DRAFT

Public-Private Partnerships

Best Practices for a Successful Deal

CDFA National Development Finance Summit

Geoffrey Dickinson, AICP

November 7, 2019

SBFRIEDMAN

VISION
ECONOMICS
STRATEGY
FINANCE
IMPLEMENTATION

DRAFT

Challenges with PPP

According to survey of public and private sectors, respondents identified the following as the greatest challenges:

62%

Public sector failure to understand private capital **underwriting criteria** and **return requirements**

49%

Validating the **"fairness"** of the deal to the public sector

49%

Negotiations dynamics—too much hard bargaining and not enough trust building

Source: Urban Land Institute, "Successful Public/Private Partnerships" (2016)

DRAFT

Best Practices for PPPs

Bridging the Public/Private Divide

- Create a shared vision with public purpose & benefit
- Expect public sector role in pro-active predevelopment
- Assemble a complete & capable development team
- Make a fair deal: “but-for…”
  - Minimize the public role & cost
  - Maximize public benefits & impacts
  - Manage risk
  - Expect documentation & monitoring

DRAFT

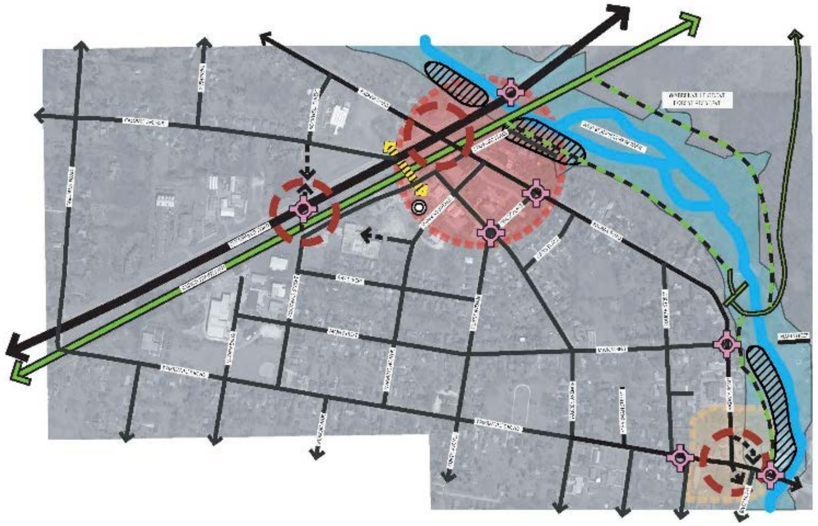
01 Creating a Shared Vision with Public Benefit

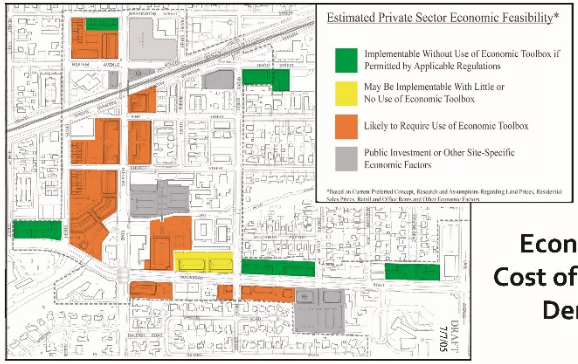
Compelling Development Strategy

- Broader Vision: The Region & Community
- The Development Project

The Broader Vision

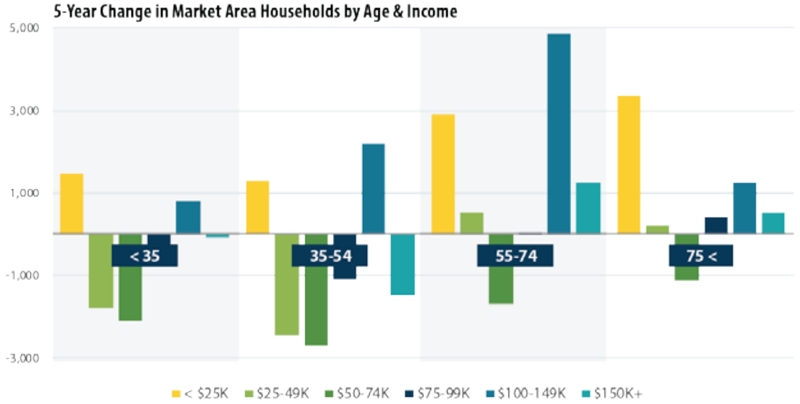
Participate in Regional, Community & Sub-Area Planning



