LARGEST GREENFIELD US TOLL ROAD

THE US PUBLIC-PRIVATE PARTNERSHIP (P3) MARKET ACHIEVED ANOTHER HALLMARK MILESTONE IN NOVEMBER OF 2017 WITH THE CLOSING OF THE TRANSFORM 66 OUTSIDE THE BELTWAY MANAGED LANES P3 PROJECT. BY ENERGY AND INFRASTRUCTURE PROJECTS COUNSEL JOSHUA NICKERSON AND ASSOCIATES JOSHUA GOLDMAN AND MATTHEW VITORLA, SKADDEN ARPS SLATE MEAGHER & FLOM LLP.

With total project costs of more than US$3.7bn, the project is the largest ever greenfield toll road P3 in the United States and features the largest loan ever awarded to a P3 project under the US Department of Transportation's Transportation Infrastructure Finance and Innovation Act (TIFIA) lending programme, which supports most large-scale P3 projects in the US.

The project is the first P3 delivered under Virginia's modified rules for identifying and approving P3 projects. Those modifications represent a success and a template for other states, as the project provides the most significant financial contribution to regional transportation development of any greenfield P3 in the US to-date.

The project will be developed, financed, built, operated and maintained by I-66 Express Mobility Partners LLC (EMP), a consortium led by Cintra and including Meridiam, John Laing and Dutch pension fund APG Groep that was selected by the Virginia Department of Transportation (VDOT) pursuant to a competitive bidding process.

Project overview

Stretching 22 miles west from the I-495 Capital Beltway in Fairfax County to US-29 in Prince William County, the project will consist of two new dynamically tolled high occupancy toll (HOT) managed lanes in each direction, adjacent to the existing three non-tolled general purpose lanes in each direction, and dedicated express lane access points. Median space will be reserved for potential future mass transit projects.

In addition to the managed lanes, the project includes safety and operational improvements at key interchanges along I-66, as well as enhanced park-and-ride facilities – including 4,000 park-and-ride spaces – and bus rapid transit services on the I-66 corridor. The project will address major traffic congestion problems in Northern Virginia, one of the most highly-trafficked corridors in the US.

Project chronology

Environmental evaluation and permitting under the National Environmental Policy Act commenced in 2011 and was completed in early 2016. VDOT issued draft and final RFQs in August and September of 2015 in a unique procurement process through which bidders were invited to submit qualifications for three alternative transaction structures: design build finance operate and maintain (DBFOM), design build operate and maintain (DBOM), and design build with alternative technical concepts (DB-ATC).

After shortlisting bidders in each category in October 2015, VDOT requested conceptual financial proposals from the bidders for each project delivery type. Based on responses to this request, VDOT decided to pursue the project as a privately financed P3 concession, ie DBFOM, rather than a publicly financed project with competitively bid private sector involvement in the design, build and operational phases, ie DBOM or DB-ATC.

After selecting the DBFOM approach, VDOT issued its initial draft RFP in December 2015 to the three bidding consortia that submitted full DBFOM conceptual financial proposals. Throughout the first half of 2016, VDOT engaged with the USDOT's Build America Bureau and its advisors to negotiate an indicative term sheet for a TIFIA loan, which incorporated input from the bidders and served as a basis for the bidders' financial proposals.

VDOT issued the final RFP in late July 2016 and established an early September 2016 deadline for technical bids and a mid-October deadline for financial bids. EMP emerged as the preferred bidder and VDOT issued its public announcement in November 2016.

One key to EMP's successful bid was its decision not only to forgo the up to US$600m of public sector support offered in VDOT's RFP but to also propose an upfront concession fee

> VDOT issued the final RFP in late July 2016 and established a September deadline for technical bids and mid-October deadline for financial bids

of at least US$500m. Following a month of kick off meetings and preliminary interface between EMP, prospective bond underwriters and the Build America Bureau, commercial close on the concession agreement and execution of the design-build contract was achieved on December 8 2016.

