Alternative Delivery & Public-Private Partnerships

PFM-Client Industry Discussion

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Agenda

Topics

Overview of Alternative Delivery / P3 Projects

Public Private Partnerships

P3 Delivery & Financing Methods

Private Market Development

Investor Commentary

PFM Approach to Alternative Delivery Projects

Objectives

1. Understanding of the various types of Alternative Delivery / P3 projects
2. How to determine P3 appropriateness and feasibility
3. AD & P3s financing mechanics

Overview of
Alternative Delivery / P3 Projects

What is a "P3"

- A "P3" is defined by the World Bank as *"a long-term contract between a private party and a government agency, for providing a public asset or service, in which the <u>private party bears significant risk and management responsibility</u>"*

- The term P3 is used to describe projects that vary widely in their financial and governance structures, investor base, technical complexity and impact to the host institutions

- Goal – simplify the project so the University can evaluate it in a transparent manner and determine how best to engage the private sector to achieve your goals
  - Governance
  - Design & Delivery
  - Operations
  - Finance

Finance and Delivery Options

Public (Tax-Exempt) Debt

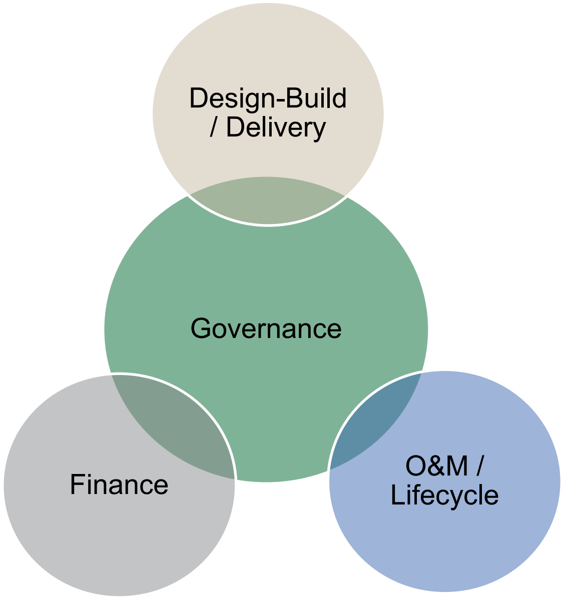
- Financing mechanism
- Public owner finances the project and separately procures and manages project

Category	Credit Example
Full Faith & Credit	• General Obligation • (Unlimited tax)
Tax-Backed / Revenue	• Road/Highway Revenue • Sales Tax
Non-Recourse, Project Finance	• Standalone Toll Revenue • (No tax pledge or govt. obligation)

Public-Private Partnership (P3)

- Financing AND delivery mechanism
- Public owner manages an integrated procurement with greater private responsibility of management and risk

P3 Components



Strategies to Leverage the Private Sector

- Municipal entities and nonprofits have leveraged the private sector to accomplish a variety of goals and objectives
  - Ownership and finance structures should be tailored to reflect the value proposition of the partnership

- **To the extent the goal is to develop or monetize an asset in order to improve balance sheet / credit capacity, the asset must:**
  - **Be a commercially viable project on a stand-alone basis**
  - **Not be a performing asset of the grantor**

Examples of Potential Goals and Objectives	
Finance	– Manage balance sheet / credit impact of the development of non-core assets ○ Debt covenants, internal debt policies – Monetize non-core assets with commercial value – Transfer demand risk
Design / Delivery	– Manage project delivery risk for on-time, on-budget project completion ○ Private sector expertise / efficiency for technically complicated development projects ○ Bundling of assets
Operations	– Transfer operating risks for noncore and/or technically complex assets – Alignment of interests with private partner for asset life cycle responsibility and risk – Private sector efficiency
Governance	– Statutory limitations – Ability to manage procurement or existing labor requirements – Disposition on non-core assets

P3 Overview

Key Benefits

- Greater opportunity for innovation and risk transfer to private sector
- Whole-life costing (alignment of capital and operational costs)
- Cost certainty (private sector responsible for over-runs)
- Scope and change order control
- Turnkey management of complex construction and operations

Key Considerations

- New delivery method with less control and prescription
- More complicated procurement
- Higher cost of capital
- Long-term contract management
- Must provide value versus conventional delivery

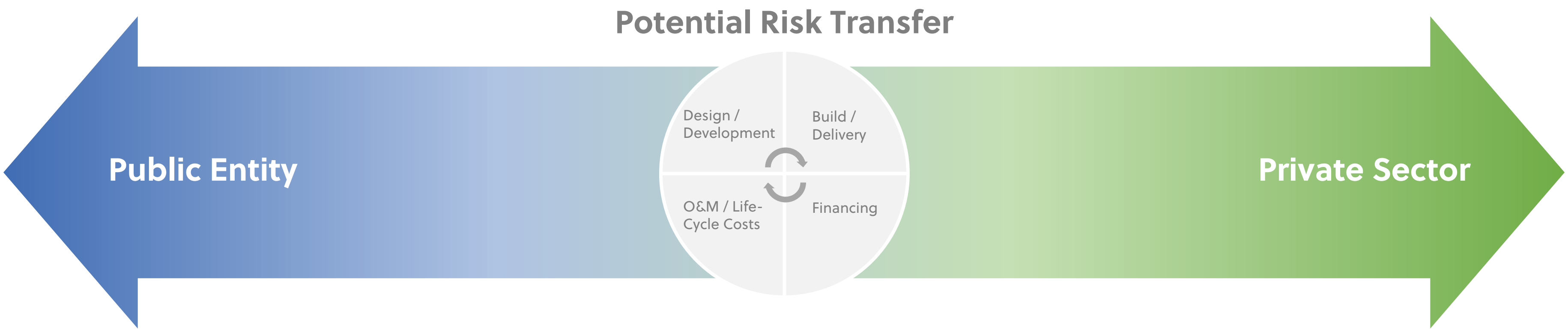
P3 Structures Are Highly Customizable

- Design-Build-Finance (DBF)
- Design-Build-Finance-Operate-Maintain (DBFOM)
  - Availability Payment DBFOM
  - Toll Concession DBFOM

