Bonding and Public-Private Partnerships

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What We Will Cover Today

- Public-Private Partnerships Basics
- Our Neighbor to the North – Insights from Canada
- Bonding a Public-Private Partnerships Project in the U.S.
- Where is PPP Market Going in the U.S.?
PPP – What is it?

- Risk transfer mechanism

- Cooperative venture between the public and private sectors, built on the expertise of each partner

- On-time, on-budget project delivery

- Model which seeks to address all of the risk factors which could potentially jeopardize “on-time, on-budget” delivery

- Effective, efficient delivery model
PPP – What It Is Not

- Not a mechanism to permit privatization of public assets
- Not purely a financial transaction
- Not that the private sector can borrow money more cheaply than the government
- Not a windfall for the construction community
- Not a panacea or a magic bullet
A Typical PPP Structure

- Owner
- Project Co
  - Lender(s)
  - Design - Builder
  - Operator
  - Surety Bond

Abbreviations:
- M.O.R (Multiple Obligee Rider)
- P.A. (Project Agreement)
- C.A. (Credit Agreement)
- D.B.A (Design Build Agreement)
- O.M.A. (Operation & Maintenance Agreement)
### PPP Terms to Know

- **Design Build (DB)**
- **Finance Only**
- **Operation & Maintenance Agreement (O.M.A)**
- **Build-Finance**
- **Design-Build-Finance-Maintain (DBFM)**
- **Design-Build-Finance-Maintain-Operate (DBFMO)**
- **Build-Own- Operate (BOO)**
- **Concessionaire**
- **Concession**
- **Lender’s Direct Agreement (LDA)**
- **Request for Proposal (RFP)**
- **Request for Qualifications (RFQ)**
Why Did Canada Look to Public-Private Partnerships?

**Concern with delivery Model:**

- Schedule and cost overruns
- Under-performance, poor maintenance & operation
- Life-cycle maintenance and operational costs are difficult to predict
- Adversarial agreements
- Not the holistic life-cycle costs of infrastructure
- Large infrastructure deficit results from delayed payment, deferred maintenance, demographic & geographic shifts
First Steps

- Consulted with other countries which had either dealt with, or were facing similar challenges
- Consulted with other countries who had successfully developed a PPP market place

- Consulted with private sector stakeholders integral to PPP process

- Identified infrastructure projects already in the procurement pipeline which might be suitable PPP candidates
Challenges in Developing the Canadian PPP Market

- The need for a political champion
- The development of a consistent approach and documents
- Each private sector stakeholder had differing risk and political culture focused on near term
- The need to collect and/or development the public sector expertise
- A lack of understanding around PPP
- Concern within the Canadian construction community that the PPP model would prohibit Canadian contractors from participating
Where Did We Hit The Mark?

- Created Provincial Near Government Organizations (NGO’s) which were not subject to political will, but yet still accountable to the Canadian tax payer

- The mandate for these NGO’s incorporated all levels of public infrastructure procurement within their respective

- Each NGO developed “in-house” expertise in finance, legal, engineering, construction, operations and maintenance

- Created a Federal Agency, PPP Canada

- Considerable consultation and negotiation with private sector stakeholders as to commercially available terms, risk transfer and abilities
Where Did We Hit the Mark?(Continued)

- Most jurisdictions took a conservative approach to the implementation of PPP
- Continued consultation with private sector stakeholders to “tweak” the model, and address the concerns / flaws inherent to the model and the documents on a project by project basis
- Did not take a “one size fits all” approach to the project documents
- The NGO’s looked to established documents in other common-law countries, borrowed what worked, developed the missing bits, and “Canadianized” the model
- This approach of “borrowing” made it easier to implement the model in Canada for many key private stakeholders
Room for Improvement, Area of Focus

- Further education and information dissemination as to the inherent value of PPP delivery
- Making the PPP marketplace more accessible to a wider group within the domestic construction industry
- Transparency in the Value for Money equation
- Union resistance to the model
- Managing Pursuit costs to make the model attractive to a wider group of potential respondents
- Higher Transaction Costs
- More Revenue Risk Transfer
Canadian Case Study - CHUM

