Development, Construction and Financing Public-Private Partnerships

Presented to

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Presented by

Brookhurst Development Corp
Who is Brookhurst Development?

- National real estate development firm that focuses **exclusively** on public-private partnerships.

- Offices in Newport Beach, Sacramento, Houston and Indianapolis.

- Senior officers represent 150 years experience in the design, construction, financing and development of public agency facilities. Experience includes many years of financing and debt securitization of all types of institutional real estate development.

- Described as one of the foremost authorities on all financing options for P3 development.

- Pioneers in P3 development in US working with local and state legislatures in creating enabling legislation as well as authoring numerous articles and books on P3 development.

- All officers of BDC have served on public commissions, directors of city planning and/or public facility directors or public agency consultants. Two officers served as faculty of major university’s public policy making and/or real estate financing departments.
“Once you label me you negate me”

Søren Kierkegaard
Definition of Public Private Partnership

“The close collaboration of a public entity(s) and a private entity or team, to structure, negotiate and implement the finance, design, development construction and operation of a building(s).”

John Stainback
Public-Private Partnership Development
Challenges and Opportunities

Benefits to Public Partner

- Construction may begin on facility prior to obtaining funding. Existing capital of public partner does not need to be tied up with the project.

- Accomplished without voter approval

- Fixed lease payments remove uncertainty and facilitate long-term planning

- Possible assistance in maintaining credit rating

- Possible optimization of public entity’s debt capacity
Benefits to Public Partner (continued)

- *Long-term operating and maintenance contracts include performance guarantees. UK and Canada studies prove life-cycle cost savings.*

- *Cost savings and efficiencies unavailable to public partner due to procurement restrictions may be realized by private partner. Studies prove lower costs.*

- *Private partner is required to guarantee price and completion date thereby removing construction risk from public partner. In addition, financing and market risks are also passed onto the private partner.*
Benefits to Public Partner (continued)

- Private partner professionals bring experience and capabilities, particularly for large complex projects.

- The process relieves over-worked staff of public partner through reassigning responsibilities to the private partner.

- Budget busts due to delay and rapid construction cost escalation are avoided. Community receives a new and much needed facility a lot quicker.
Public-Private Partnership Development
Challenges and Opportunities

Benefits to Public Partner (continued)

- Surplus land may be brought to highest and best use
- Area revitalization and economic growth
- Job creation
- Potential revenue generation for public partner
- Assistance in funding needed government facilities and infrastructure
Public-Private Partnership Development
Challenges and Opportunities

Possible Challenges for Public Partner

- The level of oversight and control of construction by public entity is reduced.
- Public staff may perceive risk to their job security.
- Rates on taxable private financing are typically higher than rates on municipal bonds.
- Private partner has harder time getting a loan if land is not owned (e.g. subject to unsubordinated ground lease)
- Future rent or concession payments must be planned for and budgeted.
Possible Challenges for Public Partner (continued)

- Private partner often feels there is not an adequate sharing of risk by public partner - public partner doesn’t understand risk-reward tradeoff.

- Public partner’s vision and requirements are often financially infeasible given economic realities of the market.

- Added costs for social infrastructure components may make returns too low for lenders and investors.

- Long-term operating contracts and maintenance agreements are often unreasonable.
Global Outlook on Public-Private Partnerships

- #1 reason P3 projects gaining usage are global deficits
- UK created momentum in 1992 with its Private Finance Initiative (PFI). Results - 450 schools, 130 hospitals and numerous prisons, transportation systems, office buildings, museums, water treatment facilities and courthouse developed through P3 delivery.
- UK National Audit Office reports P3 delivered projects are three times more likely to be delivered on time and under budget.
- Japan has $20 billion in P3 projects currently under construction.
- India is developing 75% of its public projects through P3 arrangements.
- P3 projects are experiencing exponential growth throughout Europe, Australia and Canada.
- US – P3 investments funds have recently been created with billions raised and targeted to build public projects throughout the US.
P3 Project Types

