HUSCH BLACKWELL

Public-Private Partnership Report

MARCH 2020

Methodology & Overview

Husch Blackwell's P3 team has reviewed and compared deal documents from more than a dozen U.S. P3 project agreements that reached financial close in the trailing 24 months ending December 2019. We have collected our insights and findings into our third-annual Public-Private Partnership Report and augmented our research with data drawn from multiple sources, both public and proprietary.

Additionally, this report includes select results from our sixth-annual survey of P3C registrants. Husch Blackwell collaborated with P3C organizers to query attendees about their projects, plans and perspectives. After more than a half-decade our survey results indicate that both public- and private-side partners still consider P3 for a range of projects, but consider it increasingly for so-called vertical projects, such as government facilities, student housing, and stadiums, among other types.

Thank you to everyone who gave us their time to participate in our survey, and we hope you find our Public-Private Partnership Report edifying.

Charles Renner
Editor

Will Nulton
Contributing Editor

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(Refer to Page 3 for the U.S. project map that corresponds to this list.)

Introduction

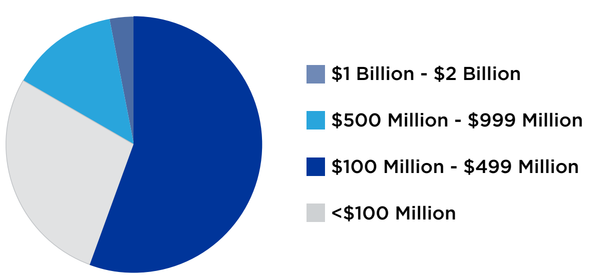
THE ROAD AHEAD FOR P3 APPEARS TO BE FORKING OFF IN SEVERAL DIRECTIONS. THERE ARE STILL MANY TRADITIONAL P3 PROJECTS IN PROGRESS—WITH SEVERAL MORE IN THE PIPELINE—BUT ALL OF THE OLD VERITIES AROUND WHAT THE MODEL IS SUPPOSED TO DO ARE BEING CHALLENGED AND ADAPTED TO NEW PURPOSES, IMPACTING THE WAY RISK IS SHARED AND CAPITAL IS ALLOCATED.

Of the nine projects in our cohort that reached financial close in 2019, only one—the I-95 express lanes extension in Virginia—qualifies as a surface transportation project of the type that has traditionally dominated P3s in the United States. As P3 models become more familiar, both public and private participants are expanding the scope of what these agreements can accomplish.

P3 continues to expand beyond horizontal transportation projects, and with these changes in project type, the model that supported that narrow application of P3 is evolving as well. The demand-risk concession model and payment mechanism—which typically includes concessionaire exclusivity in collecting revenues and shouldering the risks associated with those revenues—has fallen out of favor in recent years, replaced by availability payments or hybrid schemes where the public partner pays a concessionaire directly according to a predetermined formula and schedule. Many of these new vertical project categories—such as courthouses, student housing, prisons, and waterworks, among others—do not generate revenue in the traditional manner, if at all; therefore, the demand-risk concession model is largely incompatible with these projects.

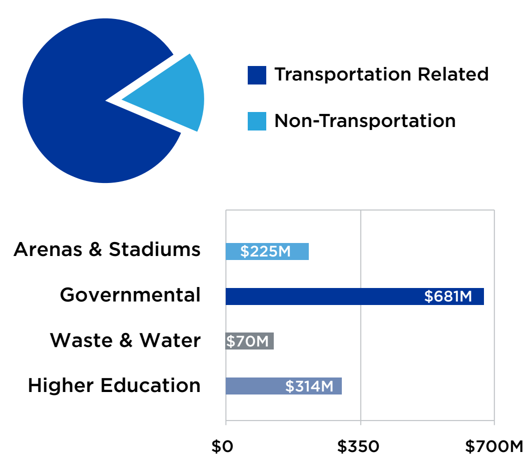
P3s by Project Value

U.S. Projects Reaching Financial Close, 2018-2019



P3s by Project Type

U.S. Projects Reaching Financial Close, 2018-2019



The Changing Face of P3

JUST AS THE PAYMENT MECHANISM HAS EVOLVED IN ORDER TO REMAIN RELEVANT TO NEWER PROJECT TYPES, THE PROJECT FINANCE MODEL HAS CHANGED AS WELL. THE DECADE-LONG SHIFT TO AVAILABILITY PAYMENTS HAS COINCIDED WITH A SIGNIFICANT DECLINE IN PRIVATE EQUITY PARTICIPATION.