- Centre Hospitalier de l’Université de Montréal (CHUM), needed to expand/upgrade their facilities
- The result was a $3 Billion P3 project for the design, construction, financing, maintenance and rehabilitation of a 24-story Acute Care Facility
- Construction was structured in two phases over 8.8 years with a construction budget of approximately $2Bn
- The construction JV used an innovative Surety/Security Solution with significant input on bond and agreement terms from the funders/lenders, JV and the co-sureties

- 12.5% Performance Bond Only
- Performance Bond Excess 17% ILOC’s
- Limited to Phase 1 Construction, 5 years, approx. $1.6Bn ECP
- Performance Bond limits obligation to design and construction
- Zurich and Liberty provided Co-surety support
Canadian Case Study - CHUM
Contractual Framework

- CHUM
  - Project Agreement
  - Lenders' Direct Agreement

- ProjectCo
  - Trust Indenture
  - Construction Contract
  - Service Contract

- Sponsors
  - Equity and Subordinated Loans
- Bondholders
  - Project Agreement

- OHL, S.A., LOR Corp Limited
  - Parent Guarantee
  - Subcontracts (85% of work)

- Construction Contractor
  - Parent Guarantee
- Service Provider
  - Dalkia S.A.S.

DBRS - Public Finance: Infrastructure - Société en Commandite Santé Montréal Collectif/Health Montréal Collective Limited Partnership
May 19, 2011 Report
Case Study - CHUM

DBRS assigned a provisional rating of BBB (high) with a Stable trend to the $1,390 Mn Senior Secured Bonds of Societe en Commandite Sante Montreal Collectif/ Health Montreal Collective Limited Partnership

Rating Considerations

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Challenges</th>
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<tbody>
<tr>
<td>1. Comprehensive lifecycle review and reserving mechanism</td>
<td>1. Long-dated, multi-phased construction in a tight urban setting</td>
</tr>
<tr>
<td>2. Above-standard break-even metrics</td>
<td>2. Relatively small subcontractors</td>
</tr>
<tr>
<td>3. Bondholders’ step-in rights</td>
<td>3. Highly leveraged structure</td>
</tr>
<tr>
<td>4. Low public sector counterparty risk</td>
<td>4. Complex contractual structure</td>
</tr>
<tr>
<td>5. Bondholders made whole in most instances of Phase 2 construction-related default</td>
<td>5. Distributions permitted during Phase 2</td>
</tr>
<tr>
<td>6. Tight contractor payment mechanism</td>
<td></td>
</tr>
<tr>
<td>Uses of funds</td>
<td>Phase 1</td>
</tr>
<tr>
<td>---------------------------</td>
<td>--------------</td>
</tr>
<tr>
<td>Construction costs</td>
<td>$1,585.4</td>
</tr>
<tr>
<td>Interest and Fees</td>
<td>$ 502.5</td>
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<tr>
<td>Sub debt int. constr.</td>
<td>$ -0-</td>
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<tr>
<td>DSRA funding</td>
<td>$ 47.4</td>
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<tr>
<td>FM &amp; Lifecycle Costs</td>
<td>$ 15.3</td>
</tr>
<tr>
<td>SPV&amp; Operating Costs</td>
<td>$ 38.0</td>
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<tr>
<td>Development Costs</td>
<td>$ 52.8</td>
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<tr>
<td>Wkg.Cap.&amp; Cash Bal.</td>
<td>$ 125.4</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>$ 2,366.7</strong></td>
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</table>
Bonding a Public-Private Partnership Project in the United States
PPP- Is it Viable for the U.S.?

PPPs Worldwide, Nominal Total Costs (in billion $USD), 1985-2012

- United States: 199.6 billion
- Canada: 373.7 billion
- Mexico + Latin America + The Caribbean: 97.1 billion
- Europe: 51.4 billion
- Africa + Mid-East: 67.8 billion
- Asia + Australia: 32.1 billion

Public Works Financing “International Major Projects database” 2012
U.S. & Canadian Transportation Projects Scorecard (1/13)

- 82 Design-Build (DB) Projects > $11.9 B
- 10 DBFinance Projects > $2.9 B
- 10 DBMaintain / Operate Projects > $8.1 B
- 32 DBFOM Projects > $32.3 B
- 6 Long-Term Lease + Improve > $11.5 B
33 States and Puerto Rico Now Have Transportation PPP Enabling Legislation

