Publication Number P-0808.AIB-LB

WHITE PAPER

Original Publication Date: 25 October 2018

UFT
COMMERCIAL FINANCE, LLC

All-Inclusive Bid™ and the CPC™;

Infrastructure with a Lighter Public Balance Sheet Load

Prepared by UFT Commercial Finance, LLC

Written by Joanne Marlowe

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"Probably the biggest challenge facing the public sector today is the lack of available balance sheet.... governments are ... between a rock and a hard place. They need to repair, improve, build, and enhance public infrastructure ... and they need to do so at record levels as the global population continues to grow and city landscapes continue to expand."

In today's world, the common denominator between most governments' goals is the need to discover new ways to make critical infrastructure projects a reality. In days past, this would have meant obtaining the necessary legislative and related approvals to authorize a bond issue and, when required, search out a bank or other institutional source of credit enhancement to get the best possible rates on the debt to be issued by the government sponsor. Short and sweet, this was the efficient way to raise the capital needed for a project. Unfortunately, there aren't too many public entities out there today that have sufficient balance sheet strength or debt capacity to meet their current infrastructure needs by taking the debt issuance head-on. So, governments necessarily prioritize and choose which projects are the most critical. Then, whatever balance sheet capacity is available goes to support the direct debt issuances that make those lucky few projects possible. But, what of the other projects?

With balance sheet and corresponding debt capacity committed elsewhere, there aren't many options left. The most common approaches are rooted in one or more variations on a theme when it comes to public private partnership, all of which come with strings attached that oftentimes bind up the public's best interests. Those strings come in the form of a public sponsor's (i) loss of control of a critical infrastructure asset that is tantamount to an outright sale to a private entity in consideration of that private entity's improvement of the asset; (ii) assignment of an outsized volume of natural resources that upon default rollover forever into the private sector, never to be used for the benefit of the citizenry, or (iii) submission to virtual predatory lending by another government or quasi-government entity, which only exacerbates the problem with new debt obligations that a sponsor government cannot support or hope to repay. In this last case, the collateral taken could be a menu of ports, highways, or other assets that the government can't afford to lose, but that are now subject to seizure upon default. Look at that any way you like, but this practice is more akin to modern colonialization than infrastructure development support.

When looked at through eyes not blurred with political need or a willingness to kick the can down the road, are today's most popular public private partnership structures really true partnerships? The answer is, no. The public sector has certain projects that need to get done for the good of its population, and those needs make government officials more susceptible to agreeing deal terms that are not good for their country, state, county, city, or local community, as the case may be. The problem remains how to get a project done without hurting the public interest today or in days to come.

Probably the biggest challenge facing the public sector today is the lack of available balance sheet. What does that mean? It means the government is performing a balancing act to determine how much debt load it can take on against public assets and revenues before the rating agencies step in and start downgrading the rating of the public entity. A rating downgrade results in a price hike on existing debt – a hike that most entities haven't budgeted for and simply can't afford. With this, governments are firmly

seated between a rock and a hard place. They need to repair, improve, build, and enhance public infrastructure for public health, safety, transportation, and economic growth, and they need to do so at record levels as the global population continues to grow and city landscapes continue to expand. These projects can't be done using the old finance structures – that is clear. Even if those structures could be rejuvenated, without market liquidity, there may not be enough investors interested or able to invest to meet the need. What is needed is a fundamental re-think of how the public sector initiates infrastructure projects and how investors position these long-dated and largely illiquid (but generally reliable) investments in their portfolios.

Looking at Infrastructure Differently

The easiest way for a government to not take debt on its balance sheet is to just not borrow. No, that's not intended to be an over-simplification, but rather a prompt to reevaluate the roles of the parties in a project and determine who among them have a vested interest in seeing an infrastructure project executed. Then, those parties need to be brought into the frame in a commercially manageable and economically incentivized manner. When it comes to a particular infrastructure project, if not the government taking on the debt obligation, then who? And, if we find the "who" – then, why? And, if we can understand the "why", then how is it possible? The larger answer starts with a slightly different way to view roles, responsibilities, and motivations in achieving public sector projects.

