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Project Delivery via P3: International v. American Approach

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International P3 and American P3 Models

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P3 Approaches for Social Infrastructure			
DBFOM	Design/Build	Finance	Operate & Maintain (O&M)
International P3	D/B Construction(1) ▪ Guaranteed Price ▪ Guaranteed Delivery	10% Equity 90% Taxable Debt	30 – 40 year "life-cycle" O&M management contract
American P3	D/B Construction ▪ Guaranteed Price ▪ Guaranteed Delivery	100% Tax Exempt	Typically, discretionary capital expenditures, but it is possible to integrate "life-cycle" O&M management contract

(1) Argument that International P3 provides stronger incentive for concessionaire to optimize project life cycle costs by encouraging otherwise unrelated private parties to work together (contractor, equity investor, operator)

International P3 and American P3 Models

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Design/Build (D/B)

- D/B is available under either approach (i.e. "American P3" or "International P3" delivery method")

Deukmejian Courthouse (Long Beach, CA)

Vermont Manchester DPSS (Los Angeles, CA)

Finance (F)

- Availability Payments and Lease Payments are technically not debt but they are treated as "debt-like" by rating agencies, since both are paid from General Fund (GF) resources. GF debt capacity is impacted under either approach.
- **International P3 Availability Payments:**
  - Long-term obligation (debt-like)
  - Subject to annual appropriation and "availability deductions."
  - **Typically, 10% equity and 90% taxable debt structure**
- **American P3 Lease Payments:**
  - Long-term obligations (debt-like)
  - Subject to annual appropriation and "abatement"
  - **100% tax-exempt debt structure**

Operate and Maintain (OM)

- Under either approach, a long-term facilities management contact for "incidental" maintenance (e.g. janitorial services, security, and property management) can be employed. Under either approach, the public agency has the right to replace the facilities manager for non-performance.
- **International P3 Approach:**
  - "Life-cycle" capital expenditures included in facilities management contract and the "sponsor" (typically an LLC formed by an equity investor) assumes the risk (cost) of all capital expenditures required to maintain pre-agreed upon "asset value" (i.e. 85%)
- **American P3 Approach:**
  - Public agency retains financial responsibility for all life-cycle capital expenditures. But, it is possible to incorporate "life-cycle" management

International P3 and American P3 Models

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- The primary difference between International and American P3 approaches for social infrastructure P3 centers on
  - (a) the cost of capital (Finance), and
  - (b) typically, which party retains financial responsibility for capital expenditures to maintain "asset value" (O&M)

- The decision to "contractually obligate" long term capital expenditures (essentially, converting an annual discretionary O&M expenditure to a long-term obligatory (fixed) expense) is both a financial (at what cost?) and public policy decision

- The key to comparing the International P3 approach to the American P3 approach is a "Value for Money" (VM) analysis
  - The VfM analysis is subjective; only as valid as the assumptions
  - Ontario Canada General Auditor's Report in 2014 examined 200 VfM studies
    - ✓ All recommended International P3
    - ✓ All assumed added project cost of traditional delivery method

Sample Case Study

- According to public records, the $490MM (incl. $325MM D/B) Long Beach Courthouse (the first social infrastructure International P3 in the US), encompasses a 35-year contract with $51MM annual Availability Payment[(1)]
  - **$36 MM capital charge service (approx. 7% taxable interest)**
  - $15 MM *escalating* service fee

- By comparison $490MM amortized over 35 years equates to:
  - **$26MM annual debt service (approx. 4% tax-exempt interest)**

(1) GASB Accounting Treatment: portion of availability payment related to debt service may be treated as debt

International P3 and American P3 Models

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- Question: Do Rating Agencies consider P3 Obligations Debt?

Moody's(1)

"We have included availability-payment PPP obligations in our debt metrics for regional governments in…the US…Contractual ongoing PPP obligations such as availability-payment PPP can have a focused, near-term credit impact."

- "Availability payments are sized to cover operating and maintenance costs, debt service costs and equity returns…"
- "The PPP model is another financing tool for a government to develop infrastructure but it is not a new source of funding…"
- "It can be a credit negative if the government's sole motivation to procure infrastructure under the PPP model is not the commercial merit of the transaction but instead is driven by efforts to achieve off-balance sheet treatment of the associated PPP assets and liabilities."

Standard & Poor's(2)

"If we consider the revenue stream used to repay the [P3] obligation to be tax-backed revenue, then we'll include the P3 obligation as tax-supported debt,"

"P3 availability payments have many features that make them debt-like…"

- "long-term contract or obligation to pay"
- "government pays these obligations from the same source as more traditional tax-exempt municipal debt"
- "similar to debt, these payments fund capital improvements"
- "the sponsoring government owns the asset"

Fitch(3)

"The measured liability may be added to the debt of the [local government's] in the Issuer Debt Rating analysis…"

- "Fitch believes that outstanding company project debt is a better proxy for the [local government's] PPP liability"
- "Fitch believes that it also fairly reflects the amount of debt that the [local government] would have issued directly to fund the capital costs of the project."

- Answer: Yes.

(1) Moody's Sector In Depth: PPP Impact on debt Metrics of Governments, February 22, 201
(2) S&P Ratings Direct: How S&P Treats Public-Private Partnerships In US. State and Local Government Analysis, September 17, 2015
(3) Fitch ratings: Rating Public sector counterparty Obligations in PPP Transactions, January 15, 2016
Note: GASB Accounting Treatment: portion of availability payment related to debt service may be treated as debt

Select P3 Projects

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Issuer	Project	Date	Developer	Funding	O & M
Higher Education					
California I-Bank (University of California)	UCSF Neurosciences Building	2010	Edgemoor / McCarthy	- Tax-Exempt Bonds - Taxable BABs	None
CSCDA (University of California)	UC Irvine East Campus Apartments	2012	CHF-Irvine / American Campus Mgmt.	Tax-Exempt Bonds	Management Agreement
University of California	Merced Campus Expansion	2016	Plenary	Tax-Exempt Bonds Taxable Debt Equity	Life Cycle Service Availability Contract
University Auxiliary and Research Services Corporation at CSUSM	CSUSM Mixed Use Space	2017*	TBD	TBD	TBD
General Government					
Los Angeles County	CDC Headquarters Building	2011	Trammell Crow	Tax-Exempt (6320)	Long Term Facilities Lease
State of California	Long Beach Courthouse	2013	Meridiam	Taxable Debt / Equity	Life Cycle Service Availability Contract
Riverside County	Law Building Project	2013	Trammell Crow	Tax-Exempt (6320)	Long Term Facilities Lease
City of Long Beach	Civic Center	2016	Plenary/Edgemoor	Taxable Debt / Equity	Life Cycle Service Availability Contract
City of Napa	Civic Center	2017*	TBD	TBD	TBD
City of Los Angeles	Civic Center	2017*	TBD	TBD	TBD
Orange County	Civic Center	2017*	Griffin Structures	Tax-Exempt Bonds	TBD
Los Angeles County	Vermont Corridor	2017*	Trammell Crow	Tax-Exempt Bonds	TBD
Transportation					
Port of Long Beach	Headquarters Building	2016	Plenary/Edgemoor	- Developer Financed Construction - Tax-Exempt Takeout: POLB Bonds	None
Los Angeles World Airports	ConRAC / People Mover	2017*	TBD	Tax-Exempt Takeout: LAWA Bonds	Availabilty Payment

* Expected date