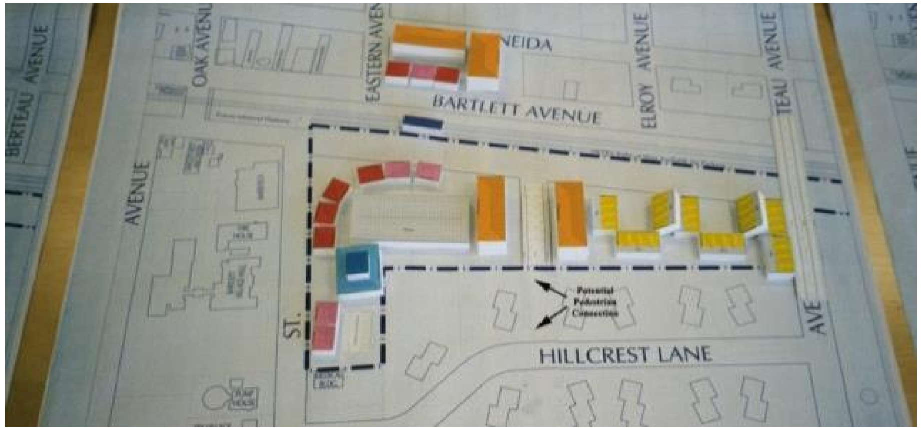


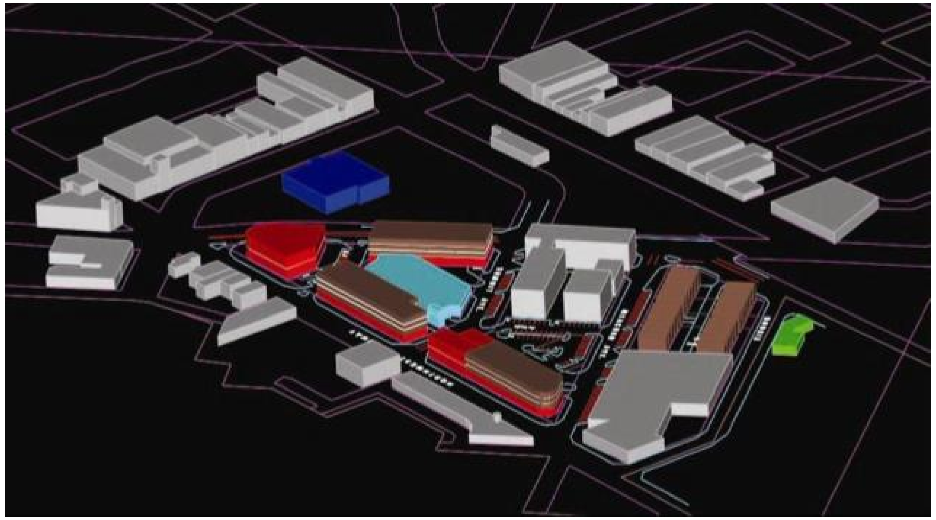
Economics: Cost of Land vs. Density

Description	Townhomes and a one-acre park	Townhomes	Mid-rise Condos
Townhome Units	23	29	0
Condo Units	0	0	120
Total Units	23	29	120
Height	30 ft.	30 ft.	50 ft.
Density (du/gross acre)	5.3	6.7	27.9
Site Asking Price	$5,619,240	$5,619,240	$5,619,240
Residual Land Value	$2,747,036	$3,913,964	$6,237,257
Surplus (Shortfall) For Land	$(2,872,204)	$(1,705,276)	$618,017