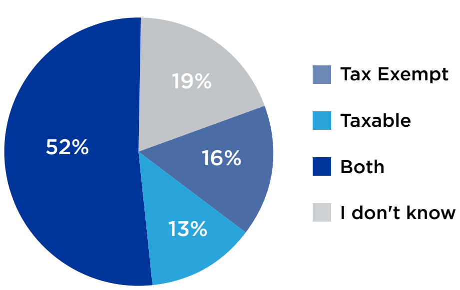
Equity commitments in the eight P3 projects reaching financial close in 2018 averaged just 5% of the total capital expenditure. Similarly, last year's nine financial closings featured but one project with a sizeable, disclosed private equity component—the capital stack for the Newark Liberty Airport ConRAC had an equity piece ranging from roughly 11% to 22% of the capital expenditure.

Given that private equity is typically the most expensive piece of the capital stack, this move away from private financing is not surprising, but P3 debt financing has also seen significant change. For the better part of a generation, P3 has depended on a trade-off between the cost of money and risk transfers. Public entities that opted for a P3 approach understood that the financing costs associated with P3 projects were going to be greater than a traditional procurement using tax-exempt bonds. The reason for this is simple: loans to private enterprises carry higher rates of interest. According to a January 2019 report from the Government Finance Officers Association, over the past two decades there has been a 200-basis point difference in the cost of money between public and private borrowers, with much of the difference made up of the average spread between corporate and tax-exempt bonds.

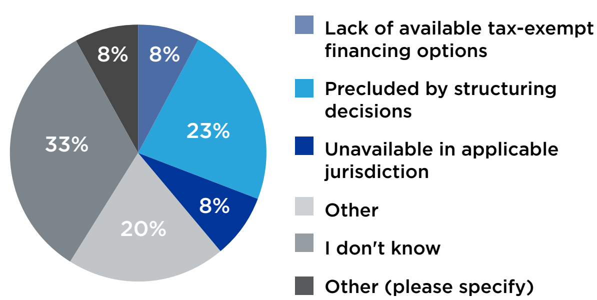
Sometimes, government entities determine that the higher cost of money associated with private financing is worth it, particularly if that project finance model is needed to secure the participation of key private partners or to get shovels in the ground more quickly. At other times, however, public partners will engage in a P3 procurement, but ultimately opt to use public financing. It is an open question whether such projects are really P3s at all, but if you take the view that P3 is just as much a procurement process as a financial model, such distinctions matter less. Call it what you may, but these hybrid P3s are here to stay and will likely become a dominant method for project delivery over time, particularly for mid-sized and smaller government entities.

P3 Financing Preferences

"Regarding your current P3 project(s), does it involve tax-exempt financing, or both?"

