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Putting the Pieces Together

It is often said about the US market that "if you've seen one P3, you've seen one P3" – meaning no two are alike. This article intendeds to clarify the different types of delivery models for those who might be less familiar with P3s, along with clarifying different payment mechanisms by which to compensate the private developer.

It is important to note that no single solution is right for all. Knowing the benefits and considerations of different P3 structures will help inform universities on how P3s can meet their goals and objectives.

Design-Bid-Build and Design-Build

The Design-Bid-Build (DBB) method of delivery is often thought of as the "traditional" model, which is the basis of comparison to P3 delivery models. In the DBB model, the university is responsible for design and retains significant risk related to construction cost overruns and delays.

Design-Build (DB) is the first step toward a P3 and begins to transfer significant risk away from the university to the private sector design-builder. Typically, the university will do some level of preliminary design (eg 30%) however, the design-builder will be responsible for completing the design and constructing the facility based on a guaranteed maximum price and date-certain schedule. The P3 models discussed in this article build upon DB delivery.

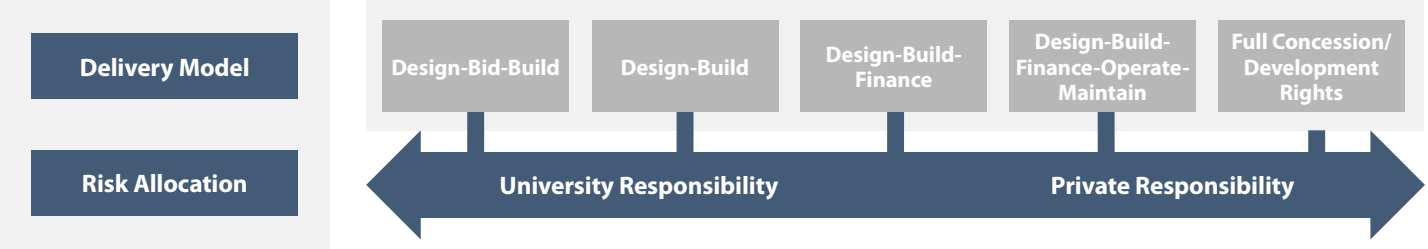
Design-Build-Finance

The Design-Build-Finance (DBF) procurement and delivery model is an agreement between the university and private-sector developer to design, construct and privately finance a project. The repayment of that private financing will depend on the funding and payment mechanism made available to the developer. Payment mechanisms are the way in which the university provides funding on a recurring basis to the private developer upon which the private developer can secure its financing.

DBFs can have fairly short-term financing which is repaid during or at the end of construction. Alternatively, DBFs may be financed using long-term debt which is often the case in triple-net facility leases (where rent equals debt service).

One of the benefits to universities of DBF is the ability to delay payments

Delivery models



significantly to the design-builder until certain milestones are complete and construction is de-risked. Not only does the delay limit the university's risk of loss but it introduces another party whose interests are aligned with the university and who will scrutinize and monitor project risks: the lenders.

Notably, the financing is non-recourse and not a legal debt of the university, thereby preserving the university's limited debt capacity for other priorities. Universities will often ask if the private sector financing is "on-credit" to them. The rating agencies evaluate the impact of all major initiatives of a university when evaluating credit. The better question is whether the project will have a positive credit impact (by attracting more students or reducing expenses for example) or a negative impact (by introducing new risks).

Commercial Structure: The diagram below broadly outlines the commercial structure for a DBF. It is typically 100% debt financed (no equity) and can utilize either taxable or tax-exempt debt. Typically, a bankruptcy remote, new limited liability project company is created as both the borrower and the entity directly entering into the DBF contract with the university. The project company will also enter into a DB agreement with the design-builder.

It is worth considering that short-term DBFs successfully transfer construction risk, but do require the university to have available funding for payments during the construction period, which can be a limiting factor.