For some insight, let's look at how most manufacturers do business. In simplest terms, the average manufacturer doesn't expect its buyers to finance its production. Of course, there are always exceptions, especially in a customized product, but generally, a furniture manufacturer, for example, relies on credit it takes on to its own books in order to produce the products it creates and sells. Because the manufacturer owns those costs, the cost of its production finance is carefully managed and monitored, so its product prices remain as competitive as possible. Its costs of manufacturing – inclusive of finance – are covered by the collection of the manufactured items' sale price. In this example, because the buyer of the product is technically covering the cost of finance with its purchase payment, is that debt being carried by the purchaser? Of course not! The debt is undeniably on the books of the manufacturer until such time as it pays off its credit lines. Not convinced with this line of thinking because infrastructure is not the equivalent of a living room set and a furniture manufacturer is not the same as an infrastructure contractor? Then, let's look at something more expensive and customized, like a "spec house" built by a developer.

In this case, sometimes the builder -- or carrying our parallel forward, the "manufacturer" -- decides to build a house without any particular buyer in mind. I don't think anyone would confidently assert that the cost of the build and the debt obligation incurred by the builder is somehow the responsibility of a yet-unidentified buyer. That debt obligation is owned by the builder and correctly held on the builder's books. Now, let's look at a situation in which not only does the builder have a good idea of who would potentially want to buy the house that's being built, but that buyer may have even entered into an underlying contract for purchase conditioned upon some future set of events occurring, such as the house being finished and, let's say, a successful petition for a change in school districts. Does the existence of a contract for the eventual purchase of the asset upon some future triggering events mean that the debt incurred by the builder today to power its building process is now the obligation of the future, contingent purchaser? The answer, again, is no. But, what if that buyer agreed to assume the debt incurred by the builder at the time that its purchase obligation becomes enforceable? The answer is still no, until such time as those triggering events have occurred, the contract is enforced, and the ownership of the

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asset being purchased and the related debt being assumed has been transferred to the buyer.

The fact is, no matter how you look at it, the debt to build the house is owned by the builder, not the purchaser of the house, even if the purchaser has conditionally committed to buy that house and assume the builder's debt at a future date upon the occurrence of certain events that may or may not occur. To make this even more interesting, let's muddy the waters a little further in our example, and say that as part of the agreement between the potential future buyer and the builder, the potential buyer is going to pay for the right to have the use of the house available to it during the interim period between the date the agreement was signed until the time that the events occur to trigger the purchase and assumption of debt and none of those "availability payments" are being applied toward any possible future purchase. Who then owns the debt the builder took on to build the house? The builder does. Now, let's advance the thought process and bring the logic forward to frame the genesis of these arguments within the infrastructure sector.

A Different Kind of Contract Bid

Applying the All-Inclusive Bid™ does for infrastructure assets what supply chain finance has done for manufacturers or what builder's lines have done for the home construction industry. It enables infrastructure contractors to independently qualify for private infrastructure finance for a particular infrastructure project, submit their bid in reliance upon that finance which includes their cost of construction and materials, and win a contract to deliver the finished infrastructure asset without fearing for a loss of continuity of public sector funding or appropriations along the way. This also empowers the infrastructure contractor to perform its contract to the best of its ability while incentivizing greater prudence in budgeting and use of proceeds toward execution since it is accountable for the debt.