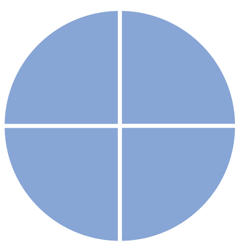
Examples of Alternative Delivery / P3 Financing Structures

		Example Assets	Description	Accounting / Credit
Financing secured by credit strength of institution	Lease	– Academic buildings – Office space	– Financing secured by fixed lease obligations made by institution	– On balance sheet and on credit
	Availability Payments	– Utility concessions – Bundling of assets (K-12 schools, bridges) – Mass transit	– Payments made to private party based on the underlying asset's availability for use – Multiple components to payment	– Financial consideration and/or new capital assets on balance sheet and on credit
Financing secured by project revenue	Demand Risk P3s	– Student housing – Parking – Toll roads – Dining contracts	– Contract where an operator provides public services through the use and operation of an underlying asset – Private party is compensated by third party fees	– FASB: Accounting treatment varies – GASB 94: Deferred inflow of resources on balance sheet – Credit treatment varies, but generally on credit
	Market Development	– Commercial office / lab – Hotels – Market rate housing	– Arms-length market rate ground lease for private development	– Potentially off-balance sheet and off credit

Procurement for Development of New Capital Asset

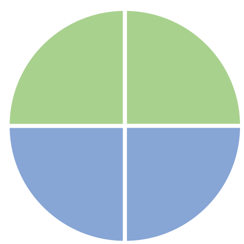


Self-Perform; Design Bid Build
(DBB)



Public Entity retains all development risk, including design, construction, delivery, financing and O&M / life-cycle costs.

Design Build
(DB)

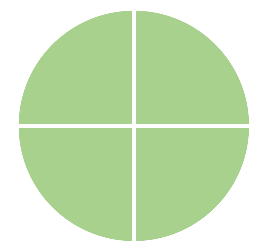


Public Entity transfers some development risk to Private Party and is delivered a turnkey project. Public Entity retains financing and O&M / life-cycle risks.

Design Build Finance
(DBF)

Private Entity assumes the project financing risks in addition to development risks

Design Build Finance Operate Maintain
(DBFOM)



Private Entity assumes O&M and Life-cycle risks including operating cost escalations and capital investment in addition to development risks.

Misconceptions about AD/P3s

- Despite increasing visibility in the U.S., many misconceptions remain about P3s

Misconception	Realities
• P3s can provide “free money” to close funding gaps for projects	• Private financing partners require some mechanism for repayment and return on investment
• Cost of borrowing is always most significant value driver	• Cost of capital is one consideration in project’s total value, along with lifecycle costs, risk-sharing, value engineering opportunities, etc.
• P3s give away government oversight and allow private sector free reign to raise rates	• Detailed project agreements preserve government oversight or define limitations on rate increases
• P3s are hostile to public-sector unions	• Successful P3s have been structured both with and without continuing union labor contracts
• Profit motives for the private sector make P3 delivery more expensive	• Private sector already profits through construction contracts. AD/P3s provide for design innovation to lower overall costs

Poll Question

Poll Question

- Only projects that generate revenues such as tolls, fares or other user fees can utilize P3 structures.

- TRUE
- FALSE

Credit Rating and Accounting Treatment

Credit and Balance Sheet Discussion

- Security pledge determines balance sheet implications for the Owner/State
- True project finance (both public and P3) is structured with NO State backing or obligation
  - Project finance relies solely on the pledged revenues of the underlying asset
  - Debt holders assume risk of default if project revenues are insufficient
  - Project finance is typically rated at the lower end of investment grade spectrum
    - BBB category for start-up toll projects
- Most public toll systems are non-recourse (not on balance sheet) of the Owner/State
- For P3, only Toll Concessions do not carry a revenue pledge from Owner/State sources

Rating Agency View
State Debt / Balance Sheet ?

Public Debt Options			P3 Financing
Full Faith & Credit GO	Yes	Yes	Design-Build Finance
Tax-Backed Revenue Bonds	Yes	Yes	Availability Payment DBFOM
Non-Recourse, Project Finance	No	No	Toll Concession DBFOM

Credit Impact of Alternative Delivery Projects – Higher Ed Example

Moody's Approach for Higher Education Institutions [1]

- Moody's typically includes the capital raise for a P3 (debt and equity) as total adjusted debt of the host institution regardless of balance sheet treatment
- Moody's definition of a P3
    1. **Project is primarily intended for use by university constituents**;
    2. Project is located on land owned by the university and falls under a long-term contract;
    3. Ownership of the project reverts to the university at the conclusion of the contractual agreement.