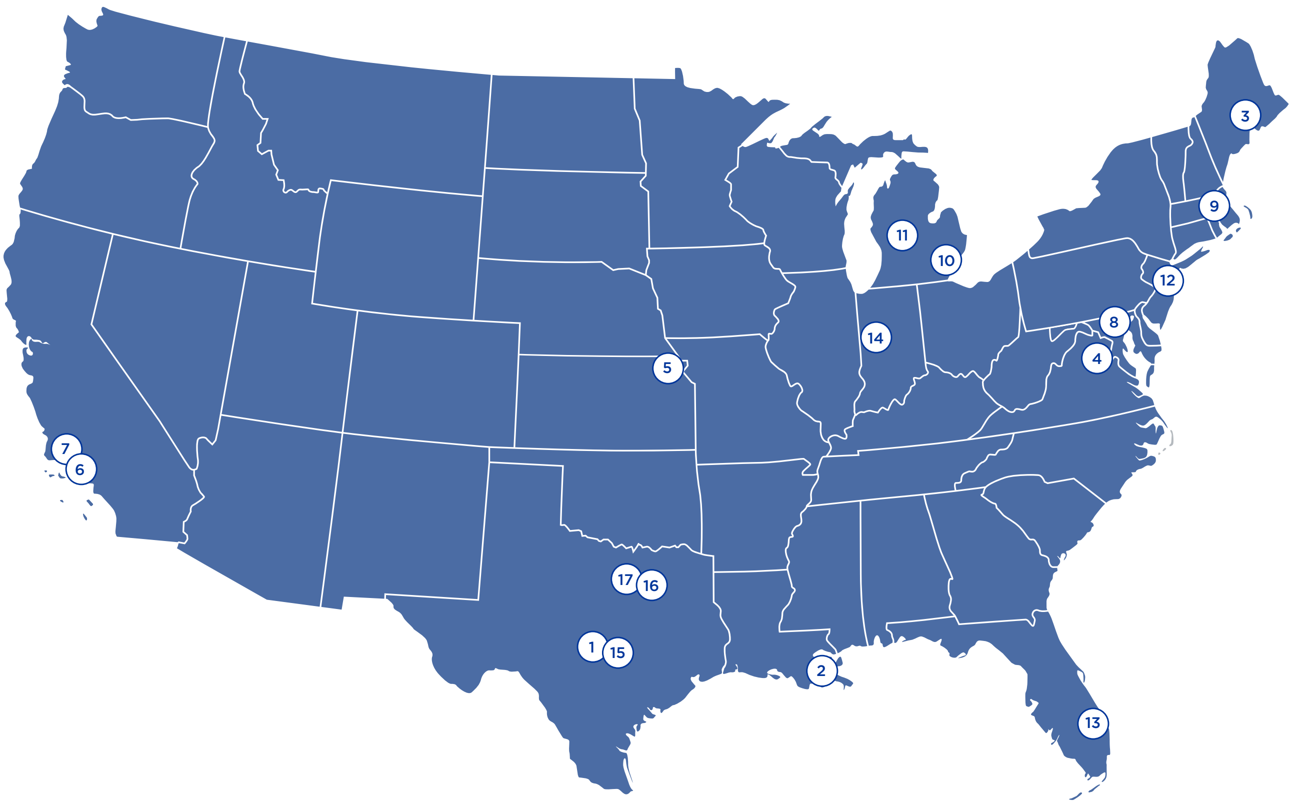


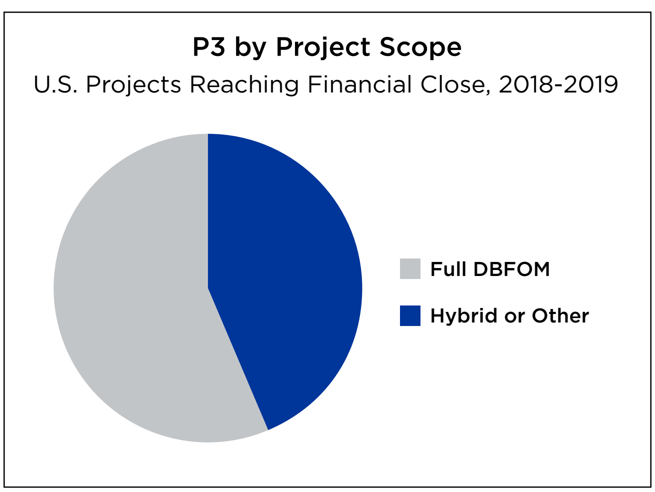
"If your current P3 project did not involve tax-exempt financing, why not?"

