

# Structuring and Financing Public Private Deals with Government Sponsorship

June 25, 2013



# Structuring and Financing Public Private Deals with Government Sponsorship

## View of the Market Environment

### Macro / Systemic Risk Persists

- Eurozone uncertainty
- Weak global GDP growth
- Shadow banking system in China
- Central bank activism / asset value inflation

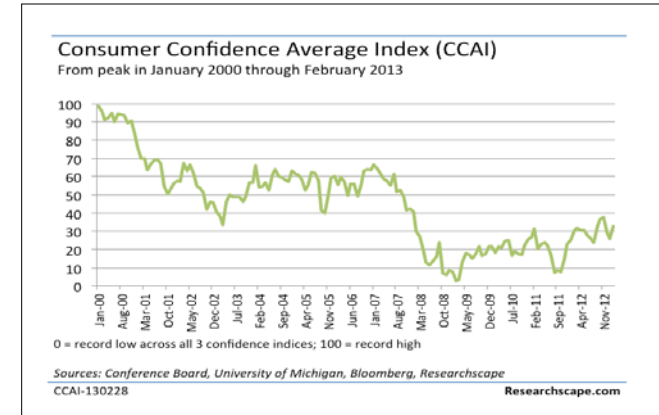
### Domestic Economy

- Divided Congress
- Mixed consumer and employment signals
- Fed options after QE3 ?
- Debt maturity “wall” remains
  - Potential for renewed capital markets dislocation

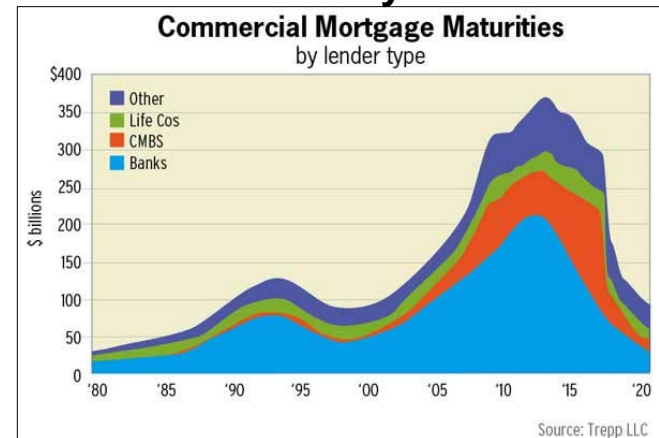
### Business / Tenant Factors

- Large cap record corporate cash balances
  - Favorable environment for consolidation / credit up-trend
  - Mitigant relative to future rate increases / margin pressure

### Consumer Confidence



### Debt Maturity “Wall”



# Structuring and Financing Public Private Deals with Government Sponsorship

## A Window of Opportunity

### Market Cycle is beginning to shift

- Excess systemic liquidity
- Fed-driven asset inflation...again
  - Divorcing of pricing from fundamentals
  - “Dash for trash” – *Financial Times*
- Global risk tolerance will change
- Benefits of reduced reliance on exit valuations
- Increasing focus on current cash returns

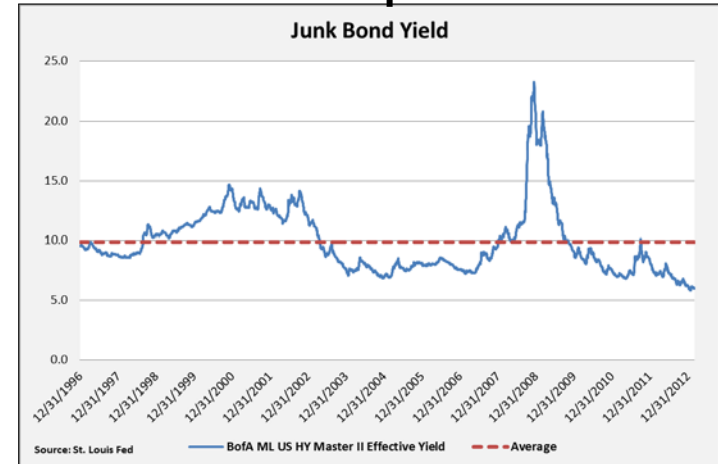
### Real Estate versus fixed income

- Attractive yield premium versus fixed income alternatives, both UST and corporate
- Less price sensitivity to interest rate movements
- Reduced volatility
- Stabilized assets are bond-like but produce significantly higher returns

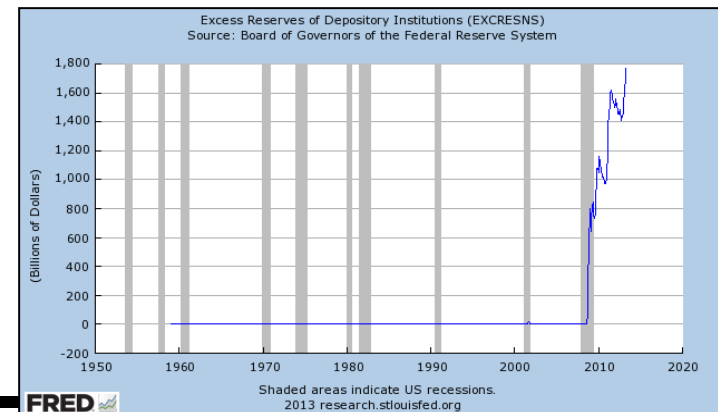
### Size / Type of Assets

- Challenges of Federal / GSA lease structures in an inflationary environment...