Framing the Successful Project





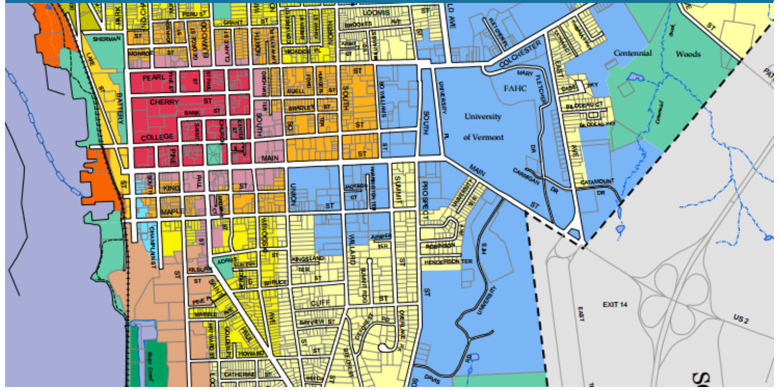
DRAFT

02 Eliminating Hurdles

DRAFT

Policy Alignment

Zoning / Parking / Stormwater



Capital Budget / Infrastructure

Public Facility Location / Anchor & Catalyst

Relocating Municipal Facilities to Free Development Site

Scenario 1: Continued Investment in Existing Facilities

Scenario 2: On-Site Reconstruction of City Hall & Public Library

Scenario 3: Public/Private Redevelopment
New On-site 71,400 sf Public Library | New Offsite 27,500 sf City Hall* with Structured Parking

Scenario 3A:	Scenario 3B:	Scenario 3C:
370 rental apartments	185 rental apartments	100,000 sf of medical office
	54 rental townhomes	54 rental townhomes
10,000 sf of commercial	10,000 sf of commercial	10,000 sf of commercial

Alternate Scenarios
- Surface, Rather than Structured Parking at New City Hall
- Acquisition/Rehab of Existing Off-Site Building for City Hall

Site Predevelopment

Heavy Lifting by Public Sector Help Get Sites to "Shovel-Ready"

Site Assembly

Remediation

Demolition

Coordination of Multiple Government Entities

Obtaining grants
Traffic signals/access
Floodplain realignment
Etc.

03 Right-Sizing & Structuring Fair Deals

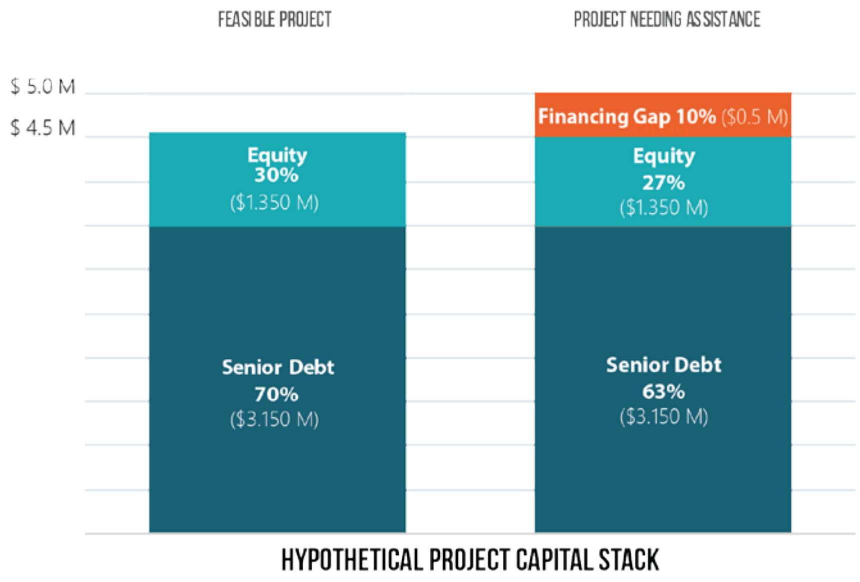
DRAFT

Keys to Right-Sizing & Structuring Fair Deals

- Fiduciary responsibility & the “but-for…” test
- Maximize private financing
  - Skin in the game
  - Maximize debt
  - Risk adjusted returns

