Prairie City Solutions
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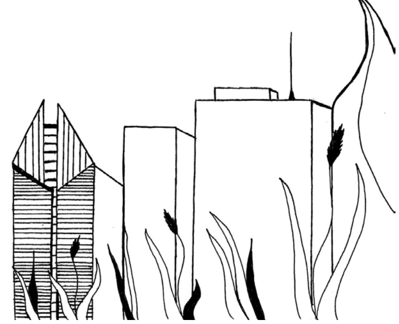


Social Infrastructure & Public Private Partnerships
A Whitepaper Presented to the
City of Chicago Department of Procurement Services

Introduction

From an urban planning and public policy perspective, one of the most compelling advantages of developing social infrastructure through the use of Public Private Partnerships (3P) is that 3P can bridge the disconnect between private sector capital, communities and the government entities tasked with economic development. 3P program management integrates the disparate initiatives designed to engage the private sector, and dramatically reduce the impact of costly public legislative delays, controversial condemnation proceedings and cumbersome public finance issuance. It can create projects that develop government destinations and municipal facilities into urban centers and valuable community assets. The best strategy for the use of 3P is one that provides for an equitable lifecycle partnership where public assets are leveraged to privately develop economically sustainable community facilities.

Sustainable Community Development

New social infrastructure development affords a Public Private Partnership with the unique opportunity to achieve the design of optimal revenue streams from inception, such as premium/upgrades, advertising and sponsorships, and ancillary commercial uses. It is possible through 3P to correlate the ultimate economic performance of an asset to the physical design of the facility. Many government entities have embraced the value of collaborating with private partners to generate capital and infrastructure improvements. Leveraging public assets to attract private investment is a superior solution to address today's economic realities, as opposed to strictly accomplishing the monetization of existing assets. When it comes to the development or renovation and repositioning of public assets, 3P recognizes that the silo-ization of development entities/disciplines results not only in costly delays but also in development and operational cost inefficiencies, and missed opportunities for sustainable revenue generating community development.

Leveraging Assets

Municipalities typically have an extensive capital program to continue to invest in and improve neighborhood facilities. Traditionally, demands exceed funding capacity - choices must be made and priorities decided. With traditional public sector development delivery, the risk and cost of maintaining new assets stays with the municipality, and today's capital deployment creates tomorrow's maintenance liability. 3P accomplishes a fundamental shift in that paradigm in that real estate development, which is viewed as expenditure by the public sector, is valued as an investment by the private sector. And the 3P method of development/renovation, management, financing and use of public assets can leverage private sector innovation and efficiencies to accelerate the delivery of public sector capital projects. A 3P development strategy will also have a significant beneficial impact on social service standards because physical outputs will be of the highest quality; there will be delivery in greater numbers; and demonstrable lifecycle cost savings will be realized for the municipality.

With 3P there is no reason that a lack of public funding should limit investment in critical infrastructure. Instead of financing infrastructure projects alone, the government can develop real assets in cooperation with private investors. 3P can be a more fiscally responsible choice for government leaders, and in fact - the competitive tendering of public works is steadily migrating toward a more market-oriented approach. 3P affords government bodies the ability to contract private sector management concepts that can achieve a more cost-effective provision of public facilities. Increased use of 3P strategies will result in a shift away from a role of the government as "producer" towards one as "quality assurer", and move communities away from collective, tax-based financing of infrastructure toward a financing model in which infrastructure is paid for by its users or by the direct economic benefit which it creates.

Public Private Partnership is Not Privatization

3P enables public authorities to build the facilities they need without the upfront cost of traditional procurement. It also creates long term risk transfer to the private partner, who will be required to guarantee the performance of the facilities over the contract term. In availability-based 3P the public client awards a franchise to a private partner to design, build, finance and maintain (DBFM) a project for a concession period. The private partner receives availability payments (related to whether rooms and facilities are available for use for the purpose intended) and service payments (related to the quality of service provided by contracted staff). These payments are spread over the contract duration and are subject to deductions for non-availability of any part of the facility, or failure to meet performance requirements.

The private partner bears the revenue risk that the pre-defined payments will be sufficient to pay for the underlying project costs over the concession life; including construction costs, finance repayment commitments, operating expenses; and provide a reasonable return on the investment. All costs are defined by the equity sponsors, funders and subcontractors, and are then processed through an open-book financial model. The model applies project costs and revenues over time to determine the availability and service revenue required to pay the project costs and achieve the required return on investment.

