

MEMO

FROM: Oregon State Treasury
TO: Joint Ways and Means General Government Subcommittee
RE: P3 in Oregon
DATE: April 30, 2015

Background

The challenge we face is this: there is a huge backlog of infrastructure needs in Oregon due to a persistent lack of funding, inadequate financing tools, and difficulties associated with jurisdictional overlap and maintenance. Small jurisdictions, in particular, face enormous hurdles securing capital for infrastructure projects. Oregon has recognized a need for innovative infrastructure financing and procurement and the expertise to carry projects out.

In Canada, the United Kingdom, Australia, and elsewhere the private sector commonly helps finance publicly-owned infrastructure projects; integrates project design, construction, and long-term maintenance responsibilities; and accepts the risks of construction and operating cost overruns. These partnerships have successfully spurred billions of investment dollars in transportation, water, and social infrastructure. They provide the financing necessary for projects to proceed. They align the public sector's goal of effective cost management with the private sector's opportunity for gain and risk of financial loss. Their efficacy in containing costs and ensuring proper upkeep is well-documented, as are the benefits they offer to both investors and the public.

The 2014 Legislature authorized \$1,080,000 for policy and technical work for the infrastructure innovation effort. Of that total, \$600,000 was allocated to the West Coast Infrastructure Exchange and \$480,000 was allocated for in-state work to support the work of the Public Infrastructure Commission, enabled by HB 4111, and to provide assistance to local jurisdictions interested in moving pilot projects forward.

Treasury has contracted with Infrastructure Oregon to assist us with the Public Infrastructure Commission and Pilot Projects. Because the public-private infrastructure market is largely undeveloped in North America, the work is complex, multi-disciplinary, and requires a high level of expertise in the legal, project development and finance professions. We have provided the committee with a sampling of monthly reports submitted by our consultant.

Treasury made the decision to contract with a single entity with expertise in this wide array of subject areas rather than several entities to take advantage of economies of scale and to reduce managerial and communication challenges. We are on track to come in under budget.

The West Coast Infrastructure Exchange

The West Coast Infrastructure Exchange (WCX) is a partnership between California, Oregon, Washington, and British Columbia to research and share innovative financing strategies. The inclusion of British Columbia in the Exchange is critical, as they have been involved in dozens of projects that have benefited from such strategies.

The WCX developed the first set of US project standards for public-private partnerships in infrastructure. (Available here: <http://westcoastx.com/news/West Coast Infrastructure Exchange-releases-final-project-standards.html>)

The following are examples of services WCX has provided to Oregon thus far:

- Assisted Oregon Water Resources Department with water supply development projects, including:
 - Umatilla basin project (on going) - project structuring, sourcing of bank loans.
 - Participation on SB 839 Taskforce (recently completed).
 - Presentation to Oregon Water Resources Commission.
 - Development of bi-state cooperation agreement on water supply development with Washington and development of list of priority projects for joint efforts.
- Proposed New Model for Water Projects
 - WCX convened a work group of EPA, USDA, investors, operators, and other experts to develop screening criteria and guidance for aggregating smaller water infrastructure projects to attract private capital and transfer risk. The report is on the West Coast Infrastructure Exchange website and the recent White House- EPA Water Center announcement echoes many of these themes/points.
- Advised local public water systems re: infrastructure financing
 - Presentations to annual conference of Oregon Water Utilities Council and (pending) Oregon Association of Clean Water Agencies (OR-ACWA) on public-private partnerships in the water sector.
 - Created training on public-private partnerships for cities of Grants Pass, Sweet Home and Gladstone re: water infrastructure investment options.
 - Collaborated with DEQ about using its Clean Water State Revolving Fund to complete septic repairs.
 - Conducted training sessions and provided information to local governments, special districts, state agencies, stakeholder groups, industry associations, League of Oregon Cities, Association of Oregon Counties, and the Legislature on the State's innovation initiative, innovative procurement practices and methods, and financing issues.

WCX has attracted significant interest from investors, labor unions, non-governmental organizations, and the federal government. Other regions of the country are now actively exploring the creation of similar organizations. Some examples:

- WCX Exchange influenced the national debate about infrastructure investment and finance, as reflected in many of the elements of the Build America Initiative recently launched by the Obama Administration.
- Representative Tobias Read was given the NewDEAL New Ideas Challenge award for his work on the WCX.
- WCX was recognized as a 2015 Harvard Ash Center Bright Idea in Government.
- The Progressive Policy Institute highlighted WCX as "one of the most promising innovations in public-private partnerships today."

The Public Infrastructure Commission

The Public Infrastructure Commission was established to identify Oregon's public infrastructure funding needs, review and examine the tools now available to close the gap in funding for public infrastructure projects in Oregon, research and evaluate a variety of innovative financing and procurement methods that could be used to deliver public infrastructure projects in Oregon, and determine whether there are any legal impediments to innovative financing and procurement methods for public infrastructure projects.

The Public Infrastructure Commission has met once a month for meetings lasting at least three hours since October 2014. The Public Infrastructure Commission has examined:

- The current state of infrastructure need and capacity.
- State funding and technical support programs.
- Gaps in both financial and capacity resources.
- Project-level innovations that would occur through procurement alternatives by examining procurement methodologies including traditional procurement (design-bid-build), existing alternative methods (CMGC and design-build), various models of public-private partnerships including design-build, design-build-finance, design-build-finance-maintain, and privatization models including lease-leaseback.
- Overview of fund-level innovations that could bring additional capital at the funding agency level, such as leveraging DEQ's Clean Water Revolving Fund.
- Overview of credit enhancement as a market void and the need to replace the bond insurance that was provided by AMBAC and MBIA prior to the recession to make credit less expensive and more available, particularly for smaller jurisdictions.
- Legal review of current financing and contracting statutes and changes that would be necessary to implement an innovative procurement (P3) program.