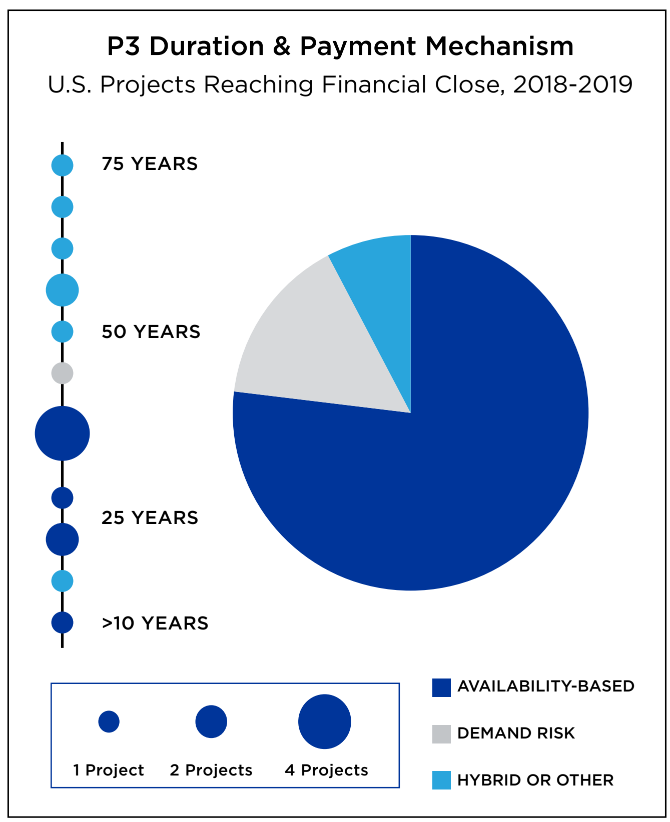


Source: 2020 Public-Private Partnership Conference & Expo Registrant Survey

Location of 2018-2019 P3 Report Projects



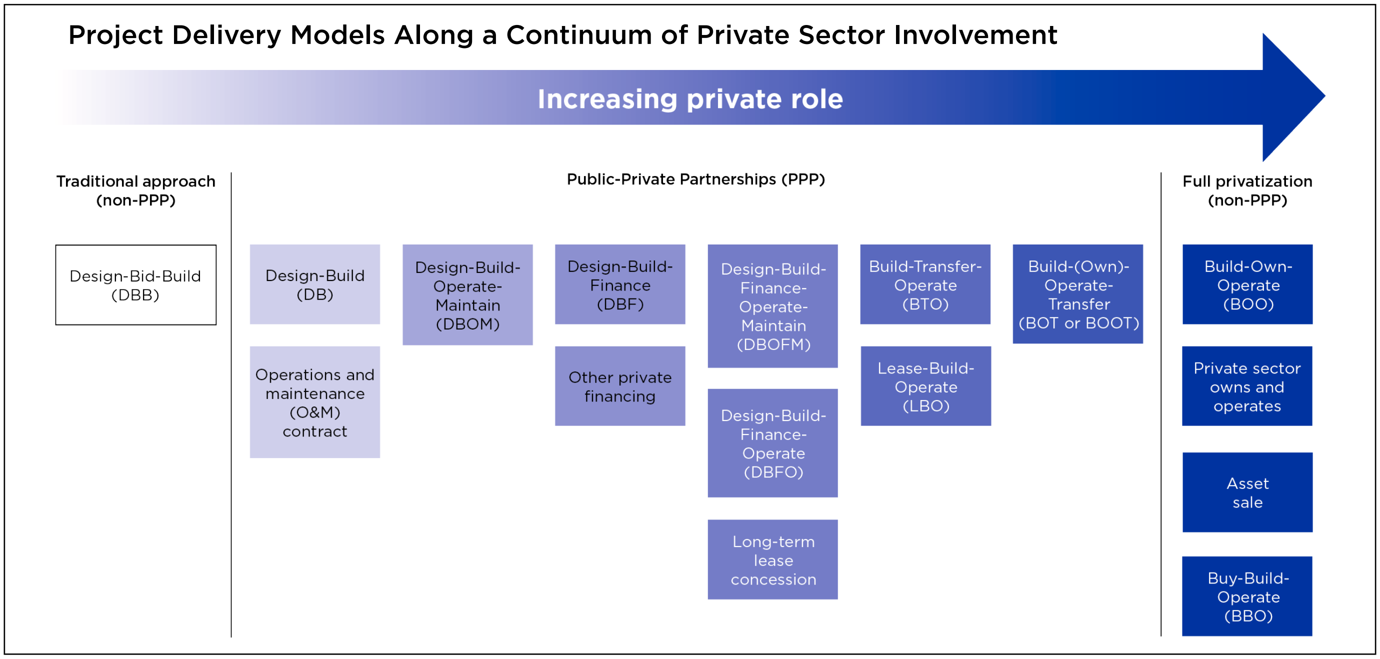




Hybrid P3s

TYPICALLY, THE FULL P3 MODEL REFERS TO ALL STAGES OF A FACILITY'S LIFE CYCLE, INCLUDING DESIGN, BUILD, FINANCE, OPERATIONS AND MAINTENANCE (DBFOM), BUT AS ALLUDED TO EARLIER, HYBRID P3 MODELS ARE EVOLVING TO MEET A VARIETY OF NEEDS AND CIRCUMSTANCES.