The Partnership Agreement between the parties is complex and will involve numerous documents since there is a private financing dimension to the project. It involves much more than a design and a construction agreement, and the partners must be able to agree on how to share the project risk. The partners must negotiate and agree on "The Deal." The roles and responsibilities of the partners must be clear and complete for both sides and must be reduced to writing. There will be opposition from various interest groups who see the 3P as an infringement on their normal rights and responsibilities, and there must be a strong political champion willing to work with these groups to mitigate their concerns.

Expertise Driven Delivery

Educators and social service providers are recognizing the value of a safe, clean facility and what that can mean to their success in expanding opportunities for their clients. Our goal is to allow these service providers to focus on their core mission. Toward this end, a 3P entity can design, build and finance new facilities and accomplish renovations to existing assets as needed by any given government entity. Many municipalities have already realized that traditional public development and finance is not the only way to meet expansion needs, and that the process of building new facilities and/or refurbishing existing facilities can be overwhelming and resource intensive. 3P can make the delivery of turn-key development a palatable one; and can help the public sector achieve their goals.

With 3P the ownership of the project is shared and the goal of 3P program management is the equitable sharing of risks and benefits. The public sector does not need to allocate experts of its own for the implementation of the project, and therefore the government agency can concentrate on its core competencies, while the private sector develops the critically needed capital improvements and upgrades that the government and its constituents want. Once a government agency has identified the facility need, a special purpose entity would be created to represent the partnership, and a team will be assembled to execute the project. The team is tailored to cover all the disciplines and expertise necessary to deliver the project and a solid project scope should be developed by these experts in conjunction with the government agency. There must be no question as to the project scope in terms of its project performance requirements; because the private financing requires the government's willingness to enter into a long-term agreement to take the product provided by the partnership and to pay for it.

Program Management

A design, build, finance and maintain model binds the interests of each party to the benefit of the taxpayer, and the private partners will not only be required to make substantial equity investments, but also will be tasked with providing the program management for the project(s). While there is no "model" of a "standard" 3P, a multi-phased program build out can be crafted and considered where standalone partnerships consider the parameters of each project, i.e., whether it is new construction or rehabilitation, one facility or a bundle of a three, etc. Identification of locations where the development of facilities are desired and the suitable sites for the development will be analyzed and appropriate development scenarios will be undertaken within the parameters of zoning and land use and community context and input.

For each project, the team will begin with the creation of conceptual plans for the facility and an estimate of construction costs will be prepared as well as a comprehensive development budget for financing, design, and construction. Then the potential financial feasibility will be undertaken; the government entity will be presented with a summary of the financial analysis and a term sheet which outlines the general principles of an agreement for the development of the facility. This document will include initial parameters for the construction and a subsequent long term lease arrangement with provisions for management and maintenance of the facility. From inception through completion the private sector will be responsible for the following development activities.

- Project Delivery Parameters
- Budget, Cost and Schedule
- Identify Programmatic Requirements
- Context Sensitive Design
- High Quality, Maintainable, Durable Construction
- Proactive Public Information
- Financial Model and Term Sheet

- Financing
- Planning Analysis of Geographic Location for Development Project
- Conceptual Site Plan
- 3P Proof – Risk and Feasibility Analysis
- Obtain All Required Permits
- Construction Operation Plan

3P not only enables the integrated design, build, ownership and maintenance of critically needed social infrastructure, but also can incentivize complementary mixed-use private development; all delivered with a build-to-suit, "concept to ribbon cutting" development entity. 3P offers a unique blend of financing, design and development services to clients in the public sector by delivering holistic real estate projects; integrating public and private resources and uses.

3P program management creates government use facilities as a component of a mixed-use project, in which private sector commercial, residential, and retail facilities are all provided in a single location or on nearby or adjacent properties. This is accomplished through the coordination of private sector capital and techniques in tandem with government land use and planning expertise, delivering comprehensive real estate and infrastructure projects. This coordination provides several important advantages, flexible funding and leasing structures, development and construction efficiencies, and superior asset management and repositioning strategies.

Lifecycle Benefits of Public Private Partnerships

In the best 3P structure – real risk is born by the private partner, specifically that the pre-defined availability payments will be sufficient to pay for the underlying project costs over the concession life; including construction costs, finance repayment commitments, operating and maintenance expenses; and the provision of a reasonable return on the investment. That is what ultimately constitutes the lifecycle benefit to the public sector. The factors to be considered in the Value for Money proposition are Cost of Capital, Design/Build, Operations and Maintenance and Economic Development.