Like in our prior example, as part of the government's award of a multi-year contract, it will agree to the disbursement of periodic availability payments to the contractor in consideration of its right to use and, dependent upon the nature of the project, operate the infrastructure asset then being built. The contractor, through a third-party collection/trust agent, collects those government payments and applies them to offset its financial obligations and maintain the asset in good operating order. Provided one concurs with our earlier discussion points, the translation of those points to an infrastructure project and the expected balance sheet treatment of the debt incurred in relation to its construction should not represent a quantum leap in logic. A reasonable conclusion recognizes the debt incurred by the infrastructure contractor should not be "owned" by the public sector, but held in the private sector until both the project and the debt are assumed by the government sponsor based upon the satisfaction of certain contractual conditions. And, now, thanks to technological advances in dynamic analytics that are embedded in an All-Inclusive Bid™ model, we can quantify the extenuating economic impact of an infrastructure project beyond its generation of direct revenue (such as the collection of tolls or fees from the operation of that infrastructure asset). With this capability, one of those conditions would include the compilation of data demonstrating that the project has had a sufficient, far-reaching economic impact that it may then be deemed "self-supporting". When that condition is met, the government should be free to take full ownership of the asset, inclusive of the assumption of the contractor's related debt, without negatively impacting its balance sheet and without the risk of a rating downgrade.

With this said, there is one factor that remains unaddressed in our earlier examples – ownership and treatment of the pre-existing asset to be improved while under construction and prior to the triggering events occurring. This means looking at how the asset -- the public sector land being built upon or the existing infrastructure asset being refurbished or revitalized -- is being managed within this structure. Whether the infrastructure funding required is as little as the 20% locally-sourced funds needed to receive up to 80% federal funds from the likes of the Federal Highway Administration (FHWA) or the Airport Improvement Program (AIP) or is as substantial as the full capital stack needed to construct a project, the accessibility of the underlying public asset is critical to the contractor's ability to qualify for infrastructure funding at the level needed to successfully execute under an All-Inclusive Bid™ structure. After all, the contractor needs something – some source of project-linked collateral – to rely upon when agreeing to take on the financial obligations that will make an approved project happen.

No such thing as a Free Lunch

In a conventionally framed infrastructure project in which the government wishes to maintain ownership and operational control of the infrastructure asset once built, the government will engage, whether by bond issuance or some other debt mechanism, to raise debt sufficient to improve the target public asset (i.e. land/site for the infrastructure project or a pre-existing infrastructure asset to be improved) and the asset remains virtually untouched on its books while it is being improved and additional value added. However, as we pointed out earlier, if it were still possible to apply old-school methods of finance broadly today, then, although the asset remains on the public sector's books, it is coupled with a substantial amount of debt that also will be carried on the government's books.

By contrast, in an All-Inclusive Bid™ structure for the delivery of an infrastructure asset, the debt will be raised by the infrastructure contractor that is undertaking the project. That debt is ring-fenced in a wholly-owned bankruptcy remote special purpose entity established by the contractor for the sole purpose of performing on its contractual obligation to deliver the agreed infrastructure asset to the "buyer" – the government. The bankruptcy remoteness of the wholly-owned entity protects the infrastructure project, the government's long-term interests, and the private sector lenders from any credit risk contagions arising from the behavior or financial standing of the contractor. It also provides an arm's length location where both the project debt incurred by the contractor as well as the infrastructure asset itself can be segregated and reside until such time as the debt obligation can be retired. This means that as one of the cornerstone conditions of a grant of an All-Inclusive Bid™ contract, the government will contribute the related unimproved asset to the winning contractor's special purpose entity. There, the asset is permitted to be encumbered by the contractor as security for the private finance required to complete the delivery of the improved infrastructure asset. The ability to encumber the public asset coupled with the contractor's pledge of its infrastructure contract, inclusive of the cashflows derived from the government's periodic availability payments, is what provides the support and security for the contractor's debt related to the delivery of the project.

> ***"... it is important to note that ... the contributed government asset will always return to the government ..."***

Provided the government performs its obligations under the contract, inclusive of making scheduled and contracted availability payments, upon the occurrence of certain contractually defined triggering events following the completion of the infrastructure improvements by the contractor or at the sole election of the government entity at any time during the contract term, the government may call for and accept the transfer of all shares of the contractor's special purpose entity. The sole asset of the special purpose entity is the infrastructure asset as originally contributed by the government and improved by the contractor, and the sole liability of the entity is the debt incurred by the contractor to perform the infrastructure contract. It is important to note that

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the contributed public asset will always return to the government, except under circumstances that are under the full control of the government, such as the government's default under its contractual obligations to the contractor or a failure to make a proactive election to call for the asset's return.