During the eleven months between commercial close and financial close, EMP, VDOT and the financing teams worked diligently to address modelling and risk allocation issues resulting from the inclusion of a substantial concession fee and the absence of risk sharing by the state in connection with toll free high occupancy vehicle (HOV) ridership.

The TIFIA loan closed on November 7 2017, followed shortly thereafter by financial close for the offering of senior lien private activity bonds on November 9 2017. Official groundbreaking for the project took place on November 20 2017 and initial construction is expected to begin in the first quarter of 2018.

VDOT and P3 in Virginia

Virginia has a well-deserved reputation as a leader in the US P3 market. Ever since becoming one of the first states to adopt P3 legislation in 1995, Virginia has consistently promoted P3 transactions across administrations from both major political parties and in diverse geographic areas within the state. No other state has brought as many transportation P3 transactions to closing as has Virginia. This success is in large part due to the leadership teams within VDOT and its Office of Public-Private Partnerships, better known as VAP3.

But this is not to say that P3s in Virginia have proceeded without controversy or political reaction. The Elizabeth River Tunnels P3 in south-eastern Virginia, which reached financial close in 2013, attracted negative publicity for high toll rates charged to low-income drivers, which ultimately led to state financial contributions to the concessionaire in order to buy down toll rates for consumers. In 2015, Virginia was forced to cancel a P3 for state highway route 460, and pay off bonds that had been issued by the concessionaire, because the project was unable to obtain a required permit from the US Army Corps of Engineers.

This misstep, and the perception that a more thorough and transparent vetting process would have avoided the financial loss, lead Virginia's state legislature to pass amendments to the Public-Private Transportation Act, the 2015 PPTA Amendments, that strengthened the procedures for identifying and qualifying P3 transactions and, in so doing, achieved a delicate balance between injecting greater public and legislative oversight during the project selection phase while at the same time protecting approved P3 projects from undue political interference.

The I-66 project was the first P3 procured after passage of the 2015 PPTA Amendments, although certain steps were taken under then existing guidelines that preceded changes introduced by the 2015 PPTA Amendments.

Before 2016, P3s in Virginia were primarily based on unsolicited offers and bilateral negotiations between VDOT and the offeror. The 2015 PPTA Amendments introduced a required public tender process and also a preliminary "finding of public interest" to approve the project for delivery under the PPTA – whether as a DBFOM, DBOM, DB+ATC or other type of transaction with P3 attributes.

The finding of public interest must be issued by the granting authority, concurred by the state Secretary of Transportation and concurred by a PPTA Steering Committee that consists of representatives from VDOT, the Commonwealth Transportation Board, which oversees VDOT, representatives from both state legislative bodies, the House of Delegates and the Senate, and a non-government public financial expert selected by the Secretary of Transportation.

Each of these steps must be completed before the responsible public agency may issue a formal RFQ. After receiving qualifications, the responsible public agency determines the preferred project delivery model, which must be approved by the PPTA Steering Committee following a public meeting.

After PPTA Steering Committee approval of the project delivery model, the responsible public agency may issue an RFP and proceed with the procurement without further legislative involvement, so long as the responsible public agency makes a certification to the governor and the legislature prior to execution of the concession agreement that the risk allocation approved in the finding of public interest has not materially changed.

> The 2015 PPTA Amendments introduced a required public tender process and also a preliminary "finding of public interest" to approve the project

The developer

EMP is owned by a consortium that initially consisted of Spanish infrastructure developer Cintra and French infrastructure investment firm Meridiam. At commercial close in December of 2016 the two held equal ownership of EMP. Meridiam subsequently sold interests in EMP to Dutch pension fund manager APG and UK infrastructure developer John Laing, resulting in the following ownership structure at financial close: Cintra (50%), Meridiam (26.7%), APG (13.3%) and John Laing (10%).

