

Infrastructure Investors Are Willing To Pound the Pavement

New public-private transport deals are sweeping across the U.S.

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Florida Dept. of Transportation officials and their advisers aren't likely to forget the year 2008. FDOT was trying to close on two different billion-dollar-plus public-private partnerships, but the financial markets were collapsing. In September, while still restructuring the year-delayed Port of Miami Tunnel (POMT) deal, FDOT accepted bids for a \$2-billion Interstate 595 expansion. Just days later, emblematic of market conditions, the financial giant Lehman Brothers filed for bankruptcy.



Photo Courtesy Of The Corridino Group
The I-595 expansion deal, including new managed lanes, was tough to close.

“Credit was just not obtainable,” recalls Jeff Parker, founder of Jeffrey A. Parker & Associates Inc., Chilmark, Mass., a financial adviser to FDOT. “The bid assumed \$900 million in private activity bonds. But there was no market for that type of debt.”

But the FDOT team rallied. Bank debt replaced bonds, which meant the concessionaire had to pony up another \$50 million in addition to the original \$150 million of equity. “We learned to accept certain risks, like risk for movements in credit spreads,” says Parker. “We recognized from the tunnel project that we needed flexibility.”

As for the tunnel, the team scrambled to make the project eligible for a \$341-million Transportation Infrastructure Finance and Innovation Act loan. It had to meet federally required environmental processes, “Buy America” provisions and Disadvantaged Business Enterprise requirements. “We basically married the POMT with the federal process,” says Gerry O’Reilly, FDOT transportation development director. The Federal Highway Administration had to be brought up to speed on maximum availability payments (ENR 5/14/07 p. 11), used for the first time on a U.S. public-private partnership project.

Ironically, the market collapse proved to be a saving grace. The original bids for POMT had come in unaffordably high. “The euro started going down. Commodities prices went down,” says Parker.

Both projects are now under way. In Miami, Bouygues Civil Works Florida Inc. is leading the \$607-million construction of two 3,900-ft-long, 41-ft-dia tunnels. In Broward County, I-595 Express—a consortium led by ACS Infrastructure Development with Dragados USA and, heading the design-build team, AECOM—is building three toll lanes in the median of I-595.

Two massive new P3 deals in Texas also have been inked. In Denver, a team has just won a \$2-billion deal for a new commuter rail line. The past two years of ramped-up activity—despite or because of the recession—marks the ongoing evolution of P3s in the U.S.

“What we’re seeing is a new wave of projects,” says Fred Kessler, partner with Nossaman LLP, a law firm specializing in infrastructure deals. The first wave was in the mid-1990s, mainly in Virginia, California and Washington. Virginia, Texas and Florida are riding the current wave, and a third is coming down the pike.

Drawing on past experiences, new deals increasingly feature availability payments, no non-compete clauses and emphasis on long-term federal loans like those in the Transportation Infrastructure Finance and Innovation Act.

As with so many other aspects of transportation legislation and financing, the future of P3s in the U.S. hinges on the delayed reauthorization of the six-year federal financing bill. “If they delay reauthorization, then the way that P3s are supported remains unclear to everybody. It inhibits the ability of things to happen,” says Michael Della Rocca, president of Halcrow’s North American operations. “On the flip side, the longer the bill is delayed, the less certainty states have with regard to public money. This suggests they might turn to P3s more [often].”

If they do, a look at P3s to date offers important lessons in revenue assumptions, payment methods and balancing risks and responsibilities among all parties.

Lessons Learned

If Greg Hulsizer, chief operating officer of San Diego’s South Bay Expressway (SBX), had to do the project all over again, he would modify the roles of the participants. “We should have the government do what it does best: environmental permitting and land acquisition,” he says. “That would take significant risk out of the project.” Hulsizer also suggests non-compete clauses, property-tax exemption and the ability to add years to the franchise if revenue forecasts aren’t met to allow the investor time to recover costs.

The 35-year contract to build and operate SBX, also known as state Route 125, a 9-mile, four-lane toll road (ENR 8/21/06 p. 24), was first awarded to New York City-based Parsons Brinckerhoff in 1991. It faced 12 years of lawsuits during environmental permitting. Australia-based Macquarie purchased the project from PB in 2003.

In 2007, the road was completed, which coincided with the beginning of a recession that thinned traffic and expected toll revenues. Lawsuits ensued between SBX and the contractor team of Fluor Corp. and URS. SBX filed for Chapter 11 reorganization in March, citing \$40 million in legal fees and the economy. A fall trial could determine lien priority among the parties. Hulsizer predicts his agency’s emergence from reorganization in about a year.

Still, the job demonstrated that P3s do work, says Hulsizer. “It did what was anticipated: It built a road decades before it would have broken ground if left in public hands.” Kome Ajise, director of the California Dept. of Transportation’s P3 program, adds, “The next generation of P3 takes into account lessons learned in South Bay and around the world.”

California's interest in P3s received a boost from SBXX4, which replaced a law that only allowed four P3 projects; the new law allows P3 projects until 2017, and several are in the works. In the Bay Area, a \$1.045-billion Presidio Parkway P3 was approved by the California Transportation Commission in May. Requests for proposals could go out this fall. To reduce private risk, Caltrans walked the project through the environmental review process before awarding the contract.

Instead of granting a franchise, Caltrans will pay the concessionaire a \$35-million availability payment over 30 years based on maintenance standards. "That adds certainty while ensuring that they have skin in the game," Ajise said. The project also includes a milestone payment for timely completion that can be used to pay back some of the financing.

