

THE NEW WAVE OF U.S. INFRASTRUCTURE PRIVATIZATION

MAYER
BROWN
ROWE
& MAW

John Schmidt
Mayer, Brown, Rowe & Maw
April 24, 2007

The Counselors of Real Estate
Montreal

WHAT IS PRIVATIZED INFRASTRUCTURE?

- Toll roads, bridges, airports, parking structures, ports
- Monopoly or quasi-monopoly public facilities that generate revenues
- Shifted to private investors through long-term lease or other agreement

RECOGNIZED WORLDWIDE AS AN ATTRACTIVE INVESTMENT

- Long-term stability with reasonable return and inflation protection
- Not like building new infrastructure that has many risks: environmental/regulatory; construction; ramp-up
- In 75 years most of today's top U.S. companies will be gone—but the Golden Gate Bridge will still be there!

WORLDWIDE INVESTOR APPETITE HAS GROWN

- Major foreign pension funds are leaders in infrastructure investment: e.g. Ontario Municipal Employees (Borealis); Caisse de depot et placement du Quebec
- Macquarie has used Australian pension funds to finance world leadership—joined by other Australian firms such as Babcock & Brown and Challenger

FOREIGN INFRASTRUCTURE NOW HEAVILY PRIVATIZED

- British airports first; then Australian airports; now many European airports—Copenhagen, Brussels, Budapest
- Most European toll roads privatized: Autostrade--Italy; Cofiroute--France; Cintra, FCC--Spain; Brisa--Portugal
- Infrastructure operators have reached out: Brisa in Brazil & Mexico; Cintra in Chile

WORLDWIDE MARKET DEVELOPED WITHOUT ANY ACCESS TO U.S.

- Strongest economy in the world
- Complete absence of political risk
- Existing U.S. infrastructure may be the single best long-term investment in the world—except U.S. government securities, which don't appreciate

WHY NO U.S. PRIVATIZATION?

- Multiplicity of jurisdictions--"federalism lives" in infrastructure: states, cities, toll road agencies, airport authorities
- National government has limited role, beyond funding
- Availability of tax-exempt funding a factor, but not decisive
- No one had DONE IT

CHICAGO SKYWAY WAS FIRST PRIVATIZATION OF EXISTING U.S. INFRASTRUCTURE

- 7.5 mile bridge and access highway— connects Indiana Toll Road to downtown
- Built by City of Chicago-opened in 1958
- Experienced early financial difficulties after competing highway opened—bonds in default in the 1970s

SKYWAY OPERATIONS IN 2003

- Revenue of \$38.7 million—17,500 toll transactions
- \$28.3 million in EBITDA (71% margin)
- \$2.00 toll rate unchanged since 1993
- \$300 million capital improvement program completed in December 2004

STRUCTURED BIDDING PROCESS

- 5 bidders initially qualified in early 2004
- City provided financial, engineering, traffic and economic forecasts--4 month due diligence period
- Bidders do their own economic and traffic forecasting, project future operating and capital costs, evaluate revenue opportunities
- Professional teams on both sides—a place for real estate counselors

LONG-TERM LEASE AGREEMENT DEVELOPED THROUGH INTERACTIVE PROCESS

- Detailed operating standards to govern operations, maintenance, capital improvements
- Toll limits—allow stepped increases to \$5.00 in 2017, then formula based on CPI and GDP per capita
- Enforcement through arbitration

CINTRA-MACQUARIE WON WITH \$1.83B BID FOR 99 YEAR LEASE

- Other bidders: ABN/OMERS/Cofiroute (\$700M) & Abertis (\$500M)
- Closed January 2005 with \$1B bank debt
- September 2005 refinancing with \$1.5B public debt offering—required new set of projections, appraisals

CITY USED PROCEEDS CAREFULLY

- \$400M Skyway debt defeased
- \$500M permanent reserve—interest alone exceeds net income from Skyway
- \$450M repayment of City debt
- \$350M “annuity” into City budget over 8 years
- \$100M into highly visible social programs

CREATED STIR IN GOVERNMENT/ FINANCIAL CIRCLES

- Many public entities began considering privatization
- Many investment bankers/managers began creating infrastructure investment funds: Goldman--\$6.4B; CSFB/GE--\$5B; Morgan Stanley--\$2B; Carlyle--\$1.5B; JPMorgan--\$2B
- Others in process: UBS; RREEF; Borealis

INDIANA DECIDED TO PRIVATIZE INDIANA TOLL ROAD

- Similar to Skyway process, except faster
- RFQ issued in late September 2005—bids received in January 2006
- Cintra-Macquarie again won with bid of \$3.8B for 75 year lease
- Other bidders: Babcock & Brown--\$2.84B; Itinere--\$2.5B; Morgan Stanley--\$1.9B

PARTISAN POLITICAL FIGHT IN INDIANA LEGISLATURE

- Two vote Republican majority in Indiana house—won by one vote
- Charges against “foreign ownership”
- Republicans lost control of House in November 2006 elections—but Governor’s ratings are now high again
- All proceeds used for other transportation infrastructure

FINANCED WITH \$4.1B BANK COMMITMENT FROM FOREIGN BANK SYNDICATE

- \$3.3B of 3.8B purchase price--\$700M for mandated capital improvements
- Lease mandates expansion of road on reaching congestion triggers
- BBVA, Banco Santander, HSBC, Credit Agricole, Depfa, RBS—foreign banks active in area—no U.S. banks

OTHER DEALS DONE

- Pocohantas Parkway—troubled Virginia toll road leased for 99 years to Transurban (Australian) in June 2006 in exchange for assumption of debt, future revenue share
- Chicago Underground Parking System—9,000 spaces--leased to Morgan Stanley in Dec 2006 for 99 years for \$563M—process included consultant’s report on possible non-parking revenues

DEALS IN PROCESS

- Pennsylvania Turnpike—Governor Rendell has proposed privatization—working with financial and other advisors
- New Jersey—Governor Corzine studying privatization of Turnpike, Garden State Parkway, lotteries
- Either Pennsylvania or New Jersey would be new order of magnitude: \$10B+

Chicago Midway Airport Privatization

- Accepted in October 2006 under FAA “pilot privatization program” as first major U.S. airport privatization
- Requires extensive analysis by City and bidders of potential growth in non-airline revenues: retail, restaurants, parking
- Bidders will be consortia of airport operators, financial groups, possibly real estate firms

TWO FORCES AT WORK

- Enormous need for funding for public infrastructure and other purposes—politicians don't want to raise taxes
- Enormously attractive U.S. infrastructure assets for which private investors will pay hundreds of millions of dollars

PRIVATIZED INFRASTRUCTURE WILL BECOME AS COMMON IN THE U.S. AS ELSEWHERE

- Now it *has* been done here
- Still requires political courage and skill—but gets easier
- Infrastructure funds have over \$100B available for U.S. investment
- Smart professionals, including real estate counselors, will help public entities and bidders take advantage of the opportunities