### Yield Compression



### Excess Bank Reserves



# Structuring and Financing Public Private Deals with Government Sponsorship

## Why Invest in Credit Leases Now ?

### Improving economic outlook

### Systemic expansion of credit

- Higher leverage on more favorable terms
- Attractive fixed rates
- Potential interest-only periods
- More favorable amortization options

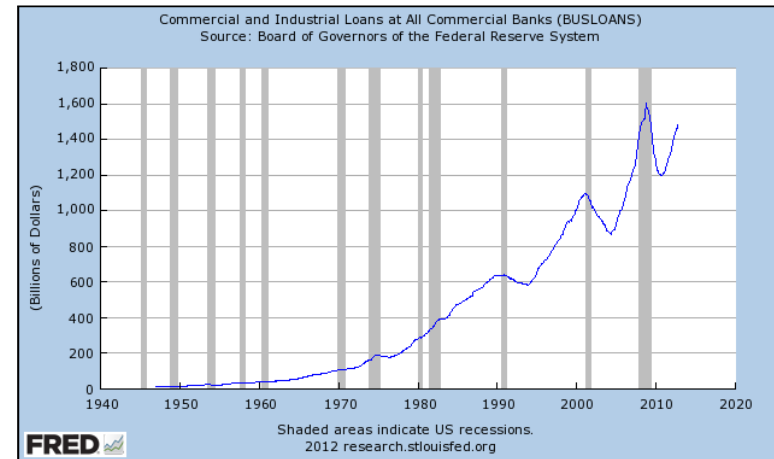
### Reduction in borrowing rates

- Improved arbitrage at the investment level
  - Higher total return *without* increased leverage

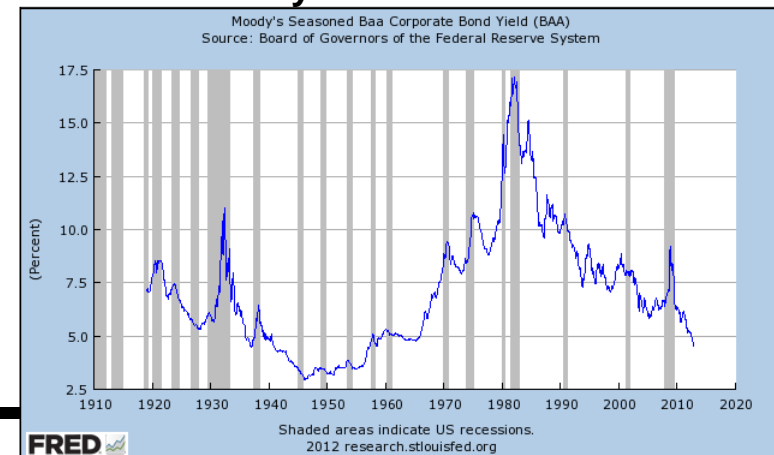
### Reduction in bond yields

- Improved real estate yield premium versus fixed income alternatives at lower volatility

### Commercial and Industrial Loans



### Moody's Seasoned Baa



# Structuring and Financing Public Private Deals with Government Sponsorship

## Federal Lease/Lease-back Transactions

---

- Public Private Development Projects involving Federal Agencies provide operating advantages and financial benefits that cannot be obtained with private sector tenants -
  - Certainty in lease duration, tenant operating requirements, and revenues
- However, these types of projects bring with them their own set of rules and issues which if not followed can result in project delays, additional cost run-ups, and failure.

The reason for the complexity is that these projects must operate in a way that comply with two distinct and often contradictory sets of financial and legal principles.