Cost of Capital

The infusion of private sector capital will enable projects to occur that would otherwise not have been financially feasible. By reducing the burden of the upfront capital requirement and spreading the payback over a longer term, access to this financing becomes a critical advantage. For example, if the 3P entity can bring fifty facilities online in the next few years as opposed to delaying that delivery over several decades, that represents a significant cost savings in terms of the predictable escalation of construction costs.

At prima facie, the cost of capital for the private sector is not less expensive than public financing, but it is offset by many other efficiencies, and it can be competitive when tax advantaged vehicles (tax-exempt and tax credit bonds) are made available to the private sector. We believe that any 3P agreement should show “whole life” cost benefits relative to a public sector comparator, irrespective of the private sector are cost of capital. Providing a subsidized tax-advantage alternative to the private sector only further enhances the 3P benefits.

Design/Build

Privately managed Design/Build will save time and money. Cost savings will be seen due to efficiencies in building projects simultaneously, which creates savings in many aspects of the process including design, program management tasks, procurement of construction materials, labor, and commissioning.

Private sector development practices can also emphasize upscale amenities and deliver specific environmental design features that can affect the engagement and attainment of clientele. Lighting, positive outdoor spaces, color contrast walls and high ceilings, temperature (heating and cooling) efficiencies, and superior acoustics are typical enhancements that the market conscious private sector will implement.

The opportunity to “Rebrand” or “Reposition” public facilities can also enhance the overall project environment. The private sector can redevelop public spaces with completely new imagery and messaging. The value of branding that effectively differentiates you from your competition or past difficulties have never been higher. The private sector can re-position the municipal brand and assist the government in bridging the gap between where you are and where you want to be.

Operations and Maintenance

Operations and maintenance will no longer be a direct cost for the government agency under the 3P delivery method but will be part of the annual service payment. Overall, operations and maintenance will be better than the status quo of deferred or backlog maintenance, which creates a better environment for the community clientele. Operating efficiencies can be obtained through central management functions, central helpdesks and enhanced productivity.

A public sector entity may be able to leverage the 3P method of paying for new capital investment by taking advantage of "off balance sheet" borrowing. By saving money in O/M it can shift that savings into capital investment. In this way, paying for capital improvements with O/M dollars the public sector partner is moving the cost of infrastructure to their O/M expenses. Any justification for 3P in this sense rests on the way in which government agency accounts for the money that it borrows and how it spends those funds.

Economic Development

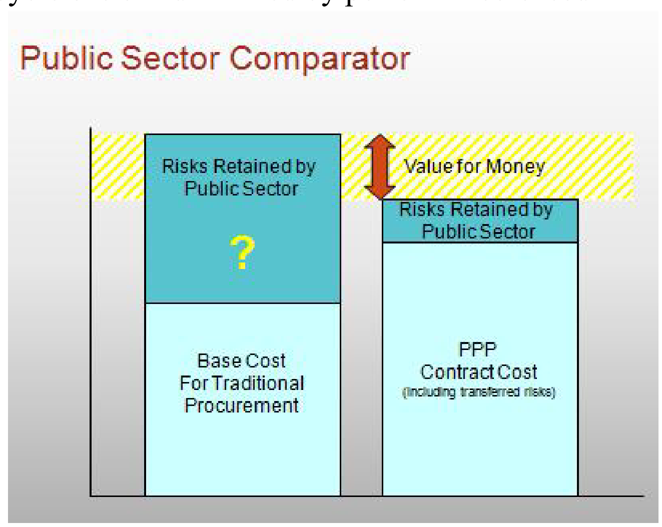
3Ps in many jurisdictions are linked to a mechanism which unlocks additional funding for social infrastructure improvements. If a municipality can make a well-founded business case for a 3P gain, access to additional government or philanthropic subsidies, over and above their usual funding sources, may be obtained. Ideally, the state or federal government would make additional funds available - contingent on bringing a successful 3P project to the market.

When appropriate, a mixed-use community facility can mean extended revenue for the project and the municipality. The government destination market may also include private education partners, child and adult daycare, and a great variety of ancillary retail uses. The private sector sees no barriers government centers and commercial opportunities; it is just one big market, with opportunities for the generation of additional income. A governance board can be set-up with the government agency and any profits obtained would be used to enhance the project and/or provide for additional facilities.

On a higher level, The Educational Construction Fund (ECF) in New York City builds mixed use real estate projects which *feature* new schools. It uses rents and other payments from the non-school portion to finance the construction of the school. This fusion of private and public sector capital delivers non-revenue producing assets in conjunction with uses that produce long term economic and community development for the municipality. This model is attractive to the private sector because infrastructure assets generate stable, inflation-protected returns that shield the investor from the market volatility of the private uses.