For some industry observers, the finance element is the key defining feature of a P3. Without private debt or equity financing, they argue, there is no P3. Taking that bright-line approach does provide apples-to-apples data sets for analysis; however, viewing P3 in this narrow way misses bigger-picture concepts that are important to delivering projects.



Source: National Conference of State Legislatures

In reality there are exigencies in the procurement process for large infrastructure projects that are hard to capture in a spreadsheet. Some processes begin as P3s and remain as such throughout the timeline; others might end as more traditional design-build procurements; and still others begin as P3s, shift to other models, and then return to P3 due to a variety of circumstances. The lesson is that procurement is a far more fluid process than our models sometimes allow for, and as an approach, P3 is far more robust than simply a financing mechanism, as demonstrated in the graphic above.

On the right, we discuss at length three projects that illustrate how P3 can take many forms and serve many purposes.

PURDUE UNIVERSITY STUDENT HOUSING

The 1,100-bed student housing project at Purdue followed a traditional P3 procurement process and contains all of the elements of the full P3 model, including O&M. The RFP was issued in February 2018, and a preferred bidder was selected in July of that year. Eight months after launch the project reached financial close, and the private consortium had sole responsibility for funding the project, achieved via a $115 million private placement of debt and $10 million in equity financing from the private partner. The need for speed was a key factor in choosing the P3 route; Purdue had experienced greater-than-full occupancy in its residence halls for some time, and the project promised to deliver a substantial increase in capacity for the 2020-21 academic year.

KANSAS CITY INTERNATIONAL AIRPORT (KCI)

KCI was not represented in our project cohort, because, ultimately, it failed to satisfy our definition of a true P3 project, but the project provides a great case study for how adaptable P3 procurements can be. After failing for several years to secure public approval for a traditional design-build project that would replace aging terminals with a new single-terminal facility, the City opened a P3 project for bidders in June 2017. From the start the City was hesitant to consider a full P3, given that it considered operations and maintenance to be a core competency. Retaining responsibility over O&M would ensure the City's ability to respond to the needs of the public and the airlines without long-term obligations to the private developer.

But there were other elements of P3 that made a lot of sense for the City. The procurement process allowed the City to enter into a period of exclusivity with a suitable private developer and provided the flexibility for the City to consider multiple avenues for financing, eventually settling on the exclusive issuance of bonds by a conduit issuer rather than private financing by the developer. The result was a hybrid agreement that not only addressed key areas of concern for the City, but also satisfied the requirements of the political process. Approximately 75 percent of Kansas Citians voted to approve the project during the MOU stage, and the City Council approved the MOU in February 2018. Financial close was reached March 2019.

TRAVIS COUNTY COURTHOUSE

The effort to build a new courthouse in Austin, Texas, lasted nearly ten years before Travis County reached an agreement with a private consortium under a design-build-finance (DBF) model. The County initially began a P3 procurement, but then entered into a traditional design-build process. The necessary bond referendum failed, however, as the project was unable to garner the public support necessary to finance the project through traditional public financing mechanisms.

The County Commissioners returned to a P3 procurement. This eliminated some of the political risk associated with another bond referendum and also allowed the County to benefit from the private partner's expertise in real estate, important since the project required the purchase of a new site. The final agreement was a DBF agreement in which the public partner retained responsibility for the operations and maintenance of the courthouse. The project provides an example of how P3 procurement can allow public partners to retain the control and cost-certainty of traditional procurement while providing flexibility to structure an agreement that all parties involved can support.

P3 Legal Trends and Issues

GIVEN THE LONG DURATION OF A TYPICAL P3 AGREEMENT, STRIKING A FAIR AND EQUITABLE BALANCE AMONG PARTNERS REQUIRES A GREAT DEAL OF FLEXIBILITY AND FORETHOUGHT.