Evaluating a Financial Gap

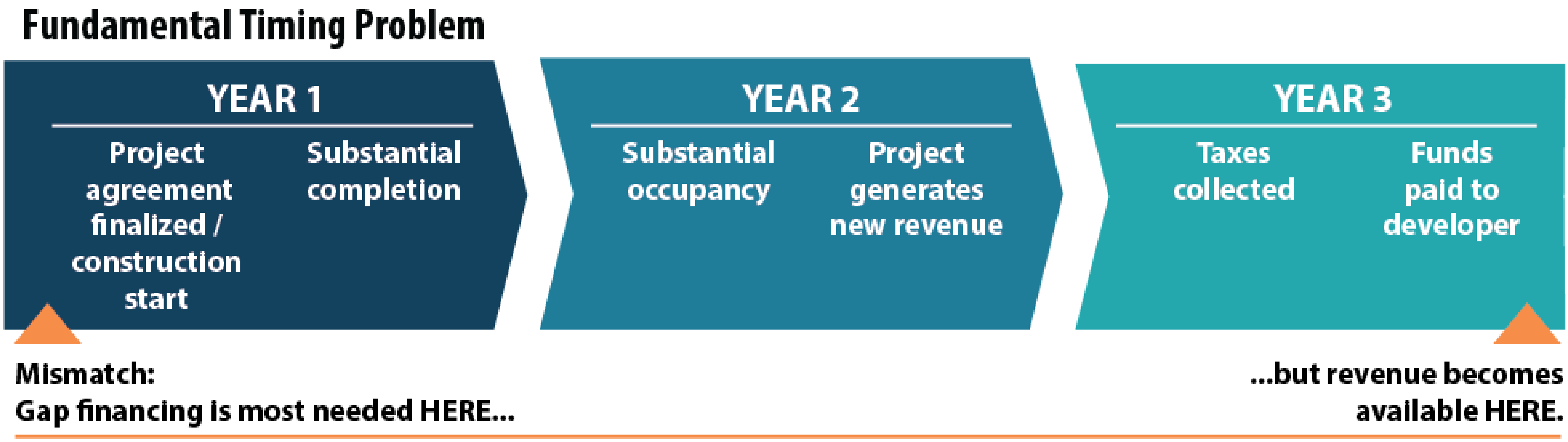
- True Gap Deal: Returns insufficient to attract capital (debt and/or equity)
  - Amount readily explained by extraordinary costs
  - Cost of providing true public improvements
  - Rent/cost mismatch
- Incentive Deal: Incremental cost of locating at proposed site or to compete with alternative site



DRAFT

Funding the Gap

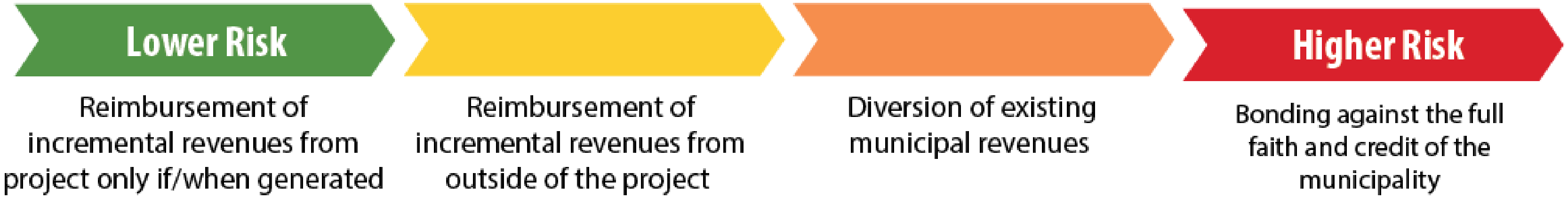
Understanding Public Sector Timing & Risk



Funding the Gap
Monetization Approaches

- Pay-As-You-Go
- Monetizing Future Revenues from Project Itself
- Developer Notes
- Special Revenue Bonds/Land Secured Bonds
- Backing Bonds with Other Revenue Pledges
- Loan Instead of a Grant
- Trigger & Take-Out Bonds

Municipal Risk Spectrum



DRAFT

Successful Public-Private Partnerships . . .

- Help achieve (realistic) community goals through a shared vision
- Provide substantial community benefit(s)
- Can be facilitated by an array of financial & non-financial public actions
- Require different & more complex relationships and transactions
- Must be sufficiently profitable and a fair deal to all parties

SBFRIEDMAN
221 N. LaSalle St, Suite 820
Chicago, IL 60601
312-424-4250 | sbfriedman.com