Standard & Poor's Proposed Approach for Higher Education Institutions [2]

- S&P's proposed approach is more subjective than Moody's
- "Nonobligated debt is typically not a direct obligation of the provider. This debt does not appear on the provider's balance sheet, but we may still consider it a liability of the provider."
- Total debt:
    - "Debt includes any obligations that we consider debt-like, when revenues of the education provider are intended to service it,"
    - "Off-balance sheet debt is a financing option used by many universities. Depending on our assessment of the **level of involvement of the sponsoring education provider and its economic interest, control, and connectivity to these projects**, we may include this debt as indirect education provider debt."

1 - Moody's Investors Service "Higher Education Methodology", August 4, 2021
2 - S&P Global Ratings "Request for Comment: Global Not-For-Profit Education Providers", June 29, 2022

Accounting Treatment for Alternative Delivery Projects *

- Accounting standards have been modified in recent years to increase transparency in financial reporting
- Lease accounting has been modified by both FASB (ASC 842) and GASB (87) to incorporate lease obligations that are longer than 12 months as liabilities on the balance sheet
- GASB (94) has provided guidance specific to public-private partnerships and availability payment arrangements
- The accounting treatment of project financed assets under FASB can be subjective and inconsistent between auditors

- General guidelines in order to structure a ground lease that is not incorporated as a long-term liability:
  - Institutional support for project: no guarantee provided by institution, financial or otherwise
  - Control: Subjective analysis on the level of control the institution may maintain over the asset
  - Compensation: No guarantee of net cash flow back to the institution
  - Accounting treatment of assets for book and tax purposes:
    - Improvements recognized by the SPE if the useful of improvements are less than the term of the lease
    - Existing assets stay with the institution
  - Sale: No sale of property / transfer of title

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Poll Question

Poll Question

- Which description best describes the treatment of alternative delivery / P3 financing?

  A. Never on credit

  B. Never on balance sheet

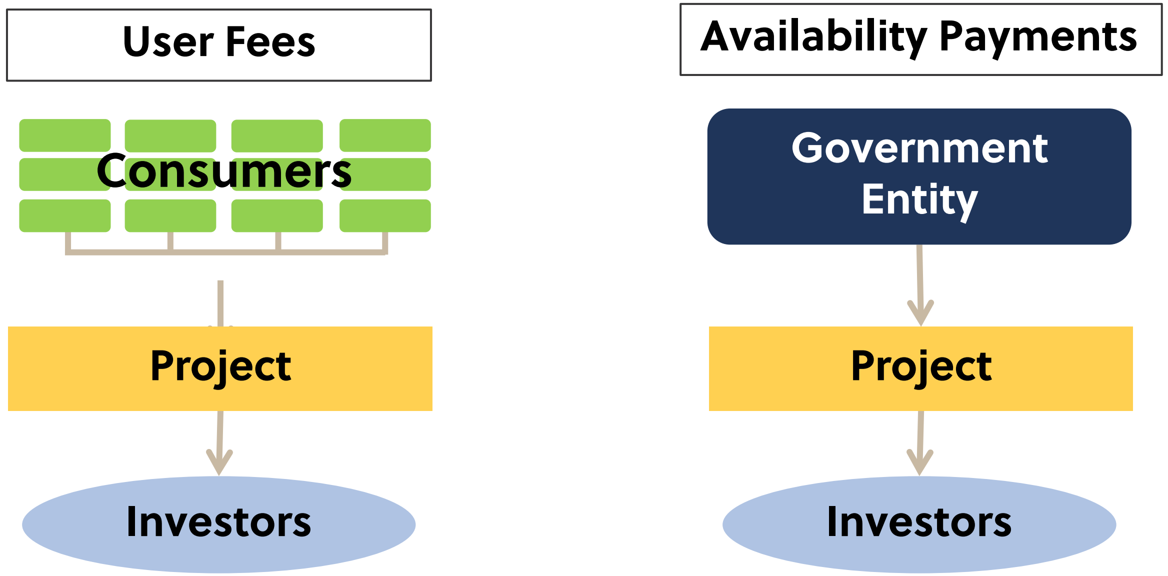
  C. Always on credit or balance sheet

  D. Dependent on specific deal terms

P3 Delivery & Financing Methods

Project revenue: availability payments vs. user fees

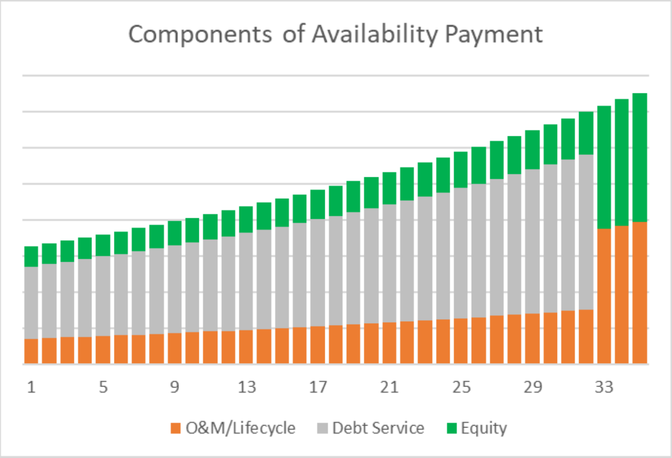
- Private investors recoup their initial investment in a P3 project via rights to the income produced over a defined period of time
- There are two high-level ways for a project to generate income:
  - User fees: Money paid directly by the consumers of a service, such as highway tolls, utility bills, transit fares or student housing rent
  - Availability payments: Periodic money that the government commits to pay to support an asset that does not generate fee revenue, such as a courthouse, academic building or non-tolled highway; payment is based on a specified performance level
- Hybrid models with a mix of both approaches also exist