- Municipal administrative offices & city halls
- Public libraries
- Judicial facilities and courthouses
- Public schools
- College and university facilities
- Correctional, adjudicated youth and detention facilities
- Student and faculty housing
- Public parking
- Hospitals and public healthcare facilities
- Toll roads, bridges, water treatment and power stations
- Metro transportation facilities and fire stations
- Convention centers, sports arenas and hotels
Different P3 Development Models

- **Shared/Mixed Use:** Development includes mixed-use commercial components (e.g. retail, residential, office, sports arena, hotel) funded by the private partner with private partner taking on market risks. Public partner contributes capital and/or land. Sometimes includes a public facility as part of the overall development.

- **Build-to-Suit/Lease Lease-Back (a.k.a. “American” or “lease” model):** Private partner acquires land, or, public entity leases property it owns to private partner under a ground/site lease. Private partner then leases back completed facilities to public entity or public entity exercises purchase agreement.

- **Performance Based Infrastructure (a.k.a. “European” model):** Capital costs repaid over time through “concessions” such as tolls, usage or management fees. Includes toll roads, water treatment and utility facilities, hospitals, schools, courthouses, prisons, etc.
Shared Use Developments

*What the developer wants -*

- **Major Tenant**
- **Retail Shops**
- **Shops**
- **Fast Food Pad**

- No Trees = Better Visibility
- Large Monument Sign
- Shared Public Use = Mailbox
Shared Use Developments

What the city wants -

- Bus Stop
- Day Care Center
- Low Income Housing
- Shopping Center
- Landscape Buffer
- Bike Trail
- City Library
- Under Overhead Bridge
- Brick Pavers
- Plaza
- Wilderness Park
- Memorial Fountain
- Statues of Councilmen & Planning Commission
- Playground
- Overhead Bridge
- Main Street Promenade
- Underground Parking
- Plaza
Lease-Leaseback Development
Step-By-Step Process

- Public entity owns raw land. Works with developer to create specifications and design
- Public Entity leases land to developer under long term ground lease ("site lease").

Developer
- Procures Financing
- Hires Contractor, architect, consultants
- Builds Facility

- Developer “leases back” the completed facility to public entity under a long-term lease ("facility lease")
Lease-Leaseback Contractual Structure

Public Partner

- Site Lease
- Facility Lease
- Ownership
- Design Collaboration
- Tenancy

Private Partner

Development Team

- Architect & Engineers
- Construction Company
- Financing & Underwriting
- Legal
- Other Consultants

Other Consultants
Performance Based Infrastructure Model

- Primary P3 model used in Europe, UK, Canada, Australia and India.
- Was a major initiative of California Governor Schwarzenegger.
- Unlike American model, no leases are entered into by any party.
- Public entity retains ownership of land and improvements at all times with developer, called a “project company”, granted a license to operate.
- Project company cannot lien project nor secure its funding using project as collateral. Public entity does not guarantee debt.
- Project company is repaid through a management contract, revenue generated from operations ("concessions"), or a combination of both.
- Project company may take on a significant amount of market risk, or risk from management contract being cancelled for cause.
- Contracts are characterized as service agreements, thus allowing offshore investors to avoid filing with the IRS as mandated under Foreign Investment In Real Property Tax Act ("FIRPTA").
**Public Private Partnerships**

**MYTH** - Lease-back and other P3 projects are a form of design-build.

**BUSTED! - Fact:** They are unrelated concepts. Statutes surrounding P3 delivery options are usually the same as those that allow public agencies to lease and/or purchase, not those that govern construction contracting. Awards should be based upon rental rates and/or purchase options, not construction cost bid.
Public Private Partnerships

MYTH - No developer can get financing as cheap as what the public agency can. All developer financing is the basically same.