VISION | ECONOMICS
MARKET ANALYSIS AND REAL ESTATE ECONOMICS

STRATEGY
DEVELOPMENT STRATEGY AND PLANNING

FINANCE | IMPLEMENTATION
PUBLIC-PRIVATE PARTNERSHIPS AND IMPLEMENTATION

P3 – Background, Trends and Contract Terms

Seth Kirshenberg, Partner

KUTAKROCK

kutakrock.com

Types of Transactions

- **Availability-based payment structures –** After construction completion, the private developer is entitled to payments from the government as long as contract conditions are fulfilled. Availability payments are sized to cover operating and maintenance costs, debt service costs and equity returns.
- **Concession/Demand-risk projects** - Project is largely financed by user payments and we monetize the new or existing asset. This model is often used for roads, student housing and parking. Less Risk to owner.
- **Asset monetization -** Public assets in return for public projects (for example land for commercial development for new schools, fire stations, libraries, etc.)
- **Hybrids** (evolution of the project need)

Contract Terms - Client Concerns P3

- **Government/Owner**
  - Risk of failure (political, project, etc)
  - Risk on non-delivery
  - Risk of injury
  - Risk of hiring the wrong long-term contractor/manager
  - Risk of cost
  - other
- **Private Party**
  - Risk of losing the project
  - Risk of Changes
  - Risk of cost escalation
  - Financing Risk
  - Risk of termination
  - Risk of politics
  - other

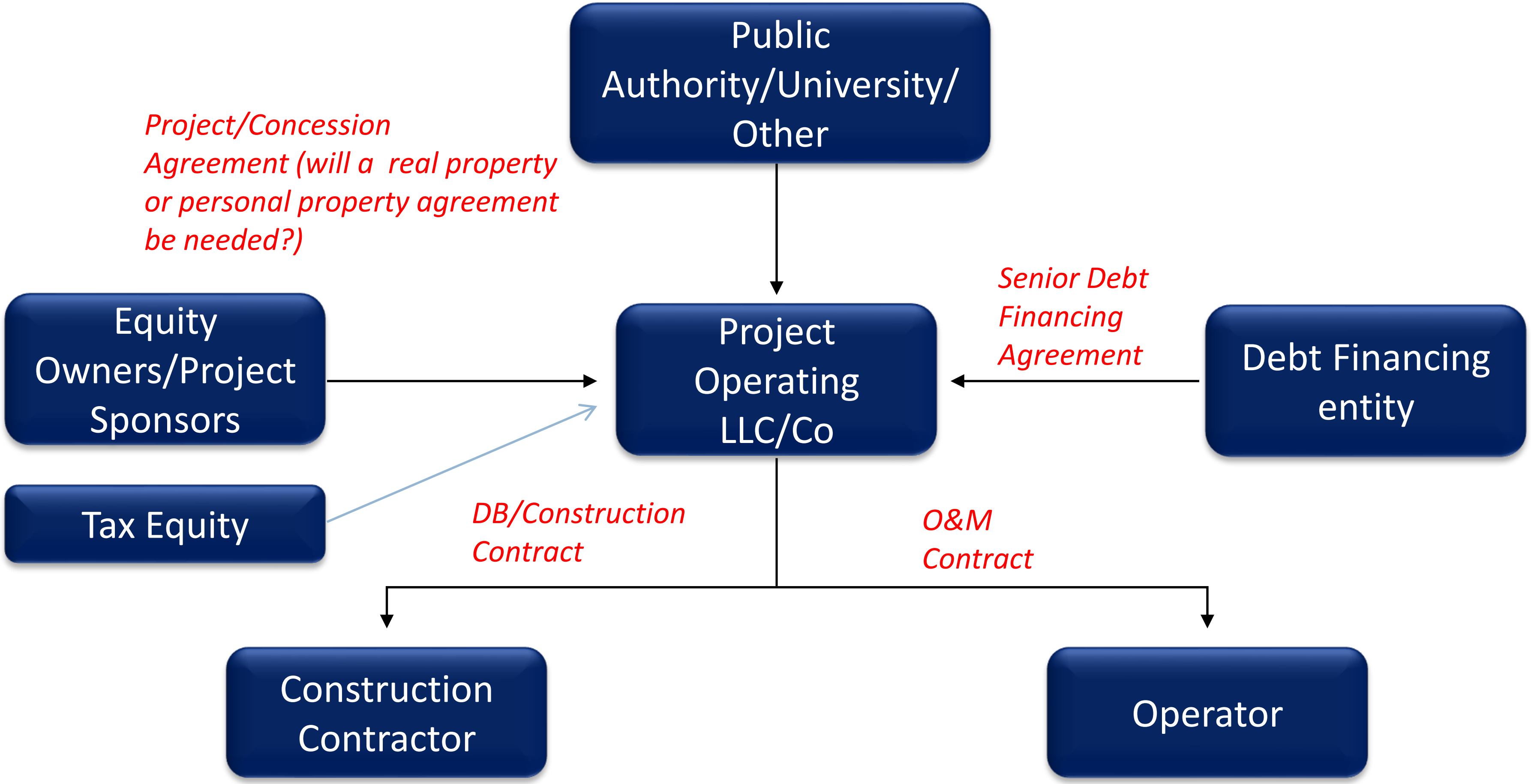
Financier - concerns regarding Government/Owner and Private Party

