Landmark PPP to reduce congestion in North Carolina, US

By Matthew Gill, KPMG in the US

This innovative 650 million US dollar (US$) initiative enables the state transportation authority to carry out much-needed enhancements to a major commuter route. At a time in the market of limited appetite for revenue risk, the transaction strikes an excellent deal for North Carolina's taxpayers and balances the risk for developers and lenders.

In the state's first ever infrastructure public-private partnership (PPP), North Carolina is to add new lanes to a notoriously crowded section of highway.

Traffic congestion on the I-77 corridor has made daily commuting a misery for thousands of workers around the city of Charlotte. Continued population increases will only worsen the situation. In response, the North Carolina Department of Transportation (NCDOT) has chosen a long-term solution to widen a 26-mile (42-kilometer (km)) stretch of road, adding dynamically-priced express lanes in each direction. Drivers that pay tolls to switch to the express lanes will enjoy shorter journey times, which should also reduce traffic on the existing general-purpose lanes. Public buses and vehicles with three or more occupants can use the express lanes for free.

A private developer was sought to manage the project design, construction, finance, operation and maintenance, and take revenue risk over a 50-year concession. The road is expected to be ready in less than four years; with state funding alone the timing would be more like 20 years. After initial interest from four consortia, the final contract was awarded to Spanish engineering and construction giant Cintra.

Although PPPs are growing in popularity in the US, a number of high profile deals have hit problems due to toll revenue failing to meet forecasts, leaving developers unable to keep up with debt repayments and in some cases leading to bankruptcy. This has made lenders, developers, public authorities and citizens nervous of such partnerships.

What sets the I-77 transaction apart from previous PPPs is the innovative financial structuring, designed to minimize the cost to the NCDOT while mitigating risk to lenders.

In order to hedge against revenue shortfalls, revenue-risk PPPs have historically included a ramp-up reserve, funded prior to commencement of operations. Should early revenues come in on target, however, the ramp-up reserve – initially funded by a mix of debt, equity, and public subsidy – can typically be released to the developer, which is not always an ideal arrangement for lenders and public authorities.

For the I-77 project, NCDOT decided to take a different approach. Rather than increase the upfront public contribution to fund a ramp-up reserve, NCDOT established an innovative contingent, credit enhancement facility. If toll revenue is insufficient to fully fund operations and maintenance costs and scheduled debt service, the developer may request additional

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public funds from NCDOT to make up the shortfall – up to a maximum of US$12 million per year and US$75 million in aggregate.

This new approach to revenue risk mitigation proved a big hit with lenders and rating agencies, with the initial senior bonds being oversubscribed by five times. Such a level of interest is especially impressive, given the aforementioned difficulties experienced with other, similar projects. Throw in the fact that Charlotte is not a region accustomed to paying road tolls, and this is a major vote of confidence in the transaction, which bodes well for the chances of creating a robust pipeline of PPP projects in North Carolina.

Financial close for this landmark deal was announced on 20 May 2015 and completion of the road is scheduled for 2018. PPPs have not always enjoyed an easy ride from public authorities, the media, lenders and the public. However, the sight of a free-flowing highway achieved at a favorable cost could do much to ease concerns, and set the tone for much-needed private finance initiatives to bring the US's creaking infrastructure into the twenty-first century.

The historic I-77 highway deal at a glance

- Total cost: US$648 million
- Upfront cost to North Carolina Department of Transportation: (NCDOT) US$95 million
- Maximum additional cost to NCDOT: US$75 million (contingent on revenue performance)
- Equity investment by developer: US$248 million: lowest ever gearing for a US PPP
- Construction period: 3.5 years

Lessons learned for future infrastructure PPPs

- Achieve a deal structure that:
  - reassures lenders that they will be repaid even if revenue is below forecast
  - gives transportation authorities greater certainty over the total cost
  - reassures developers that they can raise sufficient debt – and receive adequate financial support in the event that revenues take longer than anticipated to materialize
- Engage with local citizens, businesses and public institutions, to show how private finance can resolve infrastructure challenges swiftly and thoroughly; whereas public money alone typically leads to piecemeal change due to budget constraints

KPMG's role

As financial advisor to NCDOT, KPMG in the US helped structure this breakthrough deal. Their experience with PPPs across the US and internationally was invaluable, in particular their ability to consider the needs of all the various stakeholders – citizens, state authorities, lenders and developers – and spread the cost and the risk efficiently and fairly.

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