BUSTED! - Fact: The types of financing available to developers are as varied as the project types to be financed. Capital costs vary widely depending upon the source, nature of security and tax circumstances.
**Public Private Partnerships**

**MYTH** - There is a limited number of P3 deal structures.

**BUSTED!** - Fact: Virtually every P3 deal structure is unique. A common characteristic of all successful P3 developments is **creativity!**
The P3 Fight is on!!!

**Anti – P3’ers**

- Large government wanting to maintain control and oversight
- Staff worried about job security
- Government consultants and advisors
- Public employee unions

**Pro – P3’ers**

- Developers interested in profits from public projects
- Architects, contractors & trade unions
- Citizens and public officials tired of delayed and under-funded projects coming in late and over budget.
P3 Case Study #1

Oyster School/Henry Adams House
Washington, DC

Public Partner: Wash. DC Public Schools
Private Partner: LCORE/PDA

Project Scope: New $11 MM 50,000 S.F. Elementary School
$31 MM - 211 Luxury Apartment Units

Challenge: District had “dismal” credit and could not fund new school

Solution: Land owned by DCPS was larger than needed for school. DCPS & government of D.C. agreed to dedicate all property tax revenue from new apartments as security for bond financing of new school. Developer designed, financed and built school and apartments.
P3 Case Study #2

Chicago Skyway Toll Road
Chicago, IL

Public Partner: City of Chicago
Private Partner: Cintra/Macquarie

Project Scope: $8.1 Billion acquisition of operating rights for toll road

Challenge: Chicago was currently experiencing $220 MM deficit

Solution: In 2004, a consortium comprised of Spanish infrastructure group Cintra and Australian bank Macquarie purchased a 99 year operating contract to manage operations of toll road & bridge. Was the first privatization of a toll road in the United States and followed “PBI” structure. Deal brokered by Goldman Sachs using private debt and equity.
P3 Case Study #3

JFK International Terminal #4
Jamaica, NY

Public Partner: Port Authority of NY & NJ
Private Partner: JFK IAT, LLC

Project Scope: $1.2 Billion 1.5 MM S.F. airport terminal development

Challenge: Port Authority sought private, non-recourse capital & partner

Solution: 2002 completion - this project was the first P3 development of a major airport transportation facility. Financing included $932 MM in tax-exempt bonds not issued or guaranteed by the Port Authority. Developer Also provided $15 MM in equity. Financing structured by Lehman Bros. with Schiphol (Amsterdam-based) being private operator. Included 100K S.F. of retail.
Our story begins…

- Two virtually identical neighboring school districts
- Both needed a new high school of similar size
- Both had voter-approved bond funding on the horizon
- Both were eligible for state matching funds
- Both were growing and amassing home builder fees
- But, neither had enough funds to begin construction
- BDC approached both school districts at same time…
The tale of the first school …

- School district felt it was better to follow a “pay-as-you-go” approach and would only proceed once all funding was procured. District was also fearful and suspicious of the innovative approach of lease lease-back development and the concept of a fee paid to the developer.

- Thus, school construction was delayed almost four years. Over this period the market experienced high construction cost escalation and when combined with other costs of delay, project costs went from its original $50 million to $100 million – a 100% increase in cost despite no changes in the design or scope of the project.

- To mitigate the impact of these additional costs, district elected to eliminate performing arts and sciences buildings, sell off nine acres of athletic fields initially dedicated for students and use lower quality construction materials and methods. Unfortunately, it was still many millions over budget.

- The district’s failure to maintain the original budget and loss of the quality and quantity of amenities of the original program resulted in community protests while garnering significant media attention.
And now, the tale of the second school …

Inderkum H.S. – Natomas Unified School District
Sacramento, CA

- **CEFPI** Award-Winning project

- North Natomas Town Center would encompass over 200 acres featuring a community college, city library, regional park, aquatics center and innovative new high school

- High school would have a 2,000 student capacity with 72 classrooms, sports stadium, regulation football field and track, 2 baseball fields, gymnasium, theater and outdoor amphitheater and multi-purpose atrium.