All of the above

Clear Rules Define The Agreement and Provide Certainty to the Parties

KUTAKROCK

P3 Contract Structure



Circumstances of Termination

Termination for Convenience

- 100% debt recovery
- Equity recovery via NPV or FMV calculation

Termination for Grantor Default

Termination for Developer Default

Termination Compensation Provisions (Debt "Floor")

Termination for Force Majeure

P3 – Focus on What is Important to the Transaction

- A lot of issues that are “standard” are not always standard
- Each owner and developer (and financiers) have requirements to enable the transaction to go forward
- Recognize the motivations of the parties in the transaction
- Focus on what is important to you
- Recognize legal limitations and policy limitations
- Recognize the people that are responsible for decisions and what it will take to have the project approved

Backup Slides

KUTAKROCK

kutakrock.com

Contract Terms - Client Concerns P3

- **Government/Owner**
  - Risk of failure (political, project, etc)
  - Risk on non-delivery
  - Risk of injury
  - Risk of hiring the wrong long-term contractor/manager
  - Risk of cost
  - other
- **Private Party**
  - Risk of losing the project
  - Risk of Changes
  - Risk of cost escalation
  - Financing Risk
  - Risk of termination
  - Risk of politics
  - other

Financier - concerns regarding Government/Owner and Private Party

All of the above

What is being negotiated?
DBFOM or DBFM or DBF or ……

- Design
- Build
- Finance
- Operate
- Maintain

- Design
- Build
- Finance
- ~~Operate~~
- Maintain

- Design
- Build
- Finance
- ~~Operate~~
- ~~Maintain~~

…and asset monetization is a real estate agreement with delivery of a project (including a DBF)

KUTAKROCK

Typical Phases of the P3 Process

P3 Needs Analysis
↓
Project Selection
↓
RFQ/ Prequalification
↓
Request for Proposals
↓
P3 Contract Negotiation
↓
Authority Approval of the Project
↓
Financial Close
↓
Contract Management (of DB -O&M)
↓
Termination or expiry

Owner Control

Contractor Control

Contracts

- Certainty and Clarity of the Agreements develops long-term processes
- Relationship of the parties grows and education occurs during the negotiations
- Critical step of the process to permit the project to move forward.