States with Transportation PPP Enabling Legislation as of Jan. 24, 2013
(Updated from page 15 of the 2010 NCSL PPP Toolkit)

- Broad enabling legislation
- Limited or project-specific legislation
- Authorization by regulation
- No legislation

National Conference of State Legislatures – Public-Private Partnerships for Transportation: A Toolkit for Legislators January 2013 Updates and Corrections
Commonly Used Security For PPP

- Historically security has been ILOCs
- Large Int’l. Players have strong finance relationships
- Security requirements driven by finance institutions
- Preference for Liquidity that ILOCs present
- Known security against potential Delay Damages
- Surety Bonds perceived to be illiquid
- Rating Agencies discount Surety Perf. Bond value 2:1
- ILOC model is problematic, particularly for the N. American privately held firms, but limits for all on amount of ILOCs
## PPP – Surety Bonds Versus ILOC’s

<table>
<thead>
<tr>
<th>Feature</th>
<th>ILOC</th>
<th>Bond</th>
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<tr>
<td>Financial Prequalification</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Capabilities Prequalification</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Review of contract documents and guarantee forms</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Guarantee completion</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Warranty Period Covered</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Cancellable</td>
<td>Yes</td>
<td>No/Yes</td>
</tr>
<tr>
<td>100% Coverage</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Impact on Bank Line</td>
<td>Yes</td>
<td>No</td>
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NASBP Public Bonding Resource Kit
Types of Surety Bonds Available for PPP Projects

- Proposer Bond
- Financial Close Bond
- Performance Bond
- Payment Bond
Key PPP Finance Concept

- Project Finance
- Value for Money
- Risk Transfer
Value For Money – Simple Example

The example depicted in the bar chart portrays a comparison between a public procurement with a baseline present cost of $60 million and a P3 shadow bid for which the baseline present cost (net of financing costs) is $65 million. While the baseline P3 cost is $5 million more and imposes an additional $6 million in ancillary and financing costs, the $13 million reduction in the costs of risk due to transfer of some risks to the private sector and $8 million in competitive neutrality adjustments overcome these cost differences and result in a net savings to the government of $9 million overall, offering 7% in Value for Money. This example illustrates the central trade-offs that often characterize P3 procurement: the government trades away significant risks in exchange for higher baseline costs and financing costs in the P3 scenario.

Comparison of PSC and P3 Availability Payment Concession

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<tr>
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<th>Total=114</th>
<th>Total=105</th>
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<tr>
<td>Competitive Neutrality</td>
<td>8</td>
<td>7</td>
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<tr>
<td>Retained risk</td>
<td>20</td>
<td>15</td>
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<tr>
<td>Ancillary costs</td>
<td>11</td>
<td>17</td>
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<tr>
<td>Financing</td>
<td>15</td>
<td>65</td>
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<tr>
<td>Base cost</td>
<td>60</td>
<td>65</td>
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Value for Money Assessment for Public-Private Partnerships: A Primer December 2012
Build Indiana Council, INDOT’s Perspective on Public-Private Partnerships  March 22, 2012
Underwriting Considerations Specific to PPP Projects

- Typical P3 Surety Client
- What is Relationship of Developer/SPV to the DE Contractor and/or O&M Contractor?
- What is Contractors past experience with SPV?
- What is Financing Structure of job?
- What are potential financial risks to Contractor (and Surety)?
- What are the bonded obligations?
- Does Contractor have an Equity Interest in SPV?
- Are Dispute Resolution procedures defined in contract?
Typical PPP Agreements

<table>
<thead>
<tr>
<th>TYPES OF AGREEMENT</th>
<th>AGREED PARTIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project Agreement</td>
<td>Owner and Concessionaire or Project Co</td>
</tr>
<tr>
<td>Credit or Direct Agreement</td>
<td>Developer and Project Finance Lender</td>
</tr>
<tr>
<td>Design Build Agreement</td>
<td>Developer and Contractor</td>
</tr>
<tr>
<td>Operate/ Maintain Agreement</td>
<td>Owner/Developer and O&amp;M Contractor</td>
</tr>
<tr>
<td>Related Agreements and Schedules</td>
<td></td>
</tr>
</tbody>
</table>
Surety Bond Language Issues

