

# Potential Private Funding of Levee Repairs and Improvements

Association of State Floodplain Managers

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# Discussion Overview

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## Firm Qualifications

### **We are a specialist independent advisor to:**

- General partners (GPs) managing infrastructure and private equity funds
- Limited partners (LPs) who are investing in such funds

### **We act as an “infrastructure investor intermediary”**

- Fund placement: we represent GPs
- Secondary sales assignments: we represent LPs
- Advisory: we represent either GPs or LPs

### **Our firm:**

- Has relationships with 1,500 of the largest institutional investors throughout the world
- Maintains regular contact with 558 of such investors
- Understands a wide variety of infrastructure investment strategies

# Introduction to Institutional Investors

- **Highly sophisticated investors with considerable financial resources**
- **Examples of infrastructure LPs:**
  - Large state pension plans (e.g., CalPERS, NY Common, Florida, Canadian Pension Plan)
  - Banks, insurance companies and other financial institutions
  - High net worth individuals (but must be sophisticated)
  - Foundations/universities/endowments
  - Corporate pensions
  - Sovereign wealth funds
- **Applicable U.S. securities laws prevent GPs from offering investment products to general public**

# Introduction to Institutional Investment

## ➤ **Asset allocation:**

- Investors make decisions about where to invest their money based on relative risks and rates of return and to obtain portfolio diversification benefits
- Bigger institutional investors tend to be more sophisticated and invest in a wider range of asset classes than do most individual investors

## ➤ **Asset classes:**

- There is a full “menu” of investment opportunities
- Most big investors are familiar with traditional assets because they have been investing in them for relatively long periods of time (e.g., domestic and international listed stocks, government and corporate bonds)
- But the returns generated from such “traditional” assets are oftentimes not high enough to meet investment expectations (e.g., future pension liabilities in some countries will be higher than predicted investment returns will be able to generate)
- Professional asset managers therefore suggested investing in “alternative” or new assets (e.g., private equity, hedge funds, currencies, commodities, real estate, and infrastructure)
- Alternative asset investments are, however, among the most risky and illiquid of investments
- Pension funds thus usually have strict limits on which alternative asset classes, if any, they can invest in

# Institutional Investment in Infrastructure

- **Infrastructure investing is not new, but the asset class is**
  - Traditionally, institutional investor exposure to infrastructure has been via debt (i.e., bonds), listed companies (e.g., utilities), or via real estate portfolios (e.g., warehouse near airport)
  - Dedicated infrastructure funds were first set up in the mid-1990s in Australia. In the 2000s, the availability of cheap debt fueled the increase in fundraising for infrastructure funds. Some have since failed.
  - The high leverage available enabled funds to structure projects with attractive levels of return, leading to a rapid appreciation of infrastructure asset values (e.g., bubble in U.S. maritime port assets in 2006-2008)
  
- **Reasons for global investor interest in infrastructure:**
  - Budgetary pressures on governments worldwide forcing them to explore alternatives to traditional public sector provision of assets and services
  - Keen interest among institutional investors (e.g., public pension funds) in alternative investment opportunities that can deliver relatively predictable, income-oriented and inflation-protected returns – such as infrastructure
  - Potential value to be created by reducing political interference with infrastructure management decisions (U.S. examples: “Field of Dreams” projects and congressional earmarks)
  - International experience shows that new forms of private sector participation can boost revenues and improve services at infrastructure facilities
  - Need for massive infrastructure investment across the world

# Infrastructure Fundraising

- In 2010, 25 infrastructure funds reached a final close, raising an aggregate of \$27.3 billion
- In 2011, a record 122 unlisted infrastructure funds are on the road targeting \$85.8 billion in investor commitments
- A growing number of institutional investors are carving out allocations and looking to make infrastructure fund commitments in 2011
- Interest in the infrastructure asset class will continue to grow over the next several years among institutional investors

Source: *2011 Prequin Global Infrastructure Report*

**Will the U.S. levee sector benefit from institutional investor interest in infrastructure?**

# Recent Trends in the U.S. Levee Sector

- Underinvestment in needed levee repairs and improvements
  - Failure of levee system in New Orleans following Hurricane Katrina (Aug. 2005)
  - Truckee Canal breach in Fernley, Nevada (Jan. 2008)
  - Upper Midwest Floods (June 2008)
  - Will California Delta's levees fail after the next big earthquake?
  
