the event of default</td>
<td>• Compliance with concession law</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Safety and maintenance</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Environmental sensitivity</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Community sensitivity</td>
</tr>
</tbody>
</table>
# Risk Transfer in Value for Money

<table>
<thead>
<tr>
<th>Model #1</th>
<th>Model #2</th>
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<tbody>
<tr>
<td>Public Sector Comparator (PSC)</td>
<td>Adjusted Shadow Bid (ASB)</td>
</tr>
<tr>
<td>Total estimated costs to the public sector of delivering an infrastructure project using traditional procurement processes</td>
<td>Total estimated costs to the public sector of delivering the same project to the identical specifications using AFP</td>
</tr>
</tbody>
</table>

![Risk Transfer Graph](image-url)

**Graph Explanation**
- **Total PSC = $107.0**
  - **D: Ancillary Costs = $12.0**
  - **C: Retained Risks = $20.0**
  - **B: Financing Costs = $15.0**
  - **A: Base Costs = $60.0**
- **Total ASB = $100.0**
  - **D: Ancillary Costs = $14.0**
  - **C: Retained Risks = $7.0**
  - **B: Financing Costs = $17.0**
  - **A: Base Costs (including Premium) = $62.0**

**Value for Money = $7.0**
US Precedent Deals – The Good, The Bad and the Ugly

**Good:**  
I-595, Long Beach Courthouse, Denver RTD, Chicago Skyway, Baltimore Seagirt Marine Terminal, Puerto Rico PR-22

**Bad:**  
Alligator Alley, BART Light Rail I, Florida High Speed Rail, Chicago Parking

**Ugly:**  
Pennsylvania Turnpike, Midway Airport
Sale-Leaseback of Existing Assets

Using the Public Private Investment model more and more municipalities and government agencies are monetizing assets in sale-leaseback transactions to raise critically needed capital while retaining control over core assets.

In a sale-leaseback, the government sells the asset to a private investor for a lump sum price and in most cases is equal to Fair Market Value. Then the agency leases the asset back from the investor for 15 to 30 years. At lease maturity the asset may revert back to the government agency.

This is an effective way of raising substantial amounts of inexpensive capital without incurring additional debt or reducing services to the community.
Government Lease Financing

Government leasing can be separated into four (4) transaction and lease types:

1. **Build to Suit | New Construction Lease**: This type of lease is used to build and privately finance a new asset. Lessor/Landlord will invest 100% of construction costs. Tenant may have the ability to control design and construction.

2. **Sale-leaseback**: A Sale-leaseback is used when a government entity owns an asset and seeks to raise capital by selling an asset to an investor and entering into a lease to lease the asset from the investor. In most cases this is used as a way to raise capital as an alternative to loans or bond debt since this is considered “rent/leasing” not debt.

3. **Lease-Leaseback**: A lease-leaseback is the same type as above (1 and 2), however it allows the government agency to retain complete ownership of the asset with the investor only maintain a leasehold interest in the asset and the government agency pays rent to the investor under the Lease-leaseback structure and benefits from the lump sum funds made available from the investor or from the investor funding construction costs.

4. **Lease Purchase**: A lease purchase is an installment-purchase contract. Under this model, the private sector finances and builds a new facility, which it then leases to a public agency. The public agency makes scheduled lease payments to the private party. The public agency accrues equity in the facility with each payment. At the end of the lease term, the public agency owns the facility or purchases it at the cost of any remaining unpaid balance in the lease.
# Transaction Profile

<table>
<thead>
<tr>
<th>Project Sponsor</th>
<th>Cities, counties, states, large corporations and all public agencies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lease or Service Contract Terms:</td>
<td>10 - 30 years</td>
</tr>
<tr>
<td>Types of Real Estate Leases:</td>
<td>NNN or Bonded, non-appropriation clauses acceptable (case by case).</td>
</tr>
<tr>
<td>Locations:</td>
<td>Worldwide [some exceptions apply]</td>
</tr>
<tr>
<td>Size:</td>
<td>$10 million to $750 million</td>
</tr>
</tbody>
</table>
Transaction Structure

- **Government Agency/Entity**
  - Lease
  - Lease Expansion
  - Rebuilding New Build
  - Due Diligence
  - $ Proceeds

- **Investor/Landlord**
  - Sale
  - $ Proceeds
  - $ Transaction Capital
  - Expansion
  - Renovation
  - Capital replacement
  - New Build

- **Facility (building—not land)**
- **Institutional Investors**
  - $ Transaction Capital Capex + all costs
Historical Volume

• Over the past twenty years more than 1,400 variations of lease oriented government sponsored deals were created which represents an estimated capital value of approximately $500 billion in European Union countries alone.

• The US Government’s General Services Administration currently leases approximately 7,100 properties worldwide that are privately owned and privately financed including FBI Buildings, Social Security Offices and Post Office Buildings generally on 20-year leases to the Federal government.

• In Canada, the Federal Government as well as Provincial government utilize a privately developed, privately financed and contracted or leased model for a large percentage of large government facilities as well as universities and government run hospitals.
Examples of US Government Long-Term Private Leases with Private Sector

• The US Government’s, General Services Administration (GSA) currently leases approximately 7,100 assets and properties worldwide that are privately owned and privately financed including FBI Buildings, Social Security Offices, Veteran Affairs Hospitals and Post Office Buildings generally on 20 year leases to the Federal government. Large multinational corporations also commonly use this form of long term real estate leasing for their corporate real estate including corporations such as Wal-Mart, Home Depot, Bank of America and Walgreens.