As such, even though the underlying infrastructure asset was contributed to the contractor's special purpose entity to efficiently deliver the project, the asset should be expected never to move off the government's balance sheet. Instead, when contributed, it would potentially be moved to a different asset category on the public balance sheet, perhaps recognized as a "Deferred Asset" since the government at all times controls the conditions of the asset's return. It follows then that when the government regains full control of the asset by way of taking ownership of the special purpose entity shares, the asset should once again be recorded as a long-term asset on the government's balance sheet rather than considered "deferred".

The thesis behind this proposed positioning is that the asset -- even while contributed to the special purpose entity -- never actually leaves the government entity's balance sheet, but rather is just moved to an asset category that recognizes the deferred status of the government's continuing long-term ownership. Thus, a properly executed All-Inclusive Bid™ project should ideally result in a balance sheet neutral position for the government since the government always has a claim on the contributed hard asset and all actual debt incurred to deliver the infrastructure project is carried on the books of the special purpose entity that is wholly-owned by the contractor.

That said and dependent upon the views of each government auditor, the government may elect to categorize its obligation to make the availability payments as a form of "liability" on its balance sheet. If that were to be the case, another important factor to consider is that, at minimum, the balance sheet impact of the All-Inclusive Bid™ structure to the government should be less than the current conventions and methods for executing upon an infrastructure trade as referenced earlier. From the government's perspective, there should be a marked difference between the direct balance sheet impact of a bond-like principal plus interest obligation as infrastructure financing, and the impact of a contractual periodic payment obligation *absent* the incurrence of any direct debt by the government. The adoption of an All-Inclusive Bid™ program is the newest method for potentially reducing balance sheet burdens on government by properly and transparently removing government-issued debt from the equation when moving to implement much-needed and overdue infrastructure projects.

Pairing of an All-Inclusive Bid™ with a CPC™

Investors today, whether they be family offices, institutional investors or pensions, continue on their quest for yield discovery and liquidity to both drive performance and maintain agility in the marketplace. Infrastructure investments represent a potential wealth of yield to these investors and aid in meeting the current demand for infrastructure finance being acutely felt by public entities worldwide. Unfortunately, the long-dated nature and the inherent lack of liquidity of infrastructure investments virtually disqualifies the vast majority of investors from any consequential investment in infrastructure from the start. Infrastructure bonds are among the most illiquid assets available, typically unrated, and are usually traded in thin private markets rather than exchanges. Most investors -- regardless of appetite and desire -- simply can't take the risk of parking blocks of cash in infrastructure investments that they may not be able to easily exit and that may be slow in delivering returns while the underlying project is under construction or stabilizing. Moreover, because

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of the reasons discussed earlier in this paper, there is a significant void of infrastructure projects being made available to private investors, given the inability for public entities to successfully apply last-generation methods of funding while hindered by widespread balance sheet constraints. There is a chronic shortage of infrastructure funding and investment capacity available around the world, but there has never been a greater need for both in the market.

Now, with the advent of the All-Inclusive Bid™ to help initiate more infrastructure projects with less potential public balance sheet impact, a next generation set of investment vehicles that better addresses the most relevant issues to investors will act as a natural complement to the structure. That investment vehicle is called a Credit Participation Certificate™ or CPC™, an innovative credit asset class that applies a standardized set of global terms and conditions to fractionalize almost any type of credit -- essentially "slicing" loans or credit enhancement facilities into smaller pieces so they can be easily and efficiently digested by investors.