Despite the most carefully laid plans, numerous unforeseen events will likely occur during a P3 agreement—from refinancing gains to private-side changes in corporate control. The best agreements, therefore, should be viewed as frameworks for managing change. Below we have highlighted a few of the trending issues that have occasioned a great deal of discussion among recent P3 participants.

CHANGES IN LAW

The typical P3 agreement will include a requirement that the private partner comply, and cause all of its subcontractors to comply, with applicable law during its performance of the agreement. Given the length of P3 agreements, the parties should consider the consequences of changes in applicable law during the term of the agreement. Typically, the private partner bears the risk for negative financial impact caused by changes in applicable law; however, this is not always the case. In the Purdue Student Housing project, the University took on the risk for unforeseeable changes in the law, agreeing to compensate the private partner for the cost of any extra work or delay as well as for debt service due to any missed availability payments.

P3 agreements often make a distinction between "discriminatory" and "non-discriminatory" changes in law, with the public partner only bearing the risk of discriminatory changes in law—those that affect specific industries rather than applying across all areas of business. In developments in which tax incentives and/or tax-exempt status are involved, private developers should seek protection from the risk associated with losing such status. For example, the Austin Soccer Stadium project guarantees the cooperation of the City in case the applicable law ever changes the tax status of the property.

HIRING, LABOR, AND EMPLOYMENT

Private developers of public projects are familiar with public entities' requirements for the use of local and small businesses, as well as those owned by minorities, women, veterans or other contractors during construction. But for those P3 projects stretching beyond construction into the operations and maintenance phases, public entities at times have required additional compliance with public policy for hiring, employment and business practices based on similar principles. By conceding operations and maintenance of a property to a private developer, the public entity is sacrificing some level of control of the labor force within the property; however, public entities can contract to ensure the private developer acts in accordance with public policy with regard to hiring, labor and employment.

During the term of the Austin Soccer Stadium lease, the private developer agreed to abide by the City of Austin's labor policy, including wage and benefit requirements, as well as hiring practices. The City further required that the developer implement a labor peace agreement for the stadium's hospitality operations, including concessions and ancillary developments, such as hotels and restaurants, between all concessionaires and custodial contractors and any requesting labor organizations that reasonably might represent employees working as concessions and/or hospitality staff. Similarly, in its agreement with the private partner for the I-95 Fredericksburg Extension, the Virginia Department of Transportation agreed to annual goals and reporting requirements for the use of small, women-owned and minority-owned businesses during performance of the operations and maintenance of the asset.

HANDBACK RESERVE

Public entities have a strong interest in ensuring all project assets are in sound condition upon the expiration of the agreement. “Handback” terms—those governing the return of the property to the public partner at the end of the term of the agreement—are important and can be the subject of substantial negotiations. P3 agreements should generally stipulate the condition of all property at the end of the term. If the property does not meet the standard, the private partner becomes responsible for the cost to restore the property to the required condition.

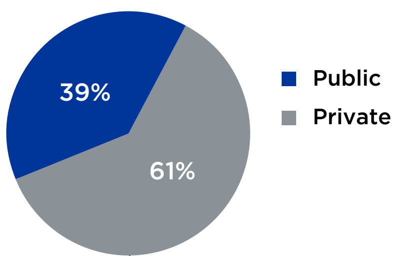
Many agreements require that the private partner establish a handback reserve account in order to cover the potential of renewal of the assets to the required condition, whether used by the private partner prior to handback or the public partner upon return of the property. The Purdue University Student Housing P3 Project requires that the developer establish a handback reserve five years prior to the end of the Term and make quarterly deposits into a handback reserve, while granting the University a priority secured interest in the reserve. The I-95 Fredericksburg Extension requires a letter of credit or performance bond to ensure the Department of Transportation has funds to address failures to meet the handback requirements.

Disclosure:
Husch Blackwell advised the grantor in the Kansas City International Airport project and advised the consortium tasked with developing the Travis County Courthouse. Both projects were highlighted on Page 5.

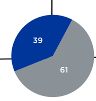
2020 P3C Survey Highlights

FOR THE SIXTH CONSECUTIVE YEAR HUSCH BLACKWELL SURVEYED REGISTRANTS OF THE P3 CONFERENCE & EXPO TO GAUGE MARKET SENTIMENT TOWARD THE P3 PROCUREMENT AND DELIVERY MODEL. BELOW, WE PRESENT SELECT RESPONSES COVERING KEY TOPICS AND ASSESSING THE OVERALL APPETITE FROM BOTH PUBLIC AND PRIVATE MARKET PARTICIPANTS.