The Commission's report to the legislature was due after it had completed only two meetings. In light of this reality, Rep. Cliff Bentz and Ken Rust, Co-Chairs of the Commission, instructed that a very brief status report be provided explaining that the Public Infrastructure Commission had started its work late and requesting an extension of time to complete the work. The extension bill is HB 2748. The Public Infrastructure Commission's last meetings will be to review and approve a final report to the Legislature, to be delivered by year-end.

Pilot Projects

Per HB 4111, Oregon is also taking an active role in pilot projects to test the viability of innovative financing and procurement strategies. While public financing remains the most cost effective way to build infrastructure, there is not enough bond capacity to meet all of the State's needs. While some projects in jurisdictions with access to capital may be fully funded from public sources, projects in other – particularly smaller – jurisdictions may not get off the ground without innovative financing.

- Technical support has occurred in two core areas: (1) development of a credit enhancement program to improve small jurisdictions' access to capital and reduce their cost and (2) advice for project sponsors on various issues.

- Credit enhancement, also referred to as bond insurance, is a loan guarantee provided for a fee by an insurer or guarantor, that gives the debt of a smaller jurisdiction an AA or AAA rating, reduces its cost, and makes it readily marketable. This financial product was available before the recession, but those who provided it failed during the recession and the product has not been replaced. The lack of enhancement is an obstacle for WISE water and other local government-sponsored projects when the sponsors do not have AA or AAA ratings or the ability to pledge general funds. One of the project support services paid for with this contract was the development of a financial structure that can provide this kind of guarantee for projects in Oregon, using capital from public and private pension funds, private investors, and public entities. The next step is to have the program proposal reviewed by rating agencies. Development of this program was time-consuming and complex, but is likely to be of significant benefit for Oregon.
- The WISE (Water for Irrigation, Streams and Economy) Project in Southern Oregon is a regionally-supported water management project that will improve the Bear Creek and Little Butte Creek watersheds in Jackson County. The contractor firm working with WISE has coordinated with jurisdictions to propose a single entity, which enables the many smaller jurisdictions to collectively achieve the financing for the project. Specific project support includes assistance in coordinating jurisdictions who need to come together to achieve a project. The WISE project is a paradigm that could translate into models for governance, cash management, contracting, debt service, and shared operations plans for other projects as well. That group identified core elements necessary for a co-governance agreement that was developed into an intergovernmental agreement draft for WISE, providing a framework and identifying the key negotiation points that need to be resolved among the sponsor jurisdictions. In-state support also included close collaboration on the cost-benefit analysis so that it would be useful in developing financing pro formas and identifying industrial-scale water purveyors to respond to an RFP to contribute rate and benefit analysis to the project pro forma.
- Liaison to facilitate IGA for project technical support between DAS and Partnerships BC.
 - Partnerships BC was selected by the Governor's Office as a technical advisor and service provider for initial project screening and business case analysis. Infrastructure Oregon assisted both parties in the evaluation of the Multnomah County Courthouse project, which provided important lessons even though the project did not go forward. Partnerships BC is providing services on the WISE project in coordination with the in-state provider, and will peer-review the screening report for the Portland Building that is now being conducted in-state as part of this contract.

Next Steps

While the PIC has not yet made any formal recommendations (it plans to meet until the end of 2015), Treasury believes next steps may include:

1. Exploring a "Center of Expertise" to facilitate the infrastructure work of local governments

While state agencies like the Department of Environmental Quality and the Infrastructure Finance Authority provide funding and technical support for local governments – particularly for wastewater and clean water facilities – and ODOT funds local transportation improvements, more resources are needed at the local government level to make projects happen, as appropriate, on the P3 continuum.

The reality is that "pre-development planning" is not adequately supported because many jurisdictions rarely do major infrastructure projects, and even those that have in the past have had staff reductions that resulted in loss of in-house skills. Pre-development funds are high-risk, so they are difficult to obtain, particularly in a time of shrinking public budgets. The WISE water project is a good example of the usefulness of using private sector expertise (e.g. the creation of a new bankable legal entity that brings together multiple communities under one umbrella) to finance a formerly intractable project.

2. Leveraging existing state funds like the DEQ Clean Water Fund

Other states use leverage to increase the number of available dollars from loan funds. To use a specific example, Oregon could increase its capacity to finance clean water infrastructure by issuing revenue or GO bonds backed by the Clean Water Revolving Fund. Currently, 27 other states do this and have been able to finance billions in additional water projects through this mechanism.

3. Creating a credit enhancement mechanism for local governments, school districts and other public entities

Public entities using public financing are dependent on their credit ratings for their cost of capital. Simply put, the stronger the credit rating, the lower the interest rate, resulting in fewer public dollars spent over the life of a project. Since the start of the recession in 2008, there has been a market void for credit enhancement as the bond insurance provided by national companies like AMBAC and MBIA has disappeared. As a result, credit is more expensive and less available, particularly to smaller government entities. Oregon could create a pool of pledged collateral to bolster the credit rating of local governments, school districts, etc. and thereby stretch taxpayer dollars.

4. Continuing to support the West Coast Infrastructure Exchange

Building a true market for public-private partnerships, broadly defined, up and down the West Coast is critical in terms of meeting our infrastructure needs over the next twenty years. Private sector partners in our pension fund say that, without more experienced and knowledgeable government partners, it isn't worth their time to deploy capital in projects on the West Coast. Unless we invest in building the expertise and executing projects, we will continue to be ignored as a potential market while Canada, Europe, and Australia attract private capital and expertise.