---

# Structuring and Financing Public Private Deals with Government Sponsorship

## Federal Lease/Lease-back Transactions

---

- Ground Lease
  - Lease-Back/Facility Use Agreement
  - Development Agreement
  - Management Agreements
  - Loan Documents
    - Bond Indenture, Loan Agreement, Leasehold Mortgage, Promissory Note, Assignment of Claims, SNDA, etc.
  - Monoline Policy
-

# Structuring and Financing Public Private Deals with Government Sponsorship

## Primary Legal Issues

---

- Bankruptcy Remoteness of Facility from Developer/Manager
  - Establishment of SPE
  - Reduced risk of rejection
- Mismatch between tenure of bonds and term of Lease-back/Facility Use Agreement
- Ability to replace Manager
- Pledge of collateral as a risk mitigant



**Central Utility Plant, Ft. Detrick, MD**

---

# Structuring and Financing Public Private Deals with Government Sponsorship

## Primary Credit Rating Issues

---

- Program/Project establishment & approval (is there formal approval of this program/project at highest levels of Government)
  - Authorization for contractual obligations (is there a clear authority and long history (15 + years) of using this authority for the contractual obligation)
  - Program/Project funding specification (is the federal cash flow within agency's overall budget or is a specific line item required)
  - Renewal & Reauthorization risk (is there renewal risk and if so, what is the nature of such risk)
-



# Structuring and Financing Public Private Deals with Government Sponsorship

## Primary Credit Rating Issues

---

- **Essentiality:** Geographic concentration and population impact (to what degree does project/program affect a large or small part of population)
  - **Local control of Federal cash flows** (does cash flow directly from federal entity to financing entity)
  - **Allotment Risk** (how dependent is cash flow upon operating performance thresholds)
-

# Structuring and Financing Public Private Deals with Government Sponsorship

## Federal Agency Issues

---

- Legal Authority for Transaction
- Bona Fide Agency Requirement
- A-94 Analysis
- Competitive Selection
- Environmental Review
- OMB A-11 Scoring



**VARO Atlanta, GA**

---

# Structuring and Financing Public Private Deals with Government Sponsorship

## Leasing Scoring Rules

---

- OMB Circular A-11, Appendix A & B
- Distinguish leases that effectively purchase the asset from leases that “use” the asset for a short period
- Criteria are based on private sector accounting standards for capital leases (Financial Accounting Standards Board standards and rules)



## Scoring “Budget Authority” for Government Leases

---

### Operating Lease.

- Obligate Budget Authority equal to 1 year lease payments plus termination liability

### Capital Leases.

- Obligate Budget Authority equal to PV of lease payments discounted using comparable Treasury rate
-

# Structuring and Financing Public Private Deals with Government Sponsorship

## Operating Lease

---

- PV of minimum annual payments don't exceed 90% of asset Fair Market Value, **and**
  - Lease term is not greater than 75% of the economic life of the asset, **and**
  - No bargain-price purchase option, **and**
  - Ownership of asset remains with lessor and is not transferred to the Government, **and**
  - Asset is a general purpose asset, not built for special purpose of the Government, **and**
  - Private sector market for the asset
-

# Structuring and Financing Public Private Deals with Government Sponsorship

## Lease Scoring Rules

---

- **90% of FMV Test**

Fair Market Value	\$20,000,000
Facility Use Agreement (FUA) Term	30 Years
Treasury Discount Rate	5.0%
Annual FUA Payments	\$1,301,029
Present Value of FUA Payments	\$20,000,000
As % of FMV	100%

- Present value of FUA payments exceeds 90% of the Fair Market Value of the asset
  - Therefore the FUA is a Capital Lease, and the EUL Transaction will be disapproved
-

# Structuring and Financing Public Private Deals with Government Sponsorship

## Lease Scoring Rules

---

- **90% of FMV Test (cont'd)**

Fair Market Value	\$20,000,000
Facility Use Agreement (FUA) Term	20 Years
Treasury Discount Rate	5.0%
Annual FUA Payments	\$1,301,029
Present Value of FUA Payments	\$16,213,693
As % of FMV	81%

- Present value of FUA payments is less than 90% of the Fair Market Value of the asset
  - As an Operating Lease, Agency obligates \$1,301,029 in each of the 20 years covered by the lease, plus termination liability.
-

# Structuring and Financing Public Private Deals with Government Sponsorship

## Alternative Structures

---

### Lease-Back Arrangements

- Projects on Government land are *presumed* to be for a special purpose of the Government.
- Government land leased to a “*totally non-Federal entity*” and leased-back will not be considered a Public/Private Partnership and *may* be an operating lease if the lease-back meets Operating Lease criteria.

### Public/Private Partnerships

- Leases from “Public/Private Partnerships” *are* capital leases.
  - Public/Private Partnerships are specifically defined -- if a partnership does not meet the defined test, the Agency assumes *all* of the partnerships obligations.
-



# Structuring and Financing Public Private Deals with Government Sponsorship

## Public/Private Partnership

---

Includes SPE wherein Federal entity is a beneficiary.

Must Have “**Substantial Private Participation**”

- Non-Federal partner has majority ownership of the partnership and revenues.
  - Non-Federal partner must contribute at least 20% of the total value of the assets owned by the partnership.
    - Total value includes Gov’t. contributions (except land)
    - Non-Gov’t. contributions can be cash, real assets and loans.
    - Government loans to Non-Federal partner do not count.
  - No Government guarantees of the project (i.e., higher rent if reduces space or rental guarantee).
-

Thank you