http://www.bondbuyer.com/issues/119_309/California_P3_Files_Chapter_11-1010232-1.html

THE BOND BUYER

THE DAILY NEWSPAPER OF PUBLIC FINANCE

Thursday, April 1, 2010

California P3 Files Chapter 11

3-Year-Old Tollway In Dire Straits

Tuesday, March 30, 2010

By Rich Saskal

SAN FRANCISCO — After California granted a franchise to build a private toll highway in San Diego County, it took almost 17 years before the 10-mile road opened to the public.

Less than three years later, the South Bay Expressway finds itself in bankruptcy court.

South Bay Expressway LP filed for Chapter 11 bankruptcy last week in the Southern District of California, citing low traffic levels that render it unable to meet its debt-service demands, combined with uncertainty caused by ongoing litigation between the toll-road firm and its primary construction contractor.

The financial failure of one of the two projects to emerge from California's early 1990s experiments in privatized highways comes as the administration of Gov. Arnold Schwarzenegger continues to promote public-private partnerships. The administration claims nine projects in various stages of the state's P3 transportation pipeline, with a capital cost of $26 billion.

South Bay Expressway's bankruptcy filing comes as other greenfield P3 toll roads get underway around the country.

Last week, Florida announced plans to start the process of awarding a concession for a 46.5-mile toll road in St. Johns and Duval counties, and earlier this month Indiana lawmakers approved bills allowing that state's governor to negotiate with private firms interested in a proposed toll road and a pair of Ohio River bridges.

The South Bay Expressway, according to a declaration filed with the bankruptcy court by chief financial officer Anthony Evans, owes $340 million on its senior loan, arranged by Spanish bank Banco Bilbao Vizcaya Argenteria SA, and owes $170 million to the federal government on a loan issued under the Transportation Infrastructure Finance and Innovation Act.

"The South Bay Expressway project is the first bankruptcy in the history of the 12-year TIFIA program," Federal Highway Administration spokeswoman Cathy St. Denis said in a statement. "While we will carefully review and learn from this particular case, we remain confident that TIFIA will continue to serve an important role in advancing critical infrastructure projects."

The expressway borrowed $140 million through TIFIA in 2003 that has grown to $170 million because of capitalized interest, according to Evans' declaration. Interest payments on the 4.46% TIFIA loan are not scheduled to commence until 2012, and principal payments until 2021.

Contractors have also asserted more than $600 million in claims against the toll road operator, Evans said.

California awarded the franchise for the toll road in January 1991. But construction of the road, which extended State Route 125 to the Mexican border at Otay Mesa, was stalled for years as builders sought environmental permits. The permits came in 2003, shortly after Australia's Macquarie group acquired a controlling interest in the concessionaire in 2002.

The highway did not open until November 2007 — just in time for the subprime mortgage market to unravel, taking a major toll on the suburban communities the expressway was built to serve.

"In addition, recent traffic flow has been further weakened by a decline in cross-border commercial traffic and a rise in unemployment in the South Bay area," Evans wrote in his declaration. "As a result, commercial traffic and commuters — the debtors' target customer base — increasingly choose to travel via free routes that are now seldom congested."

Macquarie wrote its investment in the toll road down to zero in June 2009, according to a statement issued last week by Macquarie Atlas Roads, which holds 50% of the expressway's equity.

The road is covering its operating costs, with total revenue in its first full fiscal year of $21 million, resulting in $3 million in earnings before interest, taxes, depreciation and amortization, Evans declared. The expressway remains operational.

The expressway's ongoing litigation with its prime contractor, Otay River Constructors, also helped cause the Chapter 11 filing, Evans declared. The claims arising from that litigation can now be resolved through the bankruptcy process, he wrote.

R. Alexander Pilmer (CA 166196)
KIRKLAND & ELLIS LLP
333 South Hope Street
Los Angeles, California 90071
Telephone: (213) 680-8400
Facsimile: (213) 680-8500

James H.M. Sprayregen, P.C. (*pro hac vice* pending)
Marc Kieselstein, P.C. (*pro hac vice* pending)
Chad J. Husnick (*pro hac vice* pending)
Meredith L. Shafe (*pro hac vice* pending)
KIRKLAND & ELLIS LLP
300 North LaSalle Street
Chicago, Illinois 60654
Telephone: (312) 862-2000
Facsimile: (312) 862-2200

Proposed Attorneys for the Debtors
and Debtors in Possession

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

In re: SOUTH BAY EXPRESSWAY, L.P., and CALIFORNIA TRANSPORTATION VENTURES, INC.,[1] Debtors.	Chapter 11 Case No. 10-04516-LA11 (Joint Administration Requested with Case No. 10-04518) **DECLARATION OF ANTHONY G. EVANS, CHIEF FINANCIAL OFFICER OF SOUTH BAY EXPRESSWAY, L.P., IN SUPPORT OF THE DEBTORS' CHAPTER 11 PETITIONS AND FIRST DAY MOTIONS** Date: TBD Time: TBD Place: The Jacob Weinberger U.S. Courthouse Courtroom 118 325 West F Street San Diego, California 92101

[1] Pursuant to section 342(c)(1) of title 11 of the United States Code, the last four digits of each debtor's federal tax identification number are: South Bay Expressway, L.P. (9083) and California Transportation Ventures, Inc. (5119). The location of the debtors' corporate headquarters and the debtors' service address is: 1129 La Media Road, San Diego, California 91914.

Toll road operator files for Chapter 11

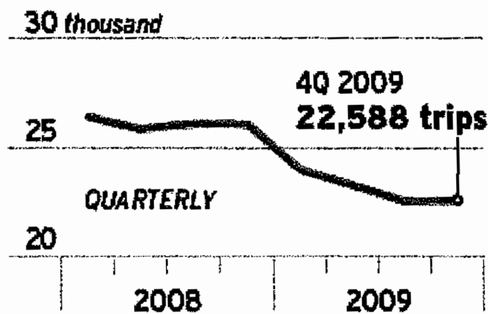
South Bay Expressway use below forecasts