Value for Money

The value for money of 3P is calculated on a life cycle basis and attained by performance-based project development and long-term lower cost guarantees. Experience has proven that there are benefits in transferring long-term maintenance risks to the private sector that produce positive results practically and monetarily. The private partner must ensure compliance with the specification laid down by the client; and since payment is linked to key performance indicators, failure to perform to specification will lead to payment deductions, and ultimately termination of the concession.



Because of the long term, fixed cost nature of 3P, it results in complex contract documentation which must identify and deal with issues arising over the 25–30-year period, allocating risk in line with ability to control, to provide best value for money to the public authority. The private sector partner agrees to the following key features and contractual relationships:

- Owned by the equity Shareholders through a holding company
- Enters into the Project Agreement with the Authority
- Enters into the loan note subscriptions with the subordinated debt providers
- Enters into the financing agreements with the senior funders
- Enters into a Design Build contract for school construction scope
- Enters into an Operation contract for school Operation and Maintenance scope
- Typically assumes inflation risk
- Typically assumes lifecycle renewal risk

The 3P entity will include banks to provide the senior debt and other investors to provide additional shareholder equity, a Design/Build contractor, and Operation and Maintenance (O&M) providers. Public agencies and community clientele would like their facilities to remain in 'like new' condition now and in the future. Asset managers understand the benefits of planned preventative maintenance and renewal, as this minimizes the need for costly unforeseen capital repairs. Administrators want stable, predictable long-term costs of ownership to facilitate budget planning.

The architectural and design requirements are typically procured directly by subcontractors to the Design/Build contractor. The 3P entity and its lenders ensure that the Design/Build contractor provides a suitable security package guaranteeing the performance of the obligations of the Design/Build contract, and in turn the 3P entity and lenders guarantee to fulfill the obligations to the public authority. Typically, the 3P entity would engage a single source planned and reactive maintenance contractor for the project and that contractor would be able to subcontract to specialist trades as appropriate to provide the following scope of services.

Reactive and planned maintenance of all aspects of the facility

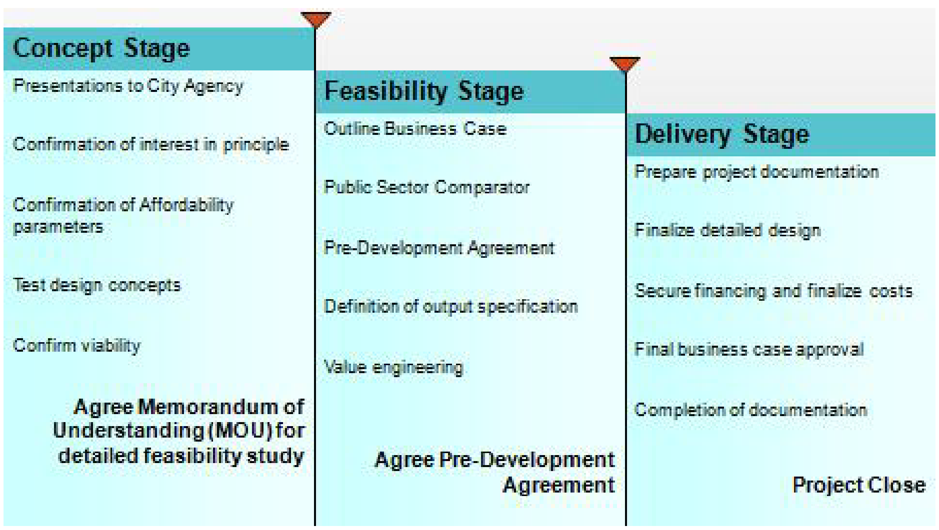
- Building maintenance
- Systems (all mechanical and electrical services, building management system, HVAC)
- Grounds maintenance and Window cleaning

Reactive Maintenance: offsite helpdesk system operating on a callout basis

- 24-hour offsite telephone helpdesk
- 1 hour response time for urgent incidents, key holder attendance etc.
- 2-hour response during school hours
- 24 hours for 'out of hours' non urgent

Planned Maintenance: all periodic inspections, interventions, replacements of consumables, landscape maintenance, window cleaning, and routine servicing in line with industry standard service intervals.