Design-Build-Finance-Operate-Maintain and Concessions

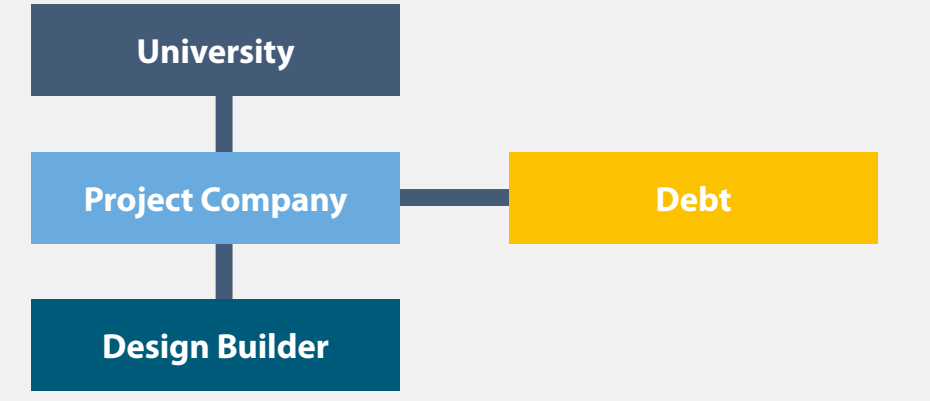
The DBFOM model includes the basic fundamentals of the DBF model with the addition of transferring long-term facility operations, routine maintenance, and life-cycle maintenance risk to the private-sector developer. Upon construction completion, the developer receives project revenues or payments from the university as governed by the project's payment mechanism.

As previously noted, payment mechanisms are the way in which the university provides funding, on a recurring basis, to the private developer upon which the private developer can secure its financing. The two main categories of payment mechanisms for DBFOMs are availability payments and project revenues.

Availability payments require the university to pay the private developer a periodic payment upon successful completion of construction of the project and its availability for use. Ongoing availability payments remain subject to the project's availability and the private developer's performance of O&M services pursuant to the project agreement.

Alternatively, the developer can collect project revenues directly from the users of the facilities, including housing, utilities, parking and sports facilities, among others. Often, the developer can set rates and change them directly at any time during the term of the concession, but within pre-agreed limits. This structure allows for the flow of project-related revenues to the developer without any additional payments from the university.

The term DBFOM is typically used for "greenfield" or new-build projects. The term concession is typically referred to for monetization of revenue generating assets whereby the university provides the private developer the right to operate an asset in exchange for an upfront payment. In most cases, the university will continue to own the asset, particularly if it is located on campus.



Commercial Structure: The diagram below outlines at a high level a typical commercial structure for a DBFOM or concession. Often a new limited liability, bankruptcy remote project company is created as both the borrower and the entity directly entering into the partnership with the university. The project company will also enter into a DB agreement with the design-builder and an O&M agreement with O&M provider. The equity investors are the owners of the project company.

This DBFOM or concession models allow for significant risk transfer as the developer is responsible for the DBFOM of the project, or financing the upfront payment, as well as operations, routine maintenance, lifecycle maintenance and specific handback requirements (pre-defined conditions upon which the asset is returned to the university).

The equity investor has "skin in the game" which they can lose if they fail to perform or keep project available for use. Equity investment is the first loss risk capital that helps ensure long-term performance of the asset. It is important to note that in the all-debt, 501(c)3 privatized student housing model, there is no long-term equity capital at risk ensuring asset performance and maintenance.

Key considerations for the DBFOM or concession models include choosing the right partner, assessing the time and cost to properly procure a multi-decade P3 agreement and evaluating whether the P3 provides value-for-money as compared to traditional delivery and financing methods.

Relevant Transactions: Examples of Greenfield DBFOMs for higher education include:
- CSU Fresno Central Utility P3
- UC Merced Campus Expansion P3
- Purdue University Student Housing P3

Examples of concessions include:
- Ohio State University Parking Concession
- Ohio State University Utility Concession
- University of Iowa Utility P3
- University of Idaho On-Campus Utility System P3

Conclusion

Compared to more mature P3 markets around the world, P3s remain a new alternative to universities in the US. The US takes a more customized approach when structuring P3s which can introduce complexity. Additionally, P3s are not suitable for every project and many will still continue to be delivered and financed traditionally.

Due to these factors, universities may want to consider identifying an in-house team and employing specialized P3 consultants such as financial advisors, technical advisors and legal counsel (P3 counsel and local law counsel) to assist in evaluating candidate P3 projects. It will take a dedicated team with diverse skill sets to help put all the right pieces together for a successful P3.

DBFOM: Fresno State University partnered with a private developer to upgrade and modernize its central heating and cooling plant which consists of three hot water boilers, four, 800-ton water chillers and a 1.7 MG storage tank. This DBFOM project is backed by availability payments over 30 years of operations.

Concession: University of Iowa closed on a concession for its utility system in 2019. The winning bidder paid $1.165bn for the right to operate and maintain system for 50 years including electricity generation, steam and condensate, domestic water, chilled water, compressed air, and sewer system.