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Long Beach Civic Center P3 Hybrid to Plenary.

The City Council of Long Beach, Calif., this month unanimously chose a DBFOM team led by Plenary Group to negotiate terms of a complicated real estate/P3 deal for developing a new downtown civic center, new port headquarters and related private development. To help meet the city's affordability cap, Plenary proposes to fund the civic center, comprising a new city hall, library and park, with tax-exempt debt. The spread risk on those bonds remains with the Plenary consortium until financial close, which could occur in mid-to-late 2015, Plenary's target, or mid-2017, the deadline set in the RFP.

The \$12.6-million (FY 2014) annual affordability cap set in the RFP is the amount the city now spends on its existing facilities, deemed seismically unsafe. The city's actual lease payment under the cap will be negotiated as scope changes are considered in Plenary's proposed design. The final amount, subject to deductions for under-performance, will be indexed to inflation, capped at 6 percent a year over the 40-year term of the agreement.

Plenary's tax-exempt structure involves City debt issuance through a non-profit corporation, a contract for development services to Plenary's project company, and Plenary purchased subdebt to backstop effective risk transfer.

"We believe we've found an innovative way to marry tax-exempt structure with the long-term risk transfer objectives of a P3," says Stuart Marks, senior vice president at Plenary. "This option is open due to the unique features of this project and the procurement methodology selected by the city," says Marks. "They kept an open mind and encouraged innovative proposals."

(Marks leads Plenary's U.S. origination activities, including directing bidding consortia across all aspects of project development and overseeing project financing, structuring and commercial activities.)

Both senior and subordinated debt would be issued by the non-profit to fund the civic center projects, estimated to cost \$180 million, and to defease \$20 million in city debt. The higher-risk subordinated debt would be purchased by Plenary and held as long-term "quasi equity" in the deal.

(Plenary does not invest for a traditional captive fund. It pursues long-term P3 opportunities with its own equity, part of which is sourced at a Plenary corporate level from strategic institutional investors.

Plenary believes this allows for greater flexibility in the types of investments it pursues, such as subordinated debt, although some equity funds also can also hold those bonds.

This also leaves Plenary fully in control of its equity without concern for 3rd party restrictions, interference or differing investment views or horizons.)

The City of Long Beach believed it could finance a new city hall, library and park using funds already budgeted to operate and maintain those city assets. Proceeds from the sale of excess property

around the new civic center to the selected developer would subsidize the civic elements of the project. Consolidation efficiencies would reduce operating costs. Building a new headquarters in the complex for the Port of Long Beach, a city department, was included as an option that would produce scale economies in design and construction.

Long Beach issued an RFI in April 2013 as a market test, got seven responses, then hired Arup Financial Services in December 2013 to develop a procurement strategy and draft an RFP. Three teams were shortlisted in June 2014 and one, real estate developer, Related California, dropped out. That left a DBFOM team led by Macquarie as the sole competitor against Plenary.

Arup had devised a competition where teams would offer “soft bids”—without committed financing or a committed price—that, after stress testing, were deemed most likely to meet the \$12.6-million FY 2014) annual affordability cap set by the city to pay the capital and operating costs of the new civic center.

That approach provided flexibility but it leaves the city without a fixed-price bid. “The City has now put themselves in a position of finalizing pricing, financing, specs etc. without the benefit of competitive pressure and the innovation that brings,” says a P3 developer that declined to compete in Long Beach.

Much remains to be negotiated between the city and Plenary’s team. “Our selection is the beginning of the partnership,” says Dale Bonner, Executive Chairman of Plenary Concessions. “We’ve still got a lot of work ahead of us” to further define the City’s goals and requirements for the project.

Extensive public outreach was added to gain the support of the city’s new mayor and council, who were seated in July. In addition, the city auditor will monitor contract terms as the negotiations proceed, says Bonner, so that there will be no surprises at the end.

Plenary’s team includes 20% partner Edgemoor Infrastructure & Real Estate. Clark Construction, Edgemoor’s parent, and architect SOM will design and construct the civic center and 11-story port headquarters, estimated to cost \$179-million. Johnson Controls Inc. (JCI) will provide facility management services for the civic center components and, potentially, subject to further discussions with the Port, the Port’s new headquarters building.

To firm up its bid price and financing details, the Plenary team now must:

- Conduct extensive public hearings on its civic center design and master plan for revitalizing the city’s downtown area;
- Obtain all environmental permits and other entitlements to the five-acre site;
- Negotiate specifications and scope;
- Confirm its authorizing legislation; (The proposed DBFOM structure is authorized by general law in California, but the City is also considering pursuing project-specific authorization at the state level.) and
- Arrange financing, which would include defeasing about \$20 million in city debt.

Plenary and Edgemoor would put in about \$30 million cash at financial close, its agreed purchase price for around three acres of city land near the civic center.

If Plenary meets its obligations during the exclusive negotiation period to get to financial close and Long Beach doesn’t, the city has agreed to pay the developers a termination fee of up to \$3.5-million.

Including that contingency, the city has budgeted \$9.2 million for legal and financial advisors to

negotiate the final agreement. Arup and law firm Sheppard Mullin Richter & Hampton LLC will represent the city. The port is expected to pay half of the consulting fees. Its advisory team, if any, was not noted in the public presentations.

The city's timeline would require consulting services through mid-2017. Plenary, which has a staff of 80 P3 specialists in North America, believes it can complete California Environmental Quality Act clearance in around six months, then finance and begin work before the end of 2015.

Sources

- City funds available for payment to the Project Company (affordability limit): \$12.6 million (FY 2014) per year, with annual inflation increases capped at 6%.
- Plenary purchase of city land: \$30 million at financial close.

Uses

- Fund Civic Center (City Hall, Library, Lincoln Park) capital costs: \$180 million
- Defease city debt: \$20 million
- Pay debt service and operating costs, including facility management costs, SPV costs, lifecycle costs, energy costs (a material component) and management fees for the tax-exempt structure. The city estimates that cost will be \$7.6 million per year, though it is subject to adjustment.

P3 Real Estate/Tax-Exempt Model - A Market Test

"The market is still trying to figure out what a social infrastructure P3 is," says Orion Fulton, Senior Manager with Arup Transaction Advice. The Canadian fixed-price concession model with private finance worked well for the Long Beach Courthouse P3 and will be tested in a few months for a new Judicial Complex in Indianapolis.

But that model didn't fit the Long Beach Civic Center project. Combining real estate development, urban revitalization and DBFOM delivery of large public buildings under an affordability cap using a P3 model requires great flexibility, he says.

Fulton admits that the hybrid real estate/P3 project in Long Beach isn't what pure P3 developers want. But "it's the cold hard reality of where the public sponsors are now," he says. "The P3 purists back away as soon as they see tax-exempt financing and real estate. Well, good luck in trying to get deals done," he says.

Long Beach transaction details won't be set for months, maybe years. "It's not a victory yet," says Ignacio Barandiaran, who heads Arup's transaction advisory group in North America. "It's an opportunity to set a precedent."

By Editor January 16, 2015

By William Reinhardt, editor, Public Works Financing

Public Works Financing is a monthly newsletter covering P3s in all infrastructure markets, since 1988. It is widely read and cited in the media, academic research, federal reports and congressional testimony.