Implementation Strategy



The 3P entity would let out a long-term fixed price contract with allowance for labor, subcontract and material inflation and the contractor would need to accept the performance deduction system. The monthly payments would be reduced in case of failure to meet key performance indicators on things like rectification times, and a 'ratchet' mechanism would be established and linked to repeated failure to meet standards. The contractor would also need to accept an element of payment deduction if an area of the school is unavailable due to a failure on the part of the contractor. Operations to remain outside of the scope would normally include utility supply waste disposal, security and janitorial.

The goal of 3P is to execute an expedient solution that maximizes the benefits of innovative thinking and planning and secures the best offers from the marketplace. Above is a framework that can facilitate a Comprehensive Development Agreement (CDA). Interim agreements prior to the CDA include: a Memorandum of Understanding (MOU) which contains an expected program, cost, finance plan, and schedule and an Agreement in Principle (AIP) outlining the expected deal subject to approval by various financing partners and legislative entities.

The 3P entity often commits to advance almost all the cost of the pre-development work in exchange for exclusive negotiating rights to implement the project if it proves to be feasible. There is often a provision for payments to the 3P entity for its initial feasibility work in the event that the project does not move forward. Ultimately though, this process will culminate with a final agreement for a not-to-exceed price for the design, financing and construction of the project.

Many government agencies have legislation which enables them to utilize alternative delivery approaches for the CIP, and the City of Chicago has recently established the, the Asset Lease Agreement Disclosure ordinance. There is a precedent nationwide for a 3P project to be proposed in conjunction with a Comprehensive Development Agreement (CDA). This strategy allows for an unsolicited proposal to be accepted, a program to be developed, and the project to be pushed out to the marketplace for competitive bidding. It would work like this:

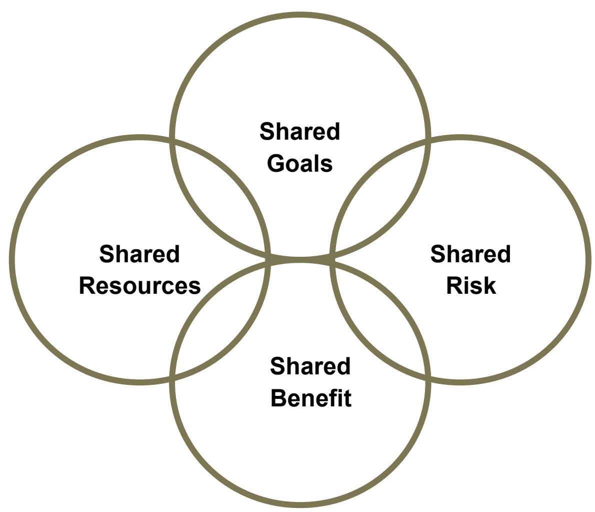
- The proposer commits to advance the cost of preliminary feasibility work once a memorandum of understanding has been reached with regards to the parameters of the project.
- The proposer is granted exclusive negotiating rights to implement the project if it proves to be feasible, and a stipend would be owed if the project does not move forward.

- Ideally, this process will culminate with a final agreement for the design, build, own and operate development of the new and renovated portfolio of facilities.
- Competitive bidding happens at the time of award, once a fixed price, fixed schedule agreement with all risks is defined and agreed upon.
- At that point, the 3P entity will be bidding the physical work to trades and suppliers etc. to ensure that a competitive bid can be submitted, no different from any other competitive bid situation.
- Once the 3P entity achieves a financial close, the government agency will not be involved in any subsequent bidding process of individual projects that the project may undertake.

Conclusion

The business model is to create partnerships that will finance, design and develop critically needed municipal facilities and complementary mixed-use private development; all delivered by a build-to-suit, "concept to ribbon cutting" development entity. The 3P entity brings expertise that is the purview of the private sector as follows, to accelerate and enhance the delivery of social infrastructure projects.

Access to Capital - Equity, Debt and Incentive Financing



Planning & Development Capacity – Specialized Government Properties Experience

Real Estate Professionals - Market Assessment, Design, Construction and Management

Best "Value for Money" - Increased Capacity and Predictable Revenue for the Municipality

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3P development can take under-utilized government assets and create better facilities to compliment a community. 3P accomplishes comprehensive community development through aligned interests with government entities to pursue a commonly shared goal, and to share risks and benefits. With 3P, the ownership of the project is shared, and there is also a sharing of risks and profits. The public sector does not need to allocate experts of its own for the implementation of the project and compared to providing the service directly, in a 3P - the government agency can concentrate on its core competences. This allows government to provide services rather than bear the responsibility for creating and maintaining the built environment.