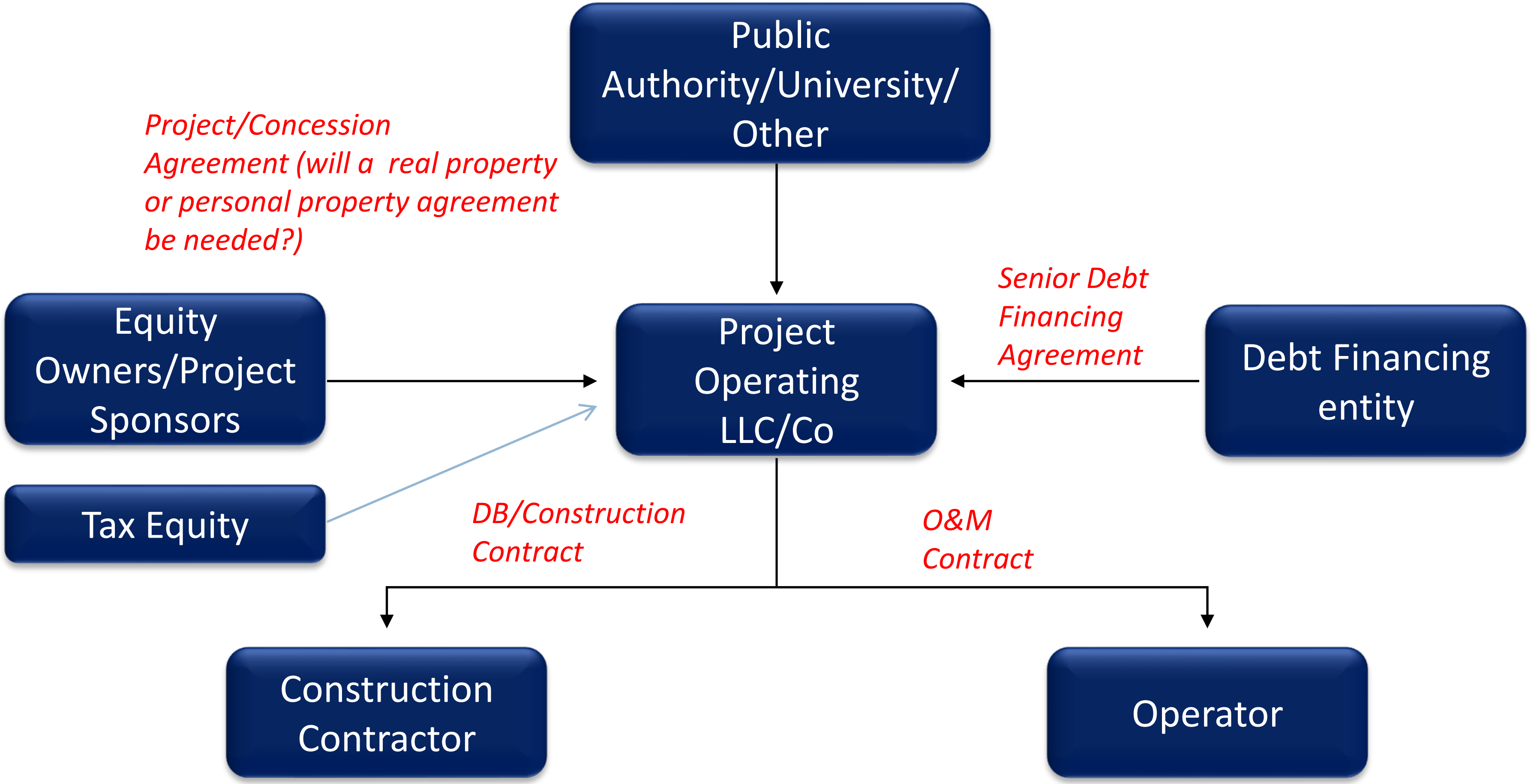
Contract - Balancing the Owner and Private Interest

- P3's reflect the Public Interest
  - Retain ultimate control over the asset — state as guardian/custodian of public assets
  - Transparency required when dealing with public assets, services and funds
  - Obtain value for money
  - Pay for performance
- P3's reflect the Private Interest
  - Profit and performance standards — usually best determined through open tender
  - Protects profit (and expense) against identified risks, especially those controlled by the public body
  - Balances transparency with protection of proprietary trade secrets or intellectual property

Contract - Balancing the Financing Entity Interest

- Financing has a say in the project
  - Equity – works closely with the developer and more behind the scenes
    - Will only invest in projects that meet criteria without requiring higher returns
    - Focused on the terms of the transactions
    - Return is based on success of the project
  - Debt
    - Must meet specific criteria
    - Needs step-in rights that protect the interest of the debt holders (ability to cure and ability to remove developer and replace with new developer)
    - Will require specific items in the contract (similar to developer needs)
    - Termination provisions are important
    - Usually fixed rate of return
  - Other investors (tax credit, etc.)
    - Requirements of specific laws (for example tax laws) must be met in the transaction

P3 Contract Structure



KUTAKROCK

Issues to Negotiate - Agreement Terms

- Parties to the Agreement
- Authority of the parties
- Description of the Project/facility/etc.
- Term of the Agreement
- Payments/Revenues
- Obligations (DBFOM, DBFM, etc.)
- Construction/Installation Obligation
- Operation and Management Obligation
- Base and incentive fees and process
- Special requirements of jurisdiction
- Ability to sell or assign
- Informal/Formal process to resolve disagreements
- Liabilities/indemnifications
- Environmental Issues/liabilities
- Insurance
- Bonding
- Default/Default Process
- Protection of financiers interest
- Bankruptcy
- Termination and Termination Process
- ….and more

Terms to Cover in the Agreement

KUTAKROCK

Terms

- Payment obligation or revenue sharing is a key negotiation term
  - Concession – what is the revenue source
  - Is the full risk on the private sector
  - Anti-competition clauses? (Owner cannot compete with the project)
  - Is there revenue sharing
  - Reserve account funding is critical
- Availability payment project—
  - clear funding source to make availability payments
  - Appropriations risk
  - Clear legal authority for the owner to make the payment and contract
  - Anti-deficiency authority issues?