- Increased urbanization/growing and aging population in flood zones means higher flood damage
  
- Paterno decision (2003 California case that increased liability for the public owners/operators of State-federal project levees)
  
- FEMA updating of flood maps and levee "deaccreditation"
  
- Expectation of Federal bailout after flood event
  
- Global warming/climate change

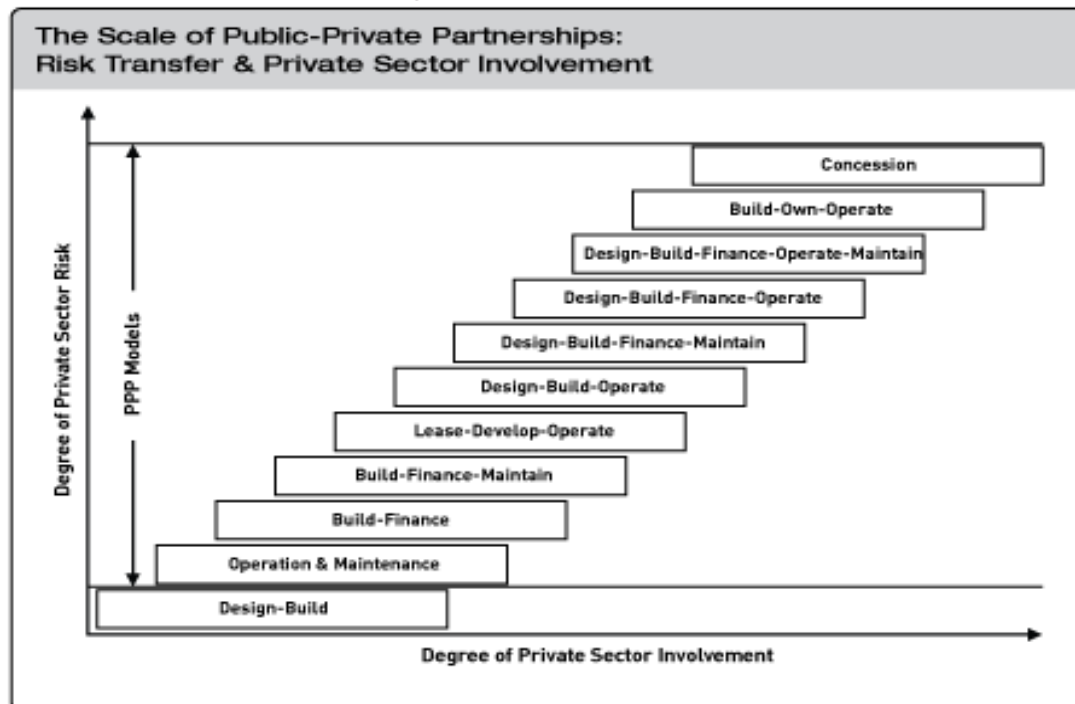




# Public-Private Partnerships

## What is a Public-Private Partnership or “PPP”?

- A contractual relationship between a public agency and a private sector entity
- Through this partnership, the skills and assets of each sector (public and private) share in delivering a service or facility to the general public
- In addition to sharing resources, each party also shares in the potential risks and rewards resulting from the delivery of the service or facility



The Canadian Council for Public-Private Partnerships

## Many different PPP structures

- Build/Operate/Transfer (BOT) or Build/Transfer/Operate (BTO)
- Build-Own-Operate (BOO)
- Buy-Build-Operate (BBO)
- Contract Services
- Operations and Maintenance
- Operations, Maintenance, & Management
- Design-Build (DB)
- Design-Build-Finance-Operate (DBFO)
- Design-Build-Maintain (DBM)
- Design-Build-Operate (DBO)
- Developer Finance
- Enhanced Use Leasing (EUL)
- Lease/Develop/Operate (LDO) or Build/Develop/Operate (BDO)
- Lease/Purchase
- Sale/Leaseback
- Tax-Exempt Lease
- Turnkey