Before leading this group, Cintra has developed a number of other infrastructure P3 projects in North America, including the Interstate 77 Express Lanes Project in North Carolina (with John Laing), the LBJ Express toll project in Texas with Meridiam and APG, the North Tarrant Express project in Texas with Meridiam and a series of projects in connection with Highway 407 in Ontario, Canada. Meridiam has also invested in several P3 projects in the United States since 2009, including the Purple Line Light Rail in Maryland and the Port of Miami Tunnel in Florida.

The concession agreement

EMP and VDOT entered into a 50-year concession agreement in December 2016. The agreement grants EMP the right to set and collect tolls for the new managed express lanes and allocates all revenue risk associated with the express lanes to EMP. The project will feature dynamic tolling with time-of-day pricing, subject to continual adjustment to maintain free flowing traffic levels, similar to the nearby managed lane projects on I-495 and I-95.

The agreement does not stipulate or impose regulation on toll rates beyond a requirement that toll rates for vehicles with three or more axles must be at least five times the toll rates for two-axle vehicles during peak travel periods, and at least three times such rates at other times. The concession agreement also includes minimum operating speed performance standard (OSPS) requirements to maintain free traffic flow, which can indirectly influence toll rates.

As a result of the competitive RFP process, the concession agreement contains many provisions that are highly favourable to the state. For example, the agreement requires no financial contribution from the state – other than a short-term, approximately US$30m working capital loan from Virginia's transportation infrastructure bank and risk-sharing of right of way acquisition cost overruns – and provides several financial benefits to VDOT that have not ben factored into prior concession agreements in Virginia.

First, EMP has paid VDOT a concession fee of US$578,919,450. Second, EMP has committed to pay a series of scheduled "Transit Funding Payments" during the construction and operation phases that have a current net present value of approximately US$800m.

Third, EMP will make "Support for Corridor Improvements" payments totalling US$350m, which will be invested into regional transportation projects by the Northern Virginia Transportation Authority. Fourth, subject to achieving certain favourable gross revenue targets, EMP will make annual revenue-sharing payments to VDOT.

This is the first P3 concession agreement in Virginia that does not obligate VDOT to subsidise the developer based on HOV penetration. Moreover, the elimination of direct public financial support and the addition of a concession fee represent significant positive changes from VDOT's original assumptions reflected in the final RFP, which assumed a public contribution of up to US$600m.

The concession agreement imposes liquidated damages for unexcused delays in achieving final project completion and also delays in achieving two intermediate milestones, one the construction of approximately 960 park-and-ride spaces, the other a set of improvements to, and elimination of, traffic signals on Route 28 at and near the interchange with I-66. Liquidated damages are also assessed in the extent of unexcused lane closures, which escalate based on the duration and location of the closure.

The concession agreement features a detailed non-compliance point system, which measures the occurrence and magnitude of performance shortfalls during the construction and operations periods. The system covers a broad range of performance categories – eg safety, environmental compliance, traffic operations, etc – and assesses different levels of non-compliance points and corresponding fines depending on the severity and duration of the shortfalls.

The construction and operations periods have separate sets of non-compliance point thresholds – measured on a rolling 365-day basis and on a point in time basis – for advanced monitoring by VDOT, implementation of a remediation plan, and default. By accumulating non-compliance points, EMP may incur financial penalties and trigger other consequences including increased monitoring, remediation plans and termination for default.

The concession agreement also includes provisions regarding delay and compensation events, including limited compensation for certain competing facilities, ie additional general purpose lanes on I-66 within the project corridor and, for approximately the first 10 years of revenue operation, the extension of the Washington DC area metro transit system in the project corridor. Compensation payments to EMP are subject to appropriation by the Virginia legislature and allocation by the state's transportation board, which oversees VDOT.

EMP is responsible for the cost of acquiring all necessary rights of way, subject to cost-sharing with VDOT of certain cost overruns. VDOT is responsible for administering the acquisition or condemnation of the rights of way. The concession agreement includes detailed technical and funding requirements related to life-cycle maintenance and project condition at the time of handback at the end of the term. It is expected that EMP will self-perform operation and maintenance of the project.