Overview of DBFOM Structures

Availability Payment Transaction

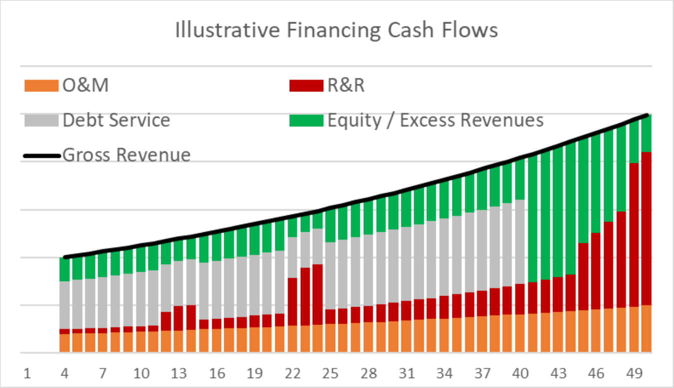
- Private sector receives annual payments based on "availability" and meeting operating requirements (subject to deductions for non-compliance)
- Revenue repayment is tied to a broad pledge of public funds (State Transportation Trust Fund)
- Project can be tolled, but doesn't have to be
  - Tolls can offset part of annual payment
- Primary risk is government appropriation



For illustrative purposes

Revenue Risk Concession

- Private sector retains toll revenues as compensation
- Also called a "revenue" or "demand" concession
- Private sector bears project revenue risk (tolls)
- Typically requires a public subsidy to cover a portion of upfront capital costs



For illustrative purposes

Availability Payment Arrangements Overview

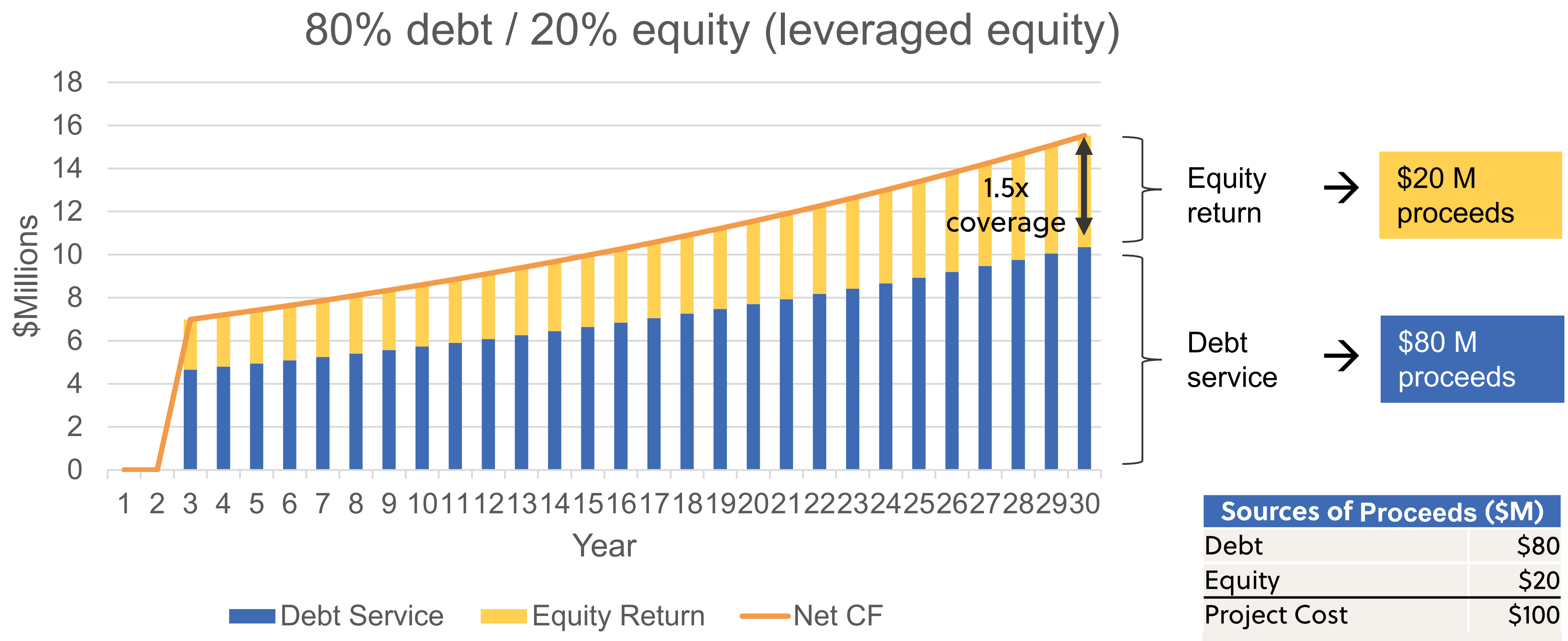
- Financing structure under which the public partner makes a present annual payment to the private partner for the use of the financed asset
  - Public partner is only required to make the full annual payment if the asset is maintained to certain negotiated operating standards