$256,500,000  
1,080,000 sq ft project leased to  
INTERNAL REVENUE SERVICE

$62,250,000  
215,000 sq ft project leased to  
DEPT OF VETERAN AFFAIRS
Examples of US Government Long-Term Private Leases with Private Sector

- $140,000,000
  - 587,528 sq ft project leased to
  - SOCIAL SECURITY ADMIN

- $106,600,000
  - 498,425 sq ft project leased to
  - NAT’L RECORDS & ARCHIVE ADMIN

- $75,000,000
  - 150,000 sq ft project leased to
  - DEPARTMENT OF ENERGY

- $19,000,000
  - 103,500 sq ft project leased to
  - US POSTAL SERVICE
Examples of US Government Long-Term Private Leases with Private Sector

- $14,500,000
  66,000 sq ft project leased to DEPT OF VETERAN AFFAIRS
- $14,500,000
  61,150 sq ft project leased to INTERNAL REVENUE SERVICE
- $15,100,000
  95,500 sq ft project leased to DEPT OF VETERAN AFFAIRS
Financial Risk Transfer

• The private sector investor assumes the financial liability of the project costs and the government agency retains freedom and full control over the asset just as would occur in ownership.

• The only requirement and obligation of the government is a lease for real estate assets or an annual contract payment for non-real estate assets. These payments can be considered part of the operating budget instead of long-term liability/debt in most cases, if properly structured.

• This method allows a contractor to build the project for the government without the government having to spend any of their money in advance. Associated costs can include architect fees, engineering fees, consultant costs, and development expenses all of which can be combined into the overall lease and amortized over an extended period of time.
Efficiency and Cost Savings

• Numerous studies have validated that Public Sector projects undertaken by the Private Sector in the form of a Public Private Partnership (PPP) were more likely to be completed on time and on/or below budget than the same project conducted by the municipality directly.

• One such study by the State of Maryland showed that State’s educational developments were only completed on time and on budget 24% of the time compared to over 70% when using a PPP design, build and finance delivery model.

• The most significant saving in private operation of public sector projects is the life cycle costs associated with risk transfer.
Sample Project Types

• Administration or Municipal Buildings; courthouses, correctional facilities, city halls, community centers and others
• Convention Centers or Tourism Related Developments
• Sporting Venues
• Hospitals and Healthcare Facilities (profit and non-profit)
• Economic Development Focused Initiatives that involve real estate or other asset development needs
• Airports and Public Transportation
• Infrastructure, Public Works and Utilities; energy, water, sewer, etc.
• Public Housing
• Universities and K-12
Transaction Profile

- Preliminary Project Information
- Letter of Intent
- Due Diligence
- Conditional Commitment Letter
- Underwriting
- Final Commitment Letter
- Documents
- Funding
Transaction Process — Simple, Fast

- **LETTER OF INTENT or LETTER OF INTEREST (3-10 DAYS)**
  Submittal of basic project information. Following review, representatives might schedule an initial due diligence call to determine preliminary level of interest. This phase culminates with a Letter of Intent (LOI).

- **CONDITIONAL INVESTMENT LETTER (15-30 DAYS)**
  Personal meetings and site visits are conducted. During this second level due diligence, project specific information, capital structure, costs, expenses and investment metrics are evaluated. Should the project meet investment criteria, a Conditional Offer Letter will be issued stipulating basic terms and conditions of project funding. If acceptable to the client, the Letter is to be returned within the required timeframe along with any required expense deposits.
Transaction Process — Simple, Fast

• **FORMAL COMMITMENT LETTER (30-60 DAYS)**
  Upon acceptance of the Conditional Offer Letter, the client will receive a comprehensive final due diligence checklist. Two complete sets of information will be required including all third party reports. Once final due diligence and underwriting is complete, a Committee Report and subsequent recommendation will be prepared and presented to the Investment Committee for approval to issue a Formal Commitment Letter.

• **FUNDING/CLOSING (15-30 DAYS)**
  Upon receipt of an executed formal commitment letter, a Master Closing Agenda, outlining all legal requirements for closing, will be issued. Documentation will be prepared and reviewed by respective counsel. The principal document is typically a standard form net lease of 40 to 50 pages in length. A Closing Notice will be issued by counsel and closing/funding shall occur per the Closing Notice.
Major Advantages to Traditional PPP

- Provides 100% of project costs
- Capital Costs are lower than traditional PPP
- Transaction can be completed quickly
- Provides long term fixed rate capital up to 30 years
- Government retains 100% control over operations with no interference from investor
- Long term proven model over decades in both government and corporate sectors
- Institutional funds available for leasing even in light of Economic Crisis
- Government can control design and construction using private capital
- Flexible and customizable lease terms and structures to meet needs
- Government can retain all asset appreciation and upside by owning asset at end of lease or via lease-leaseback
Lease Structure Resulting Advantages to the Strategic Heritage Project Objectives

This alternative finance structure retains full control. It’s less complex and uniquely flexible, with the lowest cost of capital. For the Strategic Heritage project this means:

- Phasing can be used to optimize business and operational continuity
- The lessee can assert own requirements for local and international regulatory compliance
- As all costs are included, and there is a lower cost of capital, more money to optimize information technology, communication and energy efficiency upgrades
- There is a direct accountability for life cycle extension and building quality and maintenance
- Simple, fast and not complex
- Many fewer stakeholder issues
- Control—the capital is passive
- Preservation of a strategic heritage with private partnership
Critical Success Factors

- Proper enabling legislation/framework
- Public vision
- One size does not fit all
- Reasonable expectations on all sides
- Political leadership
- Open mindedness/value of private money
- Definable project
- Reasonable project economics
- Stakeholder analysis/support/buy-in
- Best value financing vehicle
- Knowledgeable/experienced advisors
- Fair risk allocation
- Fair and balanced procurement process
- Comprehensive but simple documentation
- Progressive critical path
- Leadership and focus