Design and build

The design build contractor for the project is FAM Construction LLC, a joint venture between Cintra affiliate Ferrovial Agromán (70%) and Allan Myers (30%), a leading regional civil construction company. The design build contract (DB contract) is a fixed-price contract that provides for the design, engineering, procurement and construction of all elements of the project required under the concession agreement, except for the toll collection system and the intelligent transportation system facilities, which EMP will procure separately as project construction reaches nearer to substantial completion.

The design build contractor will perform EMP's design and construction related obligations under the concession agreement on essentially a pass-through basis and grants to the design build contractor the ability to enforce certain of EMP's rights under the concession agreement that relate to project construction.

Performance security under the DB contract includes a US$750m performance bond, effective for a five-year tail after substantial completion, and a US$750m payment bond remaining in place for a year after substantial completion, as required by the concession agreement, parent guarantees from Ferrovial and Allan Myers, and retainage up to a specified dollar amount, subject to release upon commencement of revenue service. The DB contract also provides for liquidated damages to cover EMP's exposure to damages under the concession agreement for delay in completing the project and completing the intermediate milestones identified in the concession agreement. The current construction schedule anticipates opening of the managed lanes to traffic in late 2022.

Financing

The project's financing package consists of a US$1.23bn TIFIA loan from the US Department of Transportation, US$737m in senior lien non-recourse private activity bonds (PABs) issued by the Virginia Small Business Financing Authority, and US$1.52bn in equity commitments from the project's equity investors, resulting in a gearing ratio of approximately 56:44.

Merrill Lynch Pierce Fenner & Smith Incorporated and Citigroup Global Markets Inc acted as underwriters for the PABs, which received a BBB rating from Fitch and a Baa3 rating from Moody's. The offering consists of four bond tranches, each with different year-end maturity dates and yields: 2047, 3.71% yield, 2049, 3.79%, 2052, 3.9% and 2056, 4%. EMP has optional early redemption rights on each of the bonds beginning on June 30 2027.

The TIFIA Loan bears interest at 2.8% and matures on June 30 2057 or, if earlier, the June 30 or December 31 that precedes the 35th anniversary of substantial completion. The TIFIA loan has a capitalised interest period that extends beyond substantial completion. Debt service payments are interest-only for the first ten years, followed by ten years of sculpted principal and interest payments, after which amortisation occurs on a level payment basis until final maturity.

Like the PABs, the TIFIA loan received ratings of BBB from Fitch and Baa3 from Moody's. The TIFIA loan is subordinate to the PABs in the cashflow waterfall and in respect of certain enforcement actions unless and until a bankruptcy related event occurs with respect to EMP, at which point the TIFIA loan's priority would become pari passu with the PABs.

Advisors

I-66 Express Mobility Partners LLC was advised by Gibson Dunn & Crutcher LLP, legal counsel, and ThompsonMcMullan PC, local legal counsel. Steer Davies Gleave acted as developer's traffic consultant.

The Virginia Department of Transportation was advised by Hunton & Williams LLP, legal counsel, and KPMG LLP, financial adviser.

The US Department of Transportation, under its TIFIA lending programme, was advised by Scully Capital, primary financial adviser, Project Finance Advisory Ltd, additional financial adviser, as a result of the TIFIA loan amount exceeding US$1bn, Skadden Arps Slate Meagher & Flom LLP, legal counsel, and Booz Allen Hamilton Inc, traffic consultant.

The underwriters, Citigroup Global Markets Inc and Merrill Lynch, Pierce Fenner & Smith Incorporated, were advised by Ashurst LLP, legal counsel.

The Louis Berger Group Inc acted as lenders' traffic consultant. Infrata Limited is lenders' technical adviser and Aon plc is lenders' insurance adviser.

Nixon Peabody LLP acted as bond counsel for the private activity bonds issued by the Virginia Small Business Financing Authority.

Deutsche Bank Trust Company Americas, the collateral agent, indenture trustee and intercreditor agent, was represented by Thompson Hine LLP. ■

Performance security under the DB contract includes a US$750m performance bond, effective for a five year tail after substantial completion