Do you represent a Public or Private entity?



Public	
City	39%
County	15%
State	15%
Education	18%
Other	13%



Private	
Architecture	5%
Engineering	14%
Construction	17%
Financial	14%
Legal	11%
Consulting	15%
Other	25%

What type of P3 projects could your organization pursue over the next three years?

Energy
28% Public
51% Private

Government Facilities
54% Public
68% Private

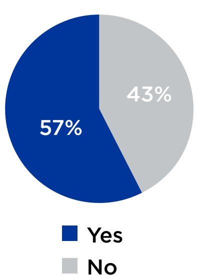
Social Infrastructure
28% Public
65% Private

Sports & Entertainment Facilities
38% Public
58% Private

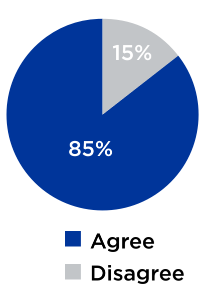
Transportation
33% Public
68% Private

Water & Environment
5% Public
54% Private

PUBLIC-PRIVATE PARTNERSHIP CONFERENCE & EXPO 2020



Has your organization engaged in a P3 procurement process where the public partners ultimately decided not to include private equity in its selection?



Even without a private financing component in the capital stack, P3 provides an ample business case to compete in the procurement process.

Most Compelling Reasons for Doing a P3 Project	Strong or Good Reason	
	Public	Private
Industry innovation/expertise	46.15%	53.45%
Budgeting certainty	35.9%	24.14%
Project delivery and life-cycle	53.85%	41.38%
Life-cycle planning	17.95%	24.14%
Financing options	64.10%	46.55%
Risk transfer and political considerations	56.41%	41.38%
None of the above	5.13%	13.79%

About Husch Blackwell's P3 Practice

HUSCH BLACKWELL KNOWS THE P3 INDUSTRY INSIDE AND OUT. WE HELP PRIVATE BUSINESSES AND PUBLIC AGENCIES FORM PARTNERSHIPS AND SHARE THE RESOURCES, RISKS AND REWARDS OF P3 PROJECTS. WE GUIDE CLIENTS THROUGH THE NEGOTIATIONS, COORDINATION AND CLOSINGS OF CONTRACTS INVOLVING DESIGN-BUILD, FINANCE, OPERATIONS, MAINTENANCE AND TRANSFER COVENANTS. OUR TEAM HAS EXTENSIVE EXPERIENCE AND DEEP UNDERSTANDING OF HOW TO MANAGE THE LEGAL, POLITICAL AND COMMERCIAL COMPLEXITIES OF P3S. OUR REPRESENTATIVE PROJECTS INCLUDE:

- Higher ed facilities
- Professional sports facilities
- Airport renovation/expansion
- Water/wastewater facilities
- Courthouses
- Broadband
- Energy districts
- Transit-based mixed-use development

Recent Work Highlights

Counsel to Garney Construction, Developer and Eventual Controlling Shareholder

San Antonio Water System (SAWS) Vista Ridge Water Supply Project – $3.4 billion

- Best Utilities Project, 2017 P3 Awards
- Water Deal of the Year, 2017 Global Water Intelligence
- North American Deal of the Year, 2016 Project Finance International
- North America Water Deal of the Year, 2016 IJGlobal Awards

Counsel to Edgemoor Infrastructure & Real Estate, Developer

University of Kansas Central District – $350 million

- Finalist, Best Social Infrastructure Project, 2016 P3 Awards

Counsel to Confluence Companies, Developer

Colorado School of Mines

- 320+ bed housing facility with structured parking, retail and residential life programming space
- Lease/lease-back structure with ownership reverting to the university at end of term

About Our Firm

Husch Blackwell leads our clients from where they are to where they want to be. From offices in 18 U.S. cities, we deliver legal insight and business leadership that helps our clients identify smart solutions, advance their goals and move forward.

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Cover Photo – Travis County, Texas, Courthouse,
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