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THE CITY OF SAN DIEGO'S LANDFILL GAS-TO-ENERGY P3 PUBLIC-PRIVATE PARTNERSHIP

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OVERVIEW

- Project Profile
- Project Elements, Drivers and Participants
- Development Challenges
- Performance-Based Contract
- Design-Build-Finance-Operate-Maintain Project Delivery

HAWKINS PERSPECTIVE

- 90 Attorney Municipal Contract and Finance Boutique
- Leading Special Counsel Law Firm Practicing Nationally in Alternative Project Delivery
- Municipal Representation Exclusively
- Perspective of 250 Infrastructure Projects in 25 States
- Owner's Lead Legal Advisor to the City of San Diego

LFGTE PROJECT (DESIGN-BUILD-FINANCE-OPERATE-MAINTAIN)

PROJECT PROFILE

Renewable Energy Project

“Green Water” from “Green Power”

Proven Technology

15 MW Plant and 2 Miles of Pipeline

Co-located with Pure Water San Diego

Publicly Sponsored, Privately Developed

Structured as a “Project Agreement” (Not a PPA)

Annual Service Fee Payments, Not Unit Pricing

DRIVERS

- Need for Electricity at Planned $1 bn. Wastewater Reclamation Project
- City of San Diego Climate Action Plan
- Renewable Energy Source
- Success of Earlier LFGTE P3 Project at Miramar Landfill
- Transfer Performance Risks
- Life-Cycle Focus
- Balance Sheet Considerations

BENEFITS OF ALTERNATIVE DELIVERY

- Extensive Use in Private Sector
- Cooperation Among Participants Permissible and Desirable
- Life-Cycle Cost Perspective
- Long Term Contracts
- Substantial Risk Transfer
- Striking Success of Projects Built Using Alternative Delivery
- 10-20% Savings Against “Benchmark”
- “Faster, Better, Less Expensive”
- Consistent Success and Growing Acceptance Nationwide

COST SAVINGS

Source of Savings

- Core Competency
- Competition As To Design
- Competition As To Operation
- Collaborative Relationship Between Designer, Builder
- Smaller Contingency Allowances
- Bulk Consumables Buying Power
- Broader Technology Access

Preventive v. Breakdown Maintenance

Optimized Balance Between Capital and Operating Costs

Excessive Redundancy Eliminated

SITE AND EXISTING FACILITIES

Navy (MCAS Miramar) is Site Lessor

City Disposes its Solid Waste at Miramar

Fortistar Operates an Existing P3 LFGTE Project

Supplies Electricity to City Biosolids Plant and Navy

Significant Unused Gas

Air Pollution NOV's from APCD

PROCUREMENT

Managed by City Public Utilities Department

Now in Progress

RFQ Issued

3 Teams Prequalified

RFP and Project Agreement Being Developed

Issuance Set for 2018

Selection and Negotiation in 2019

Commercial and Financial Close Late 2019

KEY PARTICIPANTS

City of San Diego
Project Company
Equity Sponsor
Landfill Gas System Operator
Generator System Operator
Design-Builder
Lenders

KEY COMMITMENTS

- Project Company Designs, Builds, Finances, Operates and Maintains the Project (DBFOM)
- 20-30-year Service Contract
- Guaranteed Compliance With Landfill Emissions Standards
- Maximization of LFG Production
- 15 MW Electricity Production for New Pure Water San Diego

PROJECT FINANCING (1)

- "Private Finance" for Public Infrastructure
- Financing Integrated With DBOM Responsibilities
- Contractor Forms Special Purpose Entity
- Entity Issues Debt for Project Construction
- Debt is "Non-Recourse" to City or to Project Company
- Project Company Subcontracts Construction and Operation
- P3 is in Common Use Internationally
- Greater Transactional Complexity

PROJECT FINANCING (2)

- Company's Project Debt is Mostly Taxable
- Some Private Activity Bond "Volume Cap" Possible
- Service Fee Payments Are Secured by PUD's Wastewater System Revenue
- No Grant Funding Expected
- Investment Grade Project Feasibility Report Prepared for Lenders
- Partial City Construction Milestone Payment Possible

RISK TRANSFER

- City Makes No Payments Towards Construction
- Project Company Finances Construction Using Its Own Project Borrowings
- City Makes Electricity Production Service Fee Payments Upon Project Completion
- Annual Service Fee Payments Are Contingent Upon Guaranteed Electricity Production

CONSTRUCTION RISK TRANSFER

Design Liability (Spearin Doctrine)

Completion Risk (Delay and Efficacy)