Potential Benefits	Considerations
– Transfer of construction and delivery risk to private party – Alignment of interests with private partner that has equity at risk for the future financial performance of the asset – Time and cost efficiencies in project development – More politically palatable vehicle for public sector to issue debt – Manage statutory limitations for issuance of debt	– Public sector retains demand risk for the future use of the asset – Accounted for as a long-term liability, and treated as debt by the rating agencies – Borrowing costs higher than senior lien credit of public party

Examples

General Municipal	Transportation	Higher Education
– PG County, MD: K-12 Schools – Long Beach County, CA: Courthouse	– PennDOT Bridges – LaGuardia Airport	– Purdue U: Student Housing – U Idaho: Utility Concession – UC Merced: Multi-Use Campus Development

Equity plays distinctive role in financing stack by providing both debt coverage and upfront proceeds



Sources of Proceeds ($M)	
Debt	$80
Equity	$20
Project Cost	$100
Interest Rate	6.0%
Equity IRR	10.2%
WACC (pretax)	7.3%

- Equity leverages "at risk" cashflows to reduce required borrowing (project cost and reserves)
  - Excess cash flow after debt service goes to the developer as a return on equity
- Equity provides additional flexibility for developers to reduce contingencies and other project costs

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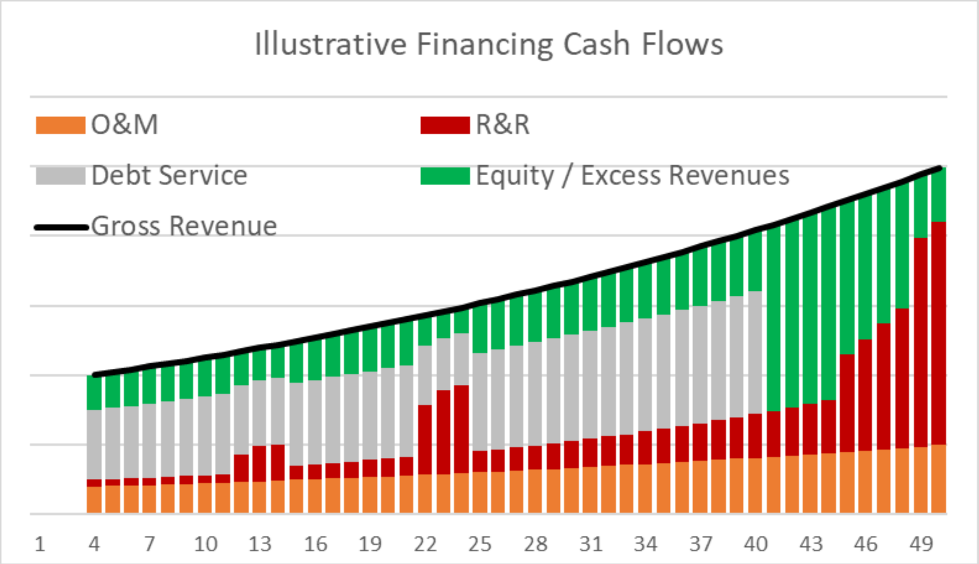
Toll Project Financing Structure



P3 Toll Concession

- Equity plays distinctive role in financing stack by providing "skin in the game"
- Upfront contribution and debt coverage
- Equity leverages "at risk" cashflows and requires a return on investment (typical IRR of 10-14%)

Public Toll Debt

- Coverage provides excess revenues for the public owner
- Public can "monetize" excess revenues with subordinate lien that is guaranteed by taxes or issued as unrated debt

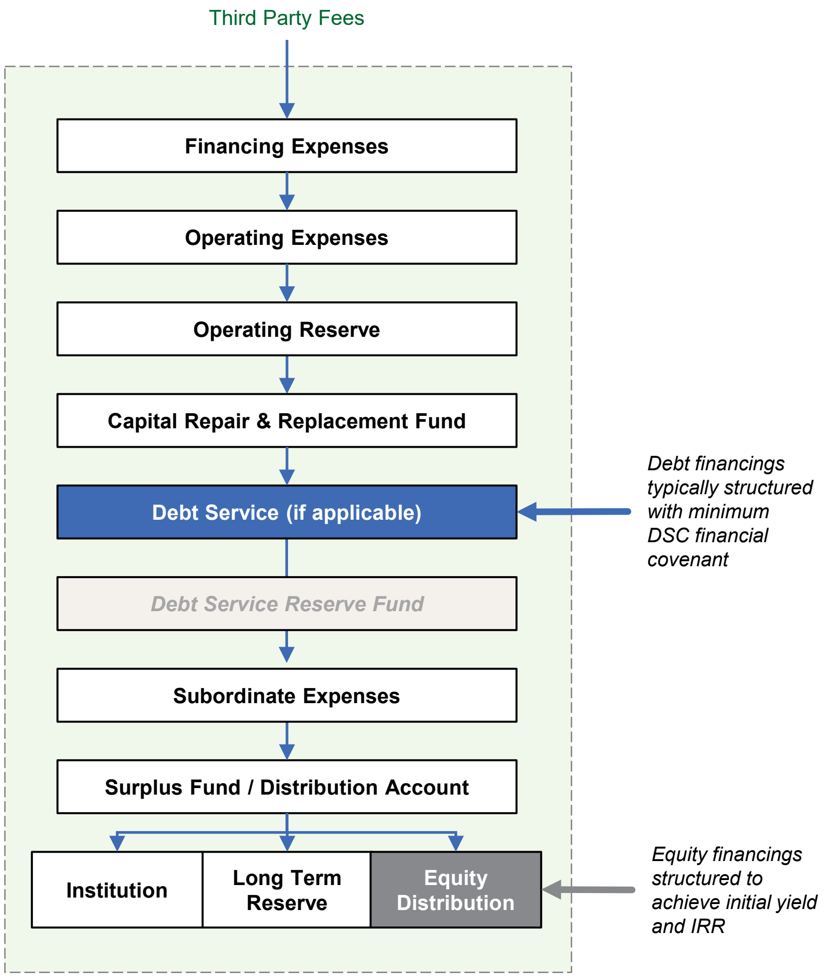
P3 Project Financing

Simplified Overview of Flow of Funds

- Demand risk P3 projects primarily leverage third party fees to support the operations of the asset and investor return requirements

