

California's Long Beach Courthouse P3

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California's Long Beach courthouse deal stands out as a trailblazer in the US infrastructure space for being the first social infrastructure P3 to reach financial close in the US.

While most P3 infrastructure deals in US relate to the transport and utility sectors and get financed through either state or municipal bonds, Long Beach's authorities managed to bring a pool of Canadian and European banks together to fund the project under the state's strict procurement requirements.

Social infra PPPs for civic buildings, schools, libraries, police departments, courthouses and hospitals have been slow to materialize in the US both at the state and local level. This is primarily due to the government's relative unfamiliarity with that kind of project delivery method, their focus on front-end costs versus lifecycle costs and its long-standing use of tax-exempt financing mechanisms.

Long Beach courthouse has finally set a precedent and will now pave the way for social infra projects to be procured through the private finance route in future [\[Projects Database\]](#).

The project is the first courthouse in the United States to be developed using the performance-based infrastructure (PBI) model – which is the US equivalent of PPP.

It is also a first for the state's court policymaking body, Administrative Office of the Courts (AOC), which took the decision to procure the project through a 'performance-based infrastructure' model to better synchronize construction and payment timetables.

Background and Project Specifics

Most Californian courthouses built during the 1950s are now in pressing need of renewal. Long Beach courthouse will be the first new courthouse built in California in 40 years, according to Public Works Financing. Official figures estimate that at least 100 courthouse projects worth US\$3 billion need to be procured in the next few years.

The Long Beach courthouse renewal project was first mooted as a P3 in 2008. The project itself involves rebuild and design of 31 court rooms spanning six acres of state-owned land. The new courthouse will replace the existing 1959 building and will be located in the West Gateway area of the city between Broadway and Third Street, west of Magnolia Avenue.

The project involves the construction of a multi-story courthouse, an approximately 545,000 square feet facility that will accommodate 31 civil and criminal courtrooms, 800 workers and 3,500 to 4,500 daily visitors. The building will include office space that will be leased to the County of Los Angeles for its justice related agencies, compatible retail space, a controlled-entry space, and an in-custody holding facility. A nearby existing parking structure will also be renovated and expanded to more than 900 spaces as part of the project.

An initial 12 teams responded to a request for qualifications (RFQ) and three remaining bidders were shortlisted in October 2009. They were:

- Balfour Beatty - Perkins & Will, Heery/Barnhart, Barclays, Linc Facilities
- Lankford-Phelps - HOK, Hensel Phelps, Piper Jaffray, Grubb & Ellis
- Meridiam - AECOM, Clark Construction, KPMG, Johnson Controls, Edgemoor Real Estate Services

In June 2010, AOC selected the Meridiam-led consortium to DBFOM the new courthouse, to replace the aging existing facility.

Under the 35-year agreement, the concessionaire will finance and develop the project over the first three years and will be responsible for operations and maintenance of the facility over the remaining 32 years. In return, the consortium will recover its upfront investment through an annual fee paid by the state over the life of the agreement.

The state will maintain ownership of the building and land throughout, and the state's annual payments to the concessionaire will be contingent upon achieving specified performance targets in operations and maintenance under the PBI model.

Michael Pikiel, senior counsel at Fulbright & Jaworski, who advised the sponsor on the deal says: "Under the PBI model, the project is required to be designed and built to meet certain specified standards and the AOC makes availability payments only if the building is operated and maintained in accordance with detailed performance criteria.

"This delivery method has broad application and can be used in other social infrastructure sectors such as schools, government buildings, prisons, military, and water and wastewater treatment."

Even though the project suffered some delays relating to the state budget and elections in October 2010, the project reached financial close in December 2010 with construction already underway now. The new courthouse is scheduled for occupancy in late August 2013.

Financing

Meridiam chose to raise 100 per cent of the debt through a purely bank debt solution. The project has a total capital value of US\$495 million with total debt standing at US\$440 million financed by a club of six banks through a 7-year mini-perm financing structure.

Equity worth US\$55 million was provided by Meridiam Infrastructure gearing the debt:equity ratio at 90:10.

Debt split among the banks is as follows:

- BBVA – US\$82 million
- BNP Paribas – US\$78 million
- Credit Agricole – US\$60 million
- Deutsche Bank – US\$78 million
- Royal Bank of Canada – US\$92 million
- Scotia – US\$50 million

The entire debt package has a 7-year tenor and was priced at Libor +275 bps during construction, which will be stepped up every second year to finally reach 375 bps. The minimum debt-service coverage ratio requirement is at 1.2x.

Milestone payments will be made towards revenues during the 3.5 year construction phase and availability payments will commence when substantial completion is achieved.

When the project was first tendered both bank debt and bond market were looked at as options for financing the project, but bank debt was finally favoured. Initial challenges during the financing process arose with regards to 'appropriation risk' - a concept new to most European banks.

Under the project agreement all payments made by the AOC are subject to appropriation including the Service Payment and any termination payment.

Appropriation risk is not unique to California and contractual payments by state governments and government agencies in the US are generally subject to appropriation by the state legislature. However, gradually lenders and their credit committees got comfortable with this risk through a combination of legal and non-legal mitigating factors.

Pikiel says that while it was an adventure for the banks when they first got into the deal, the successful close of the transaction will act as a blue print for future deals and encourage several non-US banks to finance social infra projects in the country.

The deal reached financial close on 20 December, 2010.

Conclusion

The project is a well-rounded transaction both in terms of procurement and financing. While authorities spent time working out special delivery models for the project, banking teams sat down to understand government laws and risks surrounding courthouse construction and funding in the state. Co-operation at all levels ensured private and public bodies worked in tandem to deliver the procurement within the stated time.

California was one of the hardest hit of the US states in the 2008 financial downturn and it continues to suffer in a constricted budget environment. In such times private financing may be a good way to procure projects within the social infra space in the state and in the US in general - and Long Beach has laid the foundation stone for that.

The project may not have led to a string of social infra projects being tendered yet but experts say there is hope that this isn't a one-off, and that it has made a sound case for the government to consider deals in a similar fashion.

Pikiel says: "Long Beach is trailblazing in the sense that it will certainly open the door for schools and military accommodation projects as well as waste water.

"Politically it still remains to be seen whether it will become an acceptable form of procurement, but there is definitely a need and in economically constrained times the demand for this model might be on the rise."

Project at a glance:

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| Project Name | Long Beach Courthouse P3 |
| Location | California, US |
| Description | The scheme will see completion of a multi-story courthouse, an approximately 545,000 square feet facility that will accommodate 31 civil and criminal courtrooms |
| Sponsors | Meridiam, AECOM, Clark Construction, KPMG, Johnson Controls, Edgemoor Real Estate Services |
| Loan Concession Period | 35-years |
| Total Project Value | US\$495m |
| Total equity | US\$55m |
| Total senior debt | US\$440m |
| Debt breakdown | BBVA – US\$82 million BNP Paribas – US\$78 million Credit Agricole – US\$60 million Deutsche Bank – US\$78 million Royal Bank of Canada – US\$92 million Scotia – US\$50 million |
| Debt pricing | Libor +275bps |
| Debt:equity ratio | 90:10 |
| Financial advisers to sponsor | KPMG, BNP Paribas |

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|------------------------------|--|
| Financial adviser to AOC | Ernst & Young |
| Legal Adviser to AOC | Hawkins Delafield & Wood |
| Legal adviser to sponsor | Fulbright & Jaworski |
| Legal advisers to lenders | DLA Piper, Milbank Tweed Hadley & McCloy |
| Technical adviser to lenders | Arup |
| Date of financial close | 20 December 2010 |

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