Construction Cost Overruns

Disputes Between Designer and Builder

Securing Patents and Licenses

Certain Permitting Risks

OPERATION RISK TRANSFER

Project Performance

Air Pollution Control – Landfill

Air Pollution Control – Generating Equipment

O&M Cost Overruns

Regulatory Compliance

Capital Maintenance

Technological Obsolescence

Labor Relations

RISKS RETAINED

- Landfill Gas Quality
- Landfill Gas Quantity
- Changes In Law
- Force Majeure
- Pre-Existing Site and Environmental Conditions
- General Price Inflation

PROTECTION OF THE PUBLIC INTEREST

- Establishment of Plant Design Requirements
- Pipeline Standards
- Completion and Acceptance Criteria
- Electricity Production and APC Guarantees
- City Convenience Termination Rights
- Project Handback Requirements

SECURITY FOR PERFORMANCE

- Design-Build Contractor's Surety Bond Assures Completion
- Equity and Debt Project at Risk for Performance Failure
- Potential Imposition of Deductions for Non-Performance Will Incentivize:
  - Equity to Make Necessary Repairs to Preserve Investment
  - Lenders Have Step-In "Cure Rights" to Assure Project Performs

CREDIT AND ACCOUNTING ISSUES

Are DBFOM Service Contract Payments:

- Debt, for Voter Approval?
- Debt, on the Balance Sheet?
- Debt, to the Rating Agencies?
- Debt, for Borrowing Capacity?
- Subject to Expenditure Limitations?

PRIVATE PROJECT FINANCING CONSIDERATIONS GENERALLY

PRIVATE FINANCING DRIVERS

- Legal Debt Limits On Government
- Government Debt Reduction Efforts
- Use of Debt Capacity For Other Projects
- Voter Debt Approval Rules
- Avoidance of Debt-Caused Rate Spikes
- Risk Transfer
- Need for Concession Fee
- Projects Involving New or Proprietary Technology
- Strong Security for Performance

"DBFOM" IS A REALISTIC ALTERNATIVE

- Private Capital Increasingly Drawn to Public Infrastructure Projects
- DBFOM May Prove Highest Ranked Alternative Delivery Method in "Business Case" Analyses
- Equity Sponsors and Lenders Seeking to Interest Municipal Utilities in Private Financing
- Greater Attention to DBFOM May Increase Owner Interest in DB, DBOM

POTENTIAL BENEFITIS FROM PRIVATE FINANCING

- Private Project Financing Can be More Flexible Than Municipal Financing
- Bank Construction Loans/Capital Markets
- Longer Maturities Possible
- Debt Service Payable Over the Life of the Asset Financed
- Lender and Equity Investor Involvement Heightens "Due Diligence" on Project Feasibility
- Debt May be Taxable; Exempt Facility Private Activity Bond (PAB) Exeptions
- Debt Credit Retaining Considerations

PRIVATE FINANCING NEED NOT INVOLVE PRIVATE OWNERSHIP

- Private Ownership Normally Accompanies Private Financing
- But Owners Are Reluctant to Convey Public Infrastructure Ownership
- Debt Markets Don’t Require Private Ownership to Provide Financing
- Security of Service Contract is Sufficient
- Private Equity Investment is Required by Lenders
- Mortgage on Project Would Add Little to Security

PRIVATE OWNERSHIP CONSIDERATIONS

Pros:

- **Discipline of Private Project Owners**
- **Transfers Risk of Performance/Project Efficacy**
- **Federal Tax Benefits Can Mean More Equity, Less Debt**

Cons:

- **Loss of Residual Value of the Asset**
- **Less Public Control**
- **Private Ownership of an Essential Public Asset Is Unusual**

MUNICIPAL UTILITY'S RETAINED RIGHTS UNDER DBFOM

- Ownership of System Revenues
- Setting User Rates
- Capital Planning
- Ownership of Residual Value of the Assets

OTHER DBFOM SUCCESSES

- San Diego County Water Authority Carlsbad Project (Seawater Desalination)
- San Antonio Water System Vista Ridge Pipeline Project (Regional Water Supply)
- Cranston (RI) (Wastewater)
- Sacramento County RSD (CA) (Biosolids)
- Multiple Transportation Projects (Most Are Tax-Exempt PAB-Dependent)

SUMMARY

- Private Financing Can Drive, and Better Secure, Project Development and Financing
- Single Point of Accountability
- Transfer of Risks of Development, Technology, Performance and Cost
- Private Financing Can Be Tax Exempt
- No Debt on Public Balance Sheet
- No Municipal Bonds Payable If Project Doesn't Work Well
- Payment Only For Performance

“I have ever found in my progress through life, that, acting for the public, if we do always what is right, the approbation denied in the beginning will surely follow us in the end.”

Thomas Jefferson

Light and Liberty

THANK YOU

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