- Private party compensation:
  - Developer: fixed fees paid out of capital raise
  - Property Manager: fees paid as operating expenses (a portion potentially subordinate)
  - Investors: repayment of debt service, or equity returns

- Institution compensation:
  - Debt financing: net operating income
  - Equity financing: fixed ground rent
  - Both alternatives: reimbursement of institution retained services to support project as an operating expense



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Poll Question

Poll Question

- Which of these is NOT an example of a P3?

  A. Long-term concession agreement of an airport terminal

  B. Management contract for operating a water supply system

  C. Design-bid-build of a primary school

  D. Highway financed using milestone and availability payments

Examples

The Ohio State University's CEMP – Accounting Treatment

1. **Cash and temporary investments:** increase includes upfront proceeds from the energy agreement held for future capital projects
2. **Long-term investment pool:** increase due to investment of $820 million of the upfront proceeds from the energy agreement
3. **Advance from concessionaire:** upfront payment reported as noncurrent liability and is amortized as a reduction to operating expense on a straight-line basis over the term of the 50-year agreement

- Capital investments in the utility system will be recognized as capital assets and a related long-term payable to the concessionaire

- Utility Fees:
  - Fixed Fee: $45mm annually growing at 1.5%
  - O&M Fee
    - Capped fee: controllable expenses
    - Uncapped fee: extraordinary direct costs, subject to University approval
  - Variable fee: future capital investments, to be funded by 50/50 debt/equity split

– *The University will continue to buy energy sources directly from providers*

Summary Statement of Net Position *(In thousands)*

	2018	2017
(1) Cash and temporary investments	$ 3,023,554	$ 2,230,609
Receivables, inventories, prepaids and other current assets	845,332	757,389
Total current assets	3,868,886	2,987,998
Restricted cash	564,656	666,032
Noncurrent notes and pledges receivable, net	112,019	108,073
(2) Long-term investment pool	5,211,434	4,253,459
Other long-term investments	163,946	143,638
Capital assets, net of accumulated depreciation	5,043,222	4,883,584
Total noncurrent assets	11,095,277	10,054,786
Total assets	14,964,163	13,042,784
Deferred outflows	737,903	1,012,937
Total assets and deferred outflows	$ 15,702,066	$ 14,055,721
Accounts payable and accrued expenses	$ 579,363	$ 524,754
Deposits and advance payments for goods and services	274,401	223,880
Current portion of bonds, notes and lease obligations	640,589	651,984
Other current liabilities	105,021	87,708
Total current liabilities	1,599,374	1,488,326
Noncurrent portion of bonds, notes and lease obligations	2,582,017	2,640,142
Net pension liability	2,548,009	3,565,362
Net other post-employment benefits liability	1,249,521	-
(3) Advance from concessionaire	1,046,342	-
Other noncurrent liabilities	366,344	366,057
Total noncurrent liabilities	7,792,233	6,571,561
Total liabilities	9,391,607	8,059,887
Deferred inflows	972,224	484,007
Net investment in capital assets	2,376,795	2,259,207
Restricted:		
Nonexpendable	1,551,278	1,473,074
Expendable	1,328,793	1,190,162
Unrestricted	81,369	589,384
Total net position	5,338,235	5,511,827
Total liabilities, deferred inflows and net position	$ 15,702,066	$ 14,055,721

Source: *The Ohio State University audited financial statements for FY18*

George Mason University – Fuse at Mason Square

Project

– Located on land owned by University in Arlington, VA
– Ecosystem of faculty, students, and private sector and community partners that will accelerate innovation
  - Academic Space: Classroom, lab and office space utilized by the University
  - Commercial Space: Office, lab and retail space utilized by private entities aligned with the University's technology programming

Finance / Ownership Goals

– Mitigate impact to University balance sheet / credit capacity
– Transfer lease-up risk for Commercial Space to private partner
– Achieve efficient cost of capital for Academic Space
– Participate in financial considerations based on annual performance and upon capital event

Proposed Structure

– Long-term ground lease to private development partner
  - Developer responsibilities
    - Deliver the Project on-time and on-budget
    - Raise capital for the Commercial Space (approximately $77 million)
    - At risk for lease-up and financial performance of Commercial Space
    - Operations and maintenance of entire Project to agreed upon standards

– University enters into sub-lease for Academic Space that is co-terminus with the ground lease
  - University responsibilities
    - Raise capital for development costs (approximately $156 million split b/n University and Commonwealth)
    - Pay annual costs of operations