# International Examples of Flood Control PPPs

## United Kingdom (Private Finance Initiative)

- Pevensey Bay Flood Defense
  - £27.4 million (\$50 million), 25-year project to rebuild and maintain flood defenses
  - Funded by shareholder equity to protect against 400-year storm surge
  - Goal is to incentivize innovation and investment
  - Further information: <http://www.defra.gov.uk/environment/flooding/documents/policy/strategy/pevensey.pdf>
  
- Broadland Flood Alleviation
  - £140 million (\$225 million), 20-year contract to rebuild flood defenses
  - Roles of private partner include maintenance, emergency response, design, implementation and monitoring
  - Service contract incorporates profit sharing and risk transfer
  - Further information: <http://www.halcrow.com/Our-projects/Project-details/Broadland-Flood-Alleviation-Scheme-England/>

## Malaysia (Stormwater Management and Road Tunnel)

- 6-mile storm drainage and road structure in Kuala Lumpur; mitigates flash flood problem while reducing traffic congestion
- Further information: <http://www.roadtraffic-technology.com/projects/smart/>

# Domestic Examples of Infrastructure PPPs

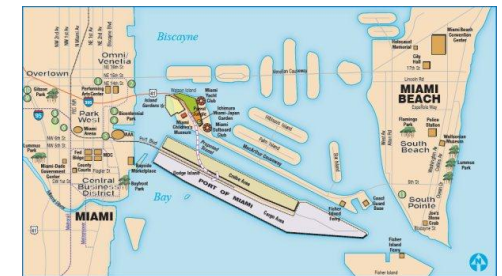
## U.S. Department of Defense Military Housing Privatization Initiative

- Private developers replace/renovate residential housing facilities
- Maintained during a 50-year lease



## Florida Department of Transportation

- Port of Miami Tunnel Project
  - Capital value of \$900 million
  - 35-year DBFMO contract (with 5-year max. to build)
  - Meridiam holds 96% of the equity
  - Availability payment of \$33 million/year
- I-595 Express Lanes Project
  - \$1.8 billion project
  - 35-year DBFMO contract
  - ACS is primary private partner
  - Availability payment of \$63 million/year to build and manage 10.5 miles of reversible express lanes



## Long Beach Courthouse

- \$495 million courthouse replacement (first new courthouse built in California in 40 years)
- 35-year DBFMO contract
- \$52 million annual service payment is subject to appropriation and performance based