The CPC™ platform and suite of CPC™ product types were originally designed to respond to the need for a more reliable, transparent investment alternative to securitizations following the financial crisis in 2008. However, in combination with an All-Inclusive Bid™, the CPC™ becomes an important addition to the broader framework for enabling infrastructure investments to be undertaken and distributed to investors on a cross-border, global basis. Products like the Infrastructure CPC™ (that fractionalizes infrastructure loans) and the Infrastructure Enhancement CPC™ (that fractionalizes credit enhancement facilities supporting infrastructure projects) capitalize on what is perceived as a *true* underlying public-private partnership for an approved infrastructure project. With both of these CPC products, the underlying credit is firmly and inextricably bound to the application of an All-Inclusive Bid™ request to initiate the infrastructure project. The resulting credit structure that can be offered to investors embodies elements of private sector asset-based lending, public sector credit risk, cashflow based lending, and best risk mitigation techniques for project finance. When coordinated in this way, CPCs™ can fundamentally alter an investor's approach to infrastructure investment, allowing them to benefit from:

- globally standardized terms, conditions, and processes, which increase efficiency of initial investment and the ability to resell positions;
- the generation of returns throughout the design and build phase of a project, making it a more attractive return model for investors;
- investment access with US$100,000 CPC™ participation units, making them ideal for exchange-based trade;
- greater market liquidity and corresponding reductions in duration risk;
- a broader potential audience for investment and resale, which includes a full spectrum of private and institutional investors;
- enhanced portfolio diversification outside the context of a derivative-based construct;
- cutting-edge dynamic analysis tools that aid in risk management, CPC indicative pricing and valuation, and reliable monitoring for "trigger events" within the All-Inclusive Bid™ lifecycle; and
- "Cashless Investment™" as an alternative point of entry for investment that reduces an investor's opportunity cost, positions infrastructure investment as a pure portfolio yield enhancement, and increases overall investment capacity.

> ***"… only when the government can demonstrably afford to take both the asset and related debt onto its books, it does."***

All of the above come together to improve the ability of almost any size investor to efficiently and confidently decide to add long-dated, infrastructure-linked CPCs™ to their broader portfolio. That confidence in investment decisions ultimately contributes to enhanced market liquidity and agility. UFT Commercial Finance believes that the introduction of deep liquidity to the infrastructure finance market globally will be the key driver in expanding market volume and available investment capacity in order to meet the growing needs of the public sector for funding. When it comes to large scale, long-term infrastructure investments, the introduction and development of a liquid marketplace changes investor behavior. Liquidity is driven by access to information and standardization in execution. Together, this inspires an investor to consider infrastructure projects that would have been disqualified from consideration due to their inherently long-dated, illiquid nature. This means the entry of more investors into the market, more CPC™ market volume, and the tangible potential for exchange-based trading of those CPCs™ – exactly what public infrastructure projects have to have in order to meet today's immediate needs and those anticipated in years to come.

Conclusion

When we consider the combination of the All-Inclusive Bid™ model as an alternative method for initiating an infrastructure project to ideally reduce balance sheet impact on the public sector, the operation of a dynamic analytics platform that captures underlying contractor performance data and measures the economic impact of an infrastructure project on the public sector during its lifetime, and the roll-out of the Infrastructure CPC™ and Infrastructure Enhancement CPC™ with their high degree of structural standardization and integrity, we are on the precipice of achieving a whole new method of making infrastructure development happen. This innovation commercially incentivizes private sector contractors to actively engage the capital markets to access funding in place of the government sponsor while an infrastructure asset is being built and maturing. Then, only when the government can demonstrably afford to take both the infrastructure asset and related debt onto its books, it does. This puts and keeps a public asset exactly where it belongs -- in public hands to be put into public service for the public good.

For more information about the CPC:

www.uftcf.com

UFT Commercial Finance, LLC
Executive Office:
2121 N Waukegan Road
Bannockburn, Illinois 60015
United States of America

info@uftcf.com

Joanne Marlowe is a Director of UFT Commercial Finance and a structured product specialist. She has been instrumental in the design of a variety of credit-linked products in the trade and commercial finance sectors.