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Lessons Learned: Florida I-595 Project

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As the dust settles on the financing of the I-595 Corridor Improvements project in Fort Lauderdale, Florida, it is instructive to explore what trends this unprecedented deal portends and what take-aways from this transaction are likely to apply to future PPP transactions in the United States.

Take-away #1: A properly structured deal can be financed, even in the toughest of markets.

With the media beating the drum of a "freeze" in the credit markets, one could have easily drawn the conclusion that talk of closing project financing on a \$1.8-billion transaction was a pipe dream at best and perhaps closer to the ramblings of a madman. Yet ACS Infrastructure Development and its public partner at the Florida Department of Transportation (FDOT) were able to pull a proverbial rabbit out of the hat and bring the deal to fruition in the midst of the biggest economic downturn since the Great Depression. A peek behind the scenes at how this was accomplished is the best way to discern what elements of the I-595 transaction may be emulated in future PPP transactions.

In our uncertain financial times, a successful PPP transaction requires a great deal of flexibility in the procurement process and the contract documents. Having such flexibility will allow the parties to adjust to the inevitable yet unpredictable changes that will occur over the course of an extended PPP procurement. For the I-595 procurement, this flexibility was essential in a number of instances. For example, both of the proposer teams sought to make changes to their team composition very late in the procurement process. FDOT anticipated the potential for such changes and put an explicit and streamlined process in place that allowed for fair and thorough consideration of the requested changes.

On the finance side, the flexibility of the parties to respond to change with a "can-do" attitude allowed ACS to shift from its planned bond financing structure to a bank financing structure just weeks before the planned financial close. Without this flexibility, the transaction may well have hit a brick wall when it became apparent that the market would not bear such a large offering of alternative minimum tax debt. Similarly, FDOT showed exceptional foresight to provide some protection from interest rate movements, and a risk-sharing mechanism for credit spread movements, which were key to keeping the transaction on the rails when volatility in the markets was at its highest levels.

On the technical side, FDOT established a process to allow proposer teams to suggest alternative technical solutions in a confidential setting prior to submitting proposals. This gave FDOT the flexibility to adjust technical requirements to accommodate meritorious ideas in the final contract released prior to bid. The approach allowed FDOT to maintain a level playing field and a transparent selection process while still benefitting from private sector innovation.

Take-Away #2: Governmental support is critical to the success of any PPP transaction.

While flexibility will oil the gears of a complex PPP transaction, it is only with true governmental and public support on multiple levels that the myriad elements of a PPP transaction will come together to a successful conclusion. In the case of the I-595 transaction, this support started at the highest levels, with Governor Crist singling out the project in his "Accelerate Florida" stimulus plan months before the Wall Street meltdown. Governor Crist challenged FDOT to bring the transaction to a successful close as quickly as humanly possible. Resolve to meet this challenge permeated through all levels of FDOT, from Secretary Kopelousis down through the District leadership to the project procurement team. The Governor's challenge energized the procurement team to short-list, develop documents, conduct extensive industry review, receive and evaluate proposals, and

close financing in the midst of the tightest credit market in modern times, all in about 15 months—an unprecedented, short time for a PPP procurement of this type.

Federal level support mirrored the state support. Substantial TIFIA credit support, to the tune of \$608 million, proved absolutely critical to keeping pricing within FDOT's affordability limits. But for the reduced cost of TIFIA at a time when credit spreads were hitting unprecedented levels, the deal would have collapsed.

Equally important to the project's success was the support of local stakeholders, including cities along the project route, Broward County, and local residents. FDOT conducted innumerable public hearings on the project and listened when some residents objected to the original design concept of elevating portions of the project. FDOT demonstrated its flexibility by redefining the project profile, which won the public support necessary to make the project a reality.

Take-Away #3: The approach to pricing risk may be the deciding factor in a successful proposal.

Philosophical differences in risk appetite, pricing of risk and sizing of returns proved to be the difference between the winning proposal and the second place finisher. Some issues of concern for proposer teams included risk allocation for delays or extra costs associated with utility relocation, hazardous materials, and permits. The parties used the pre-proposal industry review process to address legitimate concerns without losing the fundamental risk allocations that are a key to making PPP transactions work. When proposals came in, there was an extreme variation in pricing between the proposals that could only be explained in terms of risk premium and differing expectations of return on investment. The winning team's proposed annual maximum availability payment was less than half the figure put forth by the other proposer.

Perhaps the strong integration of the ACS team helps to explain its risk philosophy and ultimate success as the winning proposer. Besides taking the entire equity position as the Concessionaire, ACS's affiliated companies also took on the role of lead designbuilder and lead operations and maintenance contractor through a series of subcontracts with the Concessionaire. This "one-stop shop" for design, construction, operation and financing allows efficient pricing of both risk and expected returns.

The unsuccessful proposer, on the other hand, was a consortium of separate companies, each with its own risk philosophies and risk appetites. When confronting these differing risk appetites a common response of consortia is to price shared risks in accordance with the philosophy of its most conservative consortium member. Individual risks may be priced at a level to reflect the pass-through nature of the contracting structure. Also, the presence of the unsuccessful proposer team of a pure financial player in the form of Babcock & Brown may well have increased expectations regarding the expected return on investment, especially given the bleak financial environment at the time when proposals were submitted.

Take-Away #4: Availability payment transactions are here to stay. With the I-595 transaction successfully closed, states throughout the country are taking a hard look at availability payment structures and the features that make them attractive. For toll road projects, the structure eliminates the question of who sets toll pricing, making it far more politically palatable than allowing the private sector concessionaire, often a foreign-based company, to make these decisions. Maintaining control over toll-setting allows the agency to focus on its policy objectives, whether the objective is maximizing revenue, maximizing congestion relief, or some other objective.

Another feature of availability payment transactions is that they generally will have shorter contract tenors than a toll concession, allowing the agency to keep all real property ownership interests within the agency. The absence of a lease or other transfer of property interest may alleviate some of the tax issues that arise on longer-term toll transactions, although it does potentially eliminate the tax benefit of longterm depreciation that is a feature of toll concessions.

Performance of the construction work in accordance with contractual requirements is secured because the Concessionaire receives no payments until the construction is complete. Performance security is thus accomplished in great part by the structure itself. The availability payment structure with its payment deductions for performance shortcomings provides the Concessionaire with ample financial incentive to ensure good traffic management during

construction, and effective maintenance after the facility is open to the travelling public. The contractually-mandated hand-back standards ensure that the agency gets a fully functional facility at the end of the concession term.

From the private sector's perspective, availability payment transactions provide a more predictable payment stream, with nearly all downside risk controlled by the private sector. The Concessionaire and its lenders rely on the agency's credit rather than on often-unpredictable toll revenue.

Conclusion: The I-595 deal marks the first use of availability payments in the United States. While such deals are common and even standardized in the UK, Europe and Canada, the structure used in Florida was significantly tailored to U.S. law, Florida state law and local business practices. While the success of the deal, was as much art as science, several of the key elements, including flexibility, government support and risk-pricing approaches can be replicated in other states on other projects. That is some good news amidst the general economic gloom.

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