- Pass thru of project agreement obligation to Design Build Agreement and O&M Agreement
- Bonded obligation - how to clearly define
- Examine definition of Events of Default
- Financial regulations and constraints
- Financing Costs - No obligation of finance guarantee or credit enhancement
- Breakage Fees
- Liquidated Damages
- Other Damages
- Impact of Lender’s rights on the Surety’s rights
- Operations & Maintenance
PPP Process – Stage 1, 2: RFEI / RFQ

- Understanding the Prime Team Members
- Review the Teaming Agreement or Memorandum of Understanding (MOA) between Prime Team Members
- Overview of the project, anticipated term
- Skin-in-the-game?
- Availability Payment or Concession?
- Anticipated nature of financing
- Identity of Senior Lenders / Debt and Financial Arranger
PPP Process – Stage 3: RFP

- Review of Project Agreement (PA), all related Schedules, Lenders Direct Agreements, and other support agreements.

- Project Co Structure

- How are equity/ LOC requirements to be funded / met, and the associated term of commitments.

- Copy of Financing/ Credit Agreement, or Pre-Sale Report if a Bond issue

- Copy of any relevant project rating

- A summary of the proposed security package/ performance supports

- A copy of the Lender’s Technical Advisor (LTA) pre-RFP-close report

- Proposed Financial Model, Cash Flow, Construction Sched

- A copy of the Lender’s Insurance Advisor (LIA) pre-RFP-close report

- Anticipated Project Cost Breakdown
PPP Process – Stage 4: Proponent Chosen

- It is during this window between the naming of a preferred proponent and commercial close in which significant negotiations occur on all commercial terms.

- Essentially, updates/reconfirms all required in Stage 1 -3

- Lead time is critical during this Stage

- Bond Forms negotiated among the Surety(ies), Contractor and Lender/Funder and Rating Agency.

- Multiple Obligee Rider negotiated with any co-obligees
PPP Process – Stage 5: Commercial Close & Financial Close

- Commercial Close – representative of the day on which all project documents need to be finalized and executed
- Financial Close – representative of the day on which the financial model is finalized, rates are set, and financial structure becomes fixed
- Current trend - shortening this time frame
Regional Transportation District (RTD) of Denver, Colorado contracted with Denver Transit Partners (DTP), a special purpose company created to provide proposal to design-build-finance-operate-maintain (DBFOM) the East Rail Line, Gold Line, Northwest Electrified Segment (NWES) (segment 1 of the Northwest Rail Line) and Commuter Rail Maintenance Facility project under a single contract known as “Eagle Rail”.

Regional Transportation District, Fast Tracks, Eagle P3 Project Procurement Lessons Learned, August 2011
RTD- Key Lessons Learned:

- By creating a competitive environment among the private sector, winning bid was $300 million below internal budget estimates.
- Bring potential proposers—primes/major subcontractors and SBE/DBE firms—into the RFQ/RFP development process as early as possible.
- “Three-legged Financing Stool”—private sector financing ($486 million), local investment in the form of dedicated sales tax, and federal funding ($1.03 billion Full Funding Grant Agreement).
Advantages of Surety Bonds for PPP Security

- DB Contractor’s motivation for bonded P3 project – Continuing Surety Relationship
- Surety expertise with troubled projects vs. a lender’s experience
- Significantly increased performance and financial security to owner and developer
- Reduced financial impact on contractor’s balance sheet with Surety Bond vs. cost and collateral for an LOC
Where is PPP Market Going in the U.S.?

- The number of construction projects in the US that are more than $1 billion has gone from zero in 2005 to 104 in 2011
- Many state agencies are exploring P3, but it is a tremendous learning curve
- FY 2012, 42 States had budget shortfalls – Total $103Bn
- Forecast 2013, 30 States with budget shortfalls – Total $54Bn
- Studies demonstrate deferring maintenance to breakdown point can increase cost of repair to excess of 15:1
- P3 procurement model will be a staple over the long term

- 2012 Issue 2 FMI Quarterly, What’s Ahead for P3s in the US?
Resources for Additional Information

www.NCPPP.org
National Council for P3

www.fhwa.dot.gov/ipd/index.htm
US Department of Transportation Innovative Program Delivery

www.pwfinance.net
Trade Journal : Public Works Financing – the journal of record for P3 in infrastructure development since 1988
Questions and Answers

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