PFM Approach to Alternative Delivery Projects

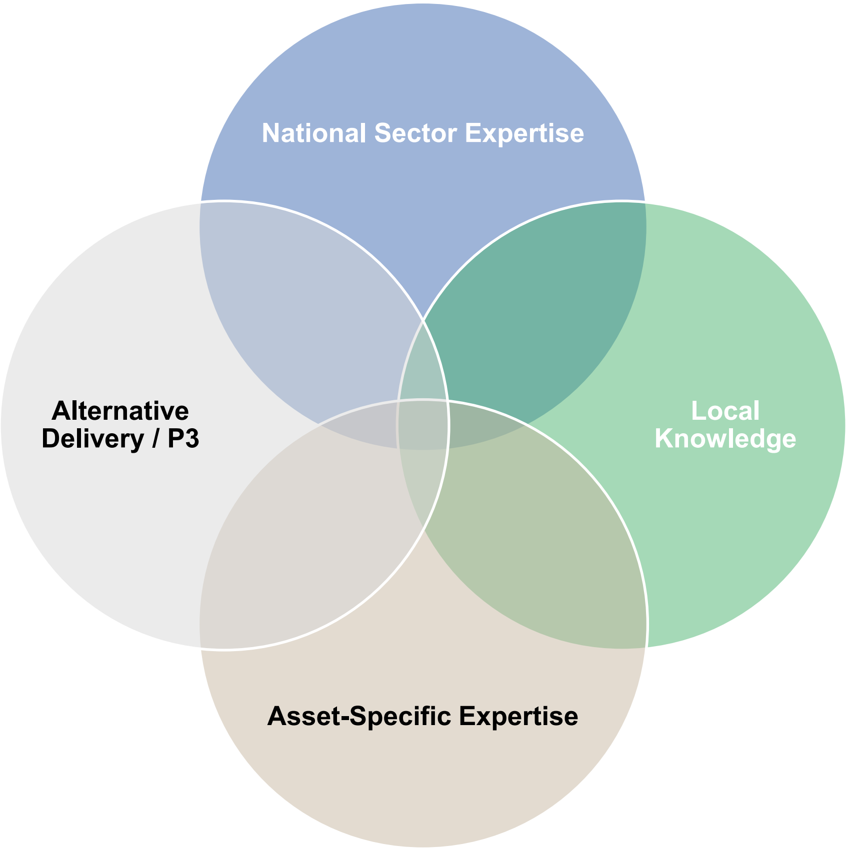
PFM Approach to Alternative Delivery Projects

- PFM's AD/P3 project teams combine industry best practices with local knowledge of our clients

- Goal – simplify the project so the client can evaluate the project in a transparent manner and determine how best to engage the private sector to achieve your goals
  - Governance
  - Design & Delivery
  - Operations
  - Finance

- Work with our clients to determine the most efficient project delivery method that accomplishes the institution's goals and objectives
  - We focus on the long-term best interest of our clients, not the development of an individual project

- We understand the nuanced details of these projects and have the ability to analyze their impact on the client's financials, credit, governance and mission as their trusted advisor



Keys to AD/P3 implementation

- Best practices for P3 create the conditions for successful outcomes (whether a transaction is executed or not)
- Understanding goals and objectives up front provides yardstick to measure value
  - Avoids “fishing expeditions” with ill-defined procurement instructions to private sector
- Maintaining a disciplined procurement schedule and competitive tension among potential bidders is critical to driving greatest value

Define the public purpose and potential benefit of the P3

↓

Identify and engage stakeholders

↓

Objectively review alternative delivery and finance models

↓

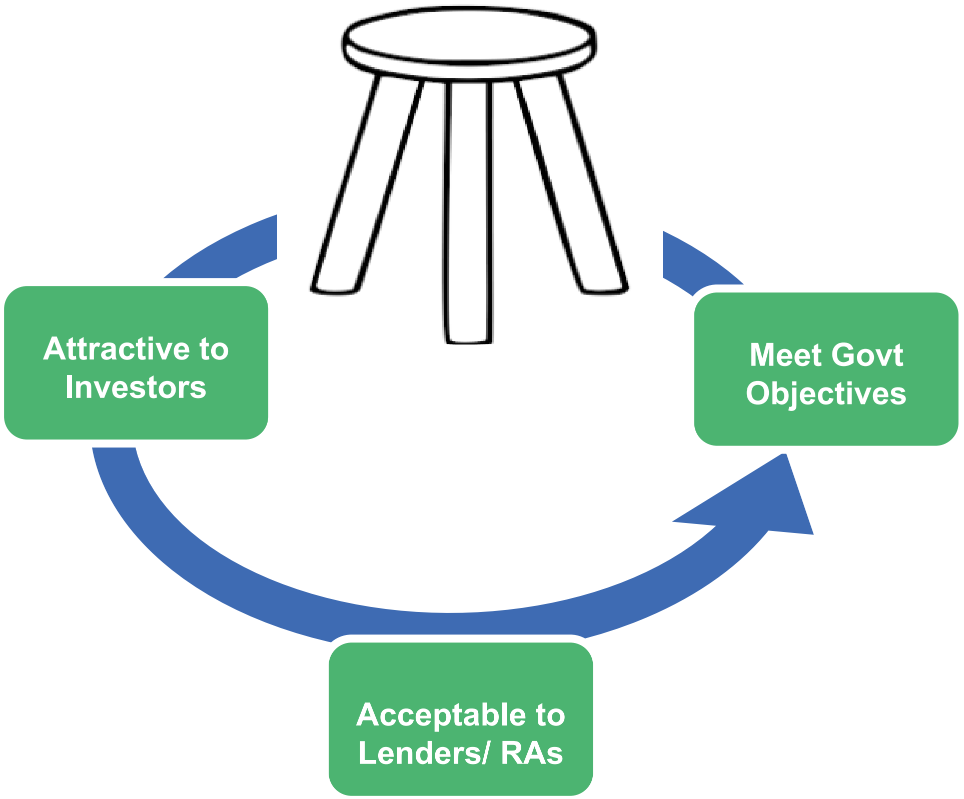
Gauge private sector interest and capability