Terms to Cover in the Agreement

ARTICLE 5
DESIGN AND CONSTRUCTION

ARTICLE 6
OPERATIONS AND MAINTENANCE

KUTAKROCK

P3 Concession/Project Agreement

Design/Build – Construction Issues

- Preparation of design — what flexibility to make changes from preliminary design
- Responsibility (including permits, zoning, environmental, etc.)
- Government input into design/plans
- Construction program and performance standards
- Plans
- Fees
- Supervision of construction
- Bonding/guaranty requirements
- Liability of Subcontractors
- Insurance requirements
- Force majeure/Delay Events
- Default
- Reporting/Confidentiality
- Delivery of Product requirements

Concession Agreement/Project Agreement (Cont.)

Operation/Maintenance Issues

- Performance standards during operation/control/modification
- Performance Plan (maintenance and reinvestment)
- Review of Contractor(s) over time and actions if the contractor is not meeting requirements
- Replacement plan
- Supervision of operations
- Fees
- Specific existing employee issues
- Force majeure
- Insurance requirements
- Performance Security and Guarantees
- Liability of Subcontractors
- Guarantee of public access
- Reporting/Confidentiality

Terms to Cover in the Agreement

KUTAKROCK

Terms to Cover in the Agreement

ARTICLE 15
PROJECT FINANCING

ARTICLE 16
RESOLUTION OF DISPUTES

ARTICLE 17

ARTICLE 18
HANDOVER AT END OF TERM

ARTICLE 19
MISCELLANEOUS PROVISIONS

Exhibit List

Concession Agreement/Project Agreement (Cont.)

Financing Issues

- Proposed cost of construction, financing and operation
- Revenue allocation — profit benchmarking/clawbacks
- Appropriation/public approvals
- Rate setting
- Performance payment criteria
- Rights of senior debt holders
- Equity at risk
- Public buy-back of asset at expiration (residual risk transfer)

Termination Issues (see subsequent slides)

- Default and termination provisions
- Step-in rights of public agency and senior debt holders
- Dispute resolution
- Payments
- Handback requirements

Legal Issues in Project Agreement

- Equity: Change of Control and Required Equity Percentage Provisions
- Debt:
    - Lenders' Cure Periods and Step In Rights
    - Limitations on Financing
    - Review of and Consent to Financing
    - Lenders Direct Agreement
- Bankruptcy Related Provisions
- Refinancing Gain Provisions
- Revenue Share Provisions

Concession Agreement/Project Agreement (Cont.)

Compensation Events/Material Adverse Events

- Duties to expand/build-out facilities in case of increased demand/deterioration of
- service levels
- Other directives
- Construction and operation of competing facilities
- Risk of future changes in law and regulations
- Undisclosed conditions
- Taxes
- Permitting/regulatory delays
- Closures
- Litigation
- Demand/usage
- Concession term and option to extend/early termination
- Remedies

KUTAKROCK

Termination – Decision-making Table

Termination Rights	"Traditional P3"	Proposed P3
Termination for Convenience		
Termination for Default Developer		
Termination for Default Owner (Govt/Universtiy/Other)		
Termination for Force Majeure		

Circumstances of Termination – Debt Provider Perspective

Termination for Convenience

- 100% debt recovery
- Equity recovery via NPV or FMV calculation

Termination for Grantor Default

Termination for Developer Default

Termination Compensation Provisions (Debt "Floor")

Termination for Developer Default

Typically 80% of debt obligations

Termination Compensation Provisions (Debt "Floor")

Intent:

- Incentivize lenders to exercise step-in rights
- Compensate SPV debt providers for completed work

Challenges:

- Bond market capability to exercise step-in rights
- Unjust enrichment argument
- International market practice
- Debt pricing impact?

Seth Kirshenberg
Partner
1625 Eye Street, NW, Suite 800
Washington, DC 20006
Tel: 202-828-2494
Fax: 202-828-2400
Email: seth.kirshenerg@kutakrock.com
Website: www.kutakrock.com