# Potential PPP Structure for Levees

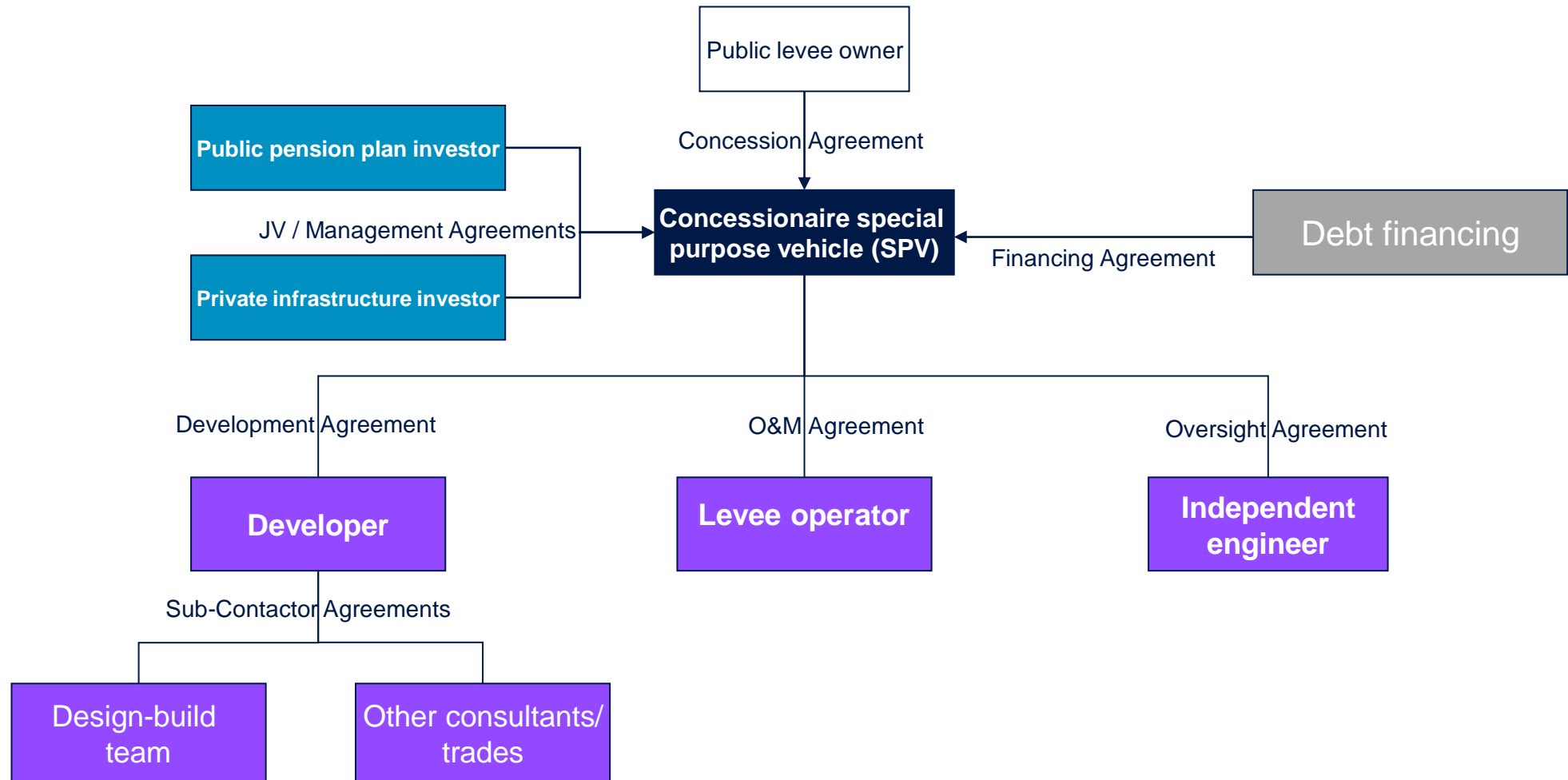
## Participants

- Public owner of urban levee system
- Private infrastructure investor (with likely public pension fund investment)
- Private firm with expertise in levee reconstruction/operations and maintenance
- Army Corps of Engineers/FEMA
- General public (users and beneficiaries of improved water control services)

## Structure

- Public levee owner enters into long-term PPP contract with special purpose vehicle
- Contract requires improvements and upgrades to flood control facilities (to 200- or even 500-year flood standard)
- Contract contains detailed operating and maintenance standards (performance based)
- Emergency action plan for notification and evacuation (as a possible risk reduction tool)
- Use of independent engineer to verify contract compliance on behalf of public levee owner
- Mandatory flood insurance (via special assessment on property owners)
- Public owner makes annual availability payment to private investor (inflation indexed)
- Minimum hand-back requirements at end of PPP contract

# Potential PPP Structure for Levees



# Potential PPP Structure for Levees

## Benefits

- Enhances public safety by speeding up delivery of needed levee improvements
- Reduces flood insurance premiums (residential, commercial & industrial)
- Raises property values
- Safeguards local economy and jobs
- Better use of public sector staff for oversight rather than project implementation
- Creates innovative corporate platform to pursue additional projects (levees, locks and dams)
- Private partners, including public pension fund investors, have opportunity to earn reasonable return on their levee investments

## Open issues

- Selection of an appropriate “demonstration” project and partners
- Financial feasibility/amount of potential cost savings
- Cost to develop and pursue a proposal
- Political support; need for stakeholder outreach and public education plans
- Legal authority to implement PPP
- Appropriate allocation of project risk (e.g., environmental/permitting)



## Group Discussion

- **Questions**
- **Comments**
- **Suggested next steps...**

**Thank you!**

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