The new measures are drawing interest from investors, says Mike Lucki, global infrastructure leader in the Irvine, Calif., office of Ernst & Young. "About \$150 billion in pension and infrastructure funds are sitting on the sidelines waiting to invest," Lucki says. By taking the risk out, it drives the cost of the financing down, which drives the project cost down."

Georgia's initial foray into P3s, the Public Private Initiative (PPI) program enacted in 2003, relied on firms or consortiums to make unsolicited proposals for transportation projects. But transportation officials became concerned. "We concluded that the private sector was cherry-picking routes that would generate the most financial return, rather than maximizing mobility options," says David Spear, spokesman for the Georgia Dept. of Transportation. "The result would be projects built and developed in a disoriented manner with no connectivity or interoperability."

The one project that did move forward under the PPI program—the Northwest Corridor plan to add managed HOV and truck lanes to I-75 and I-575 near Marietta—was scuttled as the Georgia General Assembly revisited P3s.

A revised approach, enacted in 2009, authorizes GDOT to identify and solicit proposals better suited to its long-term strategy. It has short-listed three consortiums for a project that combines the original Northwest Corridor plan with managed lanes on a stretch of Interstates 20 and 285 into a broader effort called West by Northwest. GDOT plans to issue an RFP in September, with a goal of financial close by July 2011.

The program does permit unsolicited proposals, but Spear says the State Transportation Board likely will not accept them, at least for now.

Moving Forward

Texas, which suffered setbacks in previous P3 pursuits, is trying again in a big way, with two road projects in the Dallas-Forth Worth area: the \$2.7-billion LBJ-635 Express and the \$2.5-billion North Tarrant Express (NTE).

Both the LBJ, which just achieved financial close, and the NTE, which did so last year, have the Dallas police and firefighter pension system as an equity partner. As with Florida, as legal adviser to the Texas Dept. of Transportation, Nossaman helped restructure the deals. "The credit markets froze around October 2008," recalls Christine Ryan, Nossaman partner. "The proposals for the North Tarrant Expressway were due in December. A month later, the I-635 proposals came in."

In September, TxDOT signed a comprehensive development agreement (CDA) with the LBJ Infrastructure Group (LBJIG), led by Spain's Cintra. On June 17, the \$4-billion deal reached financial close. **The goal had been to do both concurrently, says Nossaman's Kessler. "But we had to give proposers time to wait out the meltdown."**

Cintra's partners include New York City-based Meridiam Infrastructure North America, Houston-based W.W. Webber and the Spanish firm Ferrovial Agroman. The deal allows TxDOT to leverage its investment

about five times “without waiting for limited taxpayer resources to become available,” says Joe Aiello, CEO of Meridiam.

Construction will start in 2011 on the LBJ-635 and last five years. It will add up to 13 miles of six toll lanes within the existing footprint. Three lanes will dip 25 ft below grade in some areas. LBJIG spokesman Andy Rittler says after 52 years, the team will hand the road back and “will basically be able to write the project off, assuming consumer price indexes and material costs don’t fluctuate beyond the norm.”

In 2009, TxDOT awarded two CDAs for the NTE to NTE Mobility Partners—also consisting of Cintra, Meridiam, Ferrovial, Webber and other firms—to build two managed lanes in each direction, plus two general-purpose lanes along 13 miles from north of Fort Worth to southwest of the airport. The concession is for 52 years. The team will develop master plans for a total of 36 miles of managed lanes.

In Denver, the Rapid Transportation District (RTD) chose a team called Denver Transit Partners (DTP), led by Macquarie and Fluor, for its \$2.1-billion P3 proposal to build some 40 miles of commuter rail. The Eagle proposal includes opening the central line between Denver and its airport by 2016, 11 months early.

Like many P3s lately, RTD will pay the non-winning proposer a \$2.5-million stipend in exchange for intellectual property, giving RTD the option to use cost-saving ideas. DTP over 40 years will receive annual payments from RTD based on its meeting RTD’s service standards.

DTP includes partners Ames Construction, Balfour Beatty Rail Inc., Alternate Concepts Inc. and HDR. Jim Moynihan, CEO of Balfour Beatty Rail Inc., says transit poses unique challenges, including both rolling stock and fixed facilities. “The challenge for this project is going to be the systems integration,” he says.

Ongoing Debate

More P3 lessons will be learned as debates continue and critics speak out. Ken Orski, P3 expert and editor of Innovation Newsbriefs, says lawmakers are still wrestling over the ultimate role of the federal government. “As a financial partner in P3s ... the federal government shares the responsibility for protecting the public interest,” he adds. But overly regulated federal oversight of P3s would cause private investors to balk.

He also questions the availability payments at the heart of the I-595 and the Port of Miami projects, calling them “a way of financing public projects on an installment plan with public funds.”

Officials contend that I-595 and POMT involve \$280 million of equity and about \$2.2 billion of debt that is contingent upon successful completion of the contracts, and they note the risk-averse state of financial markets in 2008-2009. “We look carefully, critically and with an open mind at all processes that allow us to leverage limited funds to help us realize projects sooner,” says FDOT’s O’Reilly.

Michael Likowsky, a research fellow at New York University, warns of “the habit of shouldering too much of the risk of P3 investors. For instance, the people of Texas are providing heavily subsidized bonds in order to make the North Tarrant Expressway attractive to investors.”

Parker acknowledges that, in general, “We are seeing in some transactions a tendency to lighten up on risk transfer.” He says, “It’s key for owners to hold the line a bit. If you end up giving too many subsidies, you do have to reconsider doing projects as design-build-operate-maintain, et cetera.” **Adds Patrick Harder, a Nossaman partner, “It’s about the art of the deal—knowing when to push and when to give in.”**