↓

Execute disciplined, transparent and competitive procurement

“Three Legged Stool”

- A successful project will have to:
  - meet the financial and policy objectives of the governmental agency;
  - provide a compelling investment opportunity to attract potential investors; and;
  - provide sufficient credit strength to enable cost-effective financing.
- The PFM team’s diverse background incorporates all these elements: public, developer and lender perspectives.
- 360 degree view: provides balance, strength, & stability.



PFM’s project management approach

Analysis and valuation

Program development

- Define project / transaction objectives
- Determine public interest to be served
- Establish financial framework
  - Enterprise (user fee based)
  - Availability (tax or appropriation supported)
  - Hybrid (user fee and tax supported

Feasibility and valuation

- Build financial model
- Develop and evaluate alternative solutions
- Identify legal or legislative hurdles
- Identify stakeholder and constituent considerations
- Retain expert technical advisors as required
- Model best practices

Market outreach and communication

- Solicit input from investors and operators
- Gauge level of interest
- Identify risks
- Communications and education with stakeholders and constituents

Transaction development and execution

Procurement design

- Confirm transaction structure
  - Lease
  - Concession
  - Design-Build
  - Operate-Maintain
  - Other
- Compare to tax exempt options
- Determine procurement process requirements
- Retain balance of transaction team
- Develop procurement schedule

RFQ process

- Draft and distribute RFQ
- Develop shortlist of qualified bidders
- Initiate due diligence
  - Confidentiality agreements
  - Data room
  - Meetings with bidders
- Determine requirements for final proposals or offers

RFP and selection

- Draft transaction documents
  - Concession / lease
  - Operating standards
  - Design specifications
  - Other
- One on one meeting with finalists
- Finalize transaction documents
- Release RFP or final bid submittal form
- Select finalist
- Close and transition

Higher Education Strategic Consulting

- PFM's Higher Education Alternative Delivery / P3 team leverages resources throughout the firm to advise clients on a wide variety of projects that are unrelated to traditional debt offerings

Real Estate

- Collaborative Research / Office
- Hotels
- Multi-Use Development
- Market Rate / Workforce Housing

Financial Consulting

- Strategic Investment
- Outsourcing / Monetization Analysis
- Asset Acquisitions
- Organizational Review

Sustainable Energy

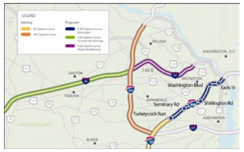
- Replacement of Utility Assets
- Utility System Concessions
- Micro-grids
- Power Purchase Agreements

Distressed Assets

- Student Housing
- Hotels

List above represents higher education clients as of June 1, 2022. Client list is provided for informational purposes only and does not constitute an endorsement or testimonial by clients listed of services provided by PFM's financial advisory business. A complete client list is available upon request.

Examples of Alternative Delivery Projects in Transportation

			Example PFM Client
Concession	– Long term lease of operating asset – Proceeds used to fund other governmental purposes	– Concessionaire takes revenue risk and is obligated to fund operations, maintenance and hand-back	IFA Indiana Finance Authority
Availability	– Private party obligated to design and construct asset, and maintain the asset over a specified period. – Compensated for project “availability”	– Government controlled through deduction regimes	MDOT Michigan Department of Transportation
Managed Lanes	– Newest toll road structures – Tolled lanes alongside freeway – Users pay for free flowing traffic	– Concessionaire developments as well as publically managed projects	
Airports and Seaports	– Car rental facilities, hotels, parking – Terminal facilities for single or multiple airlines / shipping lines	– Project financing or P3	STL ST. LOUIS LAMBERT INTERNATIONAL AIRPORT
Transit	– Outsourcing operations and maintenance – Design-Build of major investments	– Fare collection systems – Transit oriented development	M

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PFM Scope of Services

- General
  - Assess objectives and the related impact on the client's financial statements, governance, credit ratings and strategic mission
  - Review of industry best practices utilized for comparable projects
  - Development of cash flow models that can independently evaluate the quantitative aspects of the proposed project
  - Market sounding with potential investors to understand their desired structure and return objectives
  - Development and evaluation of optimal financial and ownership delivery structures for contemplated projects
  - Analyze feasibility, and potential impact, of monetization and/or alternative management of existing assets
  - Evaluate financing and ownership structuring options for large acquisition and joint ventures for both financial and credit impacts on the client
  - Develop decision matrixes and models that assess financial viability of large acquisition or partnership transactions
- Project management of procurement and implementation
  - Advise on procurement strategy and procedures
  - Prepare and review procurement documentation
  - Assist in preparing due diligence for potential private partners
  - Assist client's evaluation committee in evaluation of bids, including financial diligence on bidders / proposed financing structures
  - Develop term sheet to memorialize roles and responsibilities of each party and understanding of major business positions
  - Advise in negotiations with private partner on all business terms contained in the operative legal agreements

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