- Self sustaining energy system with 465 kW photo-voltaic panels and underground geothermal system

*Architect: Nacht & Lewis*
Challenges

- **District had weak credit – under credit watch by County.**

- **District did not have enough funds to build high school while concurrently finishing renovations of 10 other schools.**

- **Traditional approach meant significant delay on delivery due to timing of matching state funds, developer impact fees and general obligation bond funding (same challenges facing the first school district).**

- **Previous high school was delivered 24 months late and $18 million over budget – Natomas Board of Education was concerned with a repeat.**
Solution

- School district entered into a lease lease-back agreement.

- Brookhurst acquired credit enhancement allowing its procurement of $66 million in tax-exempt financing at 1.6% interest rate. Debt received highest Triple “A” credit rating.

- Developer contracted project under a guaranteed maximum price contract and built school.

- School was delivered ahead of schedule with classes in session before site work began on first school district’s high school.

- School was built under budget with $1.5 million in cost savings given back to the school district. School was voted “project of the year” by the Coalition of Adequate School Housing (C.A.S.H.).

...and they lived happily ever after.
Development, Construction and Financing Public-Private Partnerships ("P3s")

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Public/Private Partnerships:
A Critically Needed Option That’s Coming of Age

By Jeff D. Baize

IN 1992, THE UNITED Kingdom passed the Private Finance Initiative, which provided legal authority for government to pursue the use of Public-Private Partnerships (PPPs or P3s) in the funding and delivery of much-needed social infrastructure. Since then, 450 schools, 130 hospitals, numerous prisons, transportation systems, office buildings, museums, prisons, and courthouses have been constructed in the UK through P3s. The UK National Audit Office recently released an audit showing that these projects are three times more likely to be delivered on budget and on schedule when compared to the traditional governmental delivery process, and with so many successes they have sparked a wave of P3 development across the globe.

In 2009 a survey of state and local government officials conducted here in the U.S. by McGraw-Hill Construction revealed that 92 percent of government decision-makers experienced with P3 projects had a positive outlook on P3s and would embrace an opportunity for utilizing them again. But this same survey revealed that 61 percent of government officials had no experience with P3s, nor did they understand the benefits of them. And despite the success history of P3s the U.S. lags the rest of the world in embracing P3s.

In California, the debate over the desirability of P3s is at an all time high. Governor Schwarzenegger has launched a major P3 initiative his office has termed “Performance Based Infrastructure” (PBI). Schwarzenegger intends to fund some of the state’s needed infrastructure such as the proposed California High Speed Rail project, roads, courthouses and correctional facilities through PBI delivery. Joining this momentum is the world’s largest pension fund, the California Public Employees Retirement System, which last year approved five percent of its portfolio being allocated to P3s. However, on the opposite side of the debate are the California public employee unions that are fearful of loss of governmental jobs and have launched an all-out war against all proposed legislation that would allow government to use P3s. And these opponents run the ranks of government officials all the way up to California’s State Treasurer, Bill Lockyer.

But those that persevered in the UK’s 1992 groundbreaking P3 initiative now have a sense of déjà vu as they watch the U.S. fight the same battles they conquered almost two decades ago. They understand the economic crises of an under-funded government facing ever-increasing needs for infrastructure while organized labor vehemently fights to kill any usage of P3s. Fortunately, history now bears witness to the many P3 successes proving they are a viable alternative to funding needed government projects.

Few would argue that P3s are the panacea to our current financial crises. Even in the UK they still comprise only 11 percent of all government projects. But for the U.S. to remain globally competitive we must prioritize the improvement of our infrastructure and we need the financing to make that happen. P3s as an alternative should be within reach of any government seeking to meet the growing infrastructure needs of the people, which means supporting legislation that enables it to meet this critically important goal.

Jeff D. Baize is CEO of Brookhurst Development, a national firm that specializes in public-private partnerships. He is considered a foremost authority on P3s. You can learn more about Baize and Brookhurst Development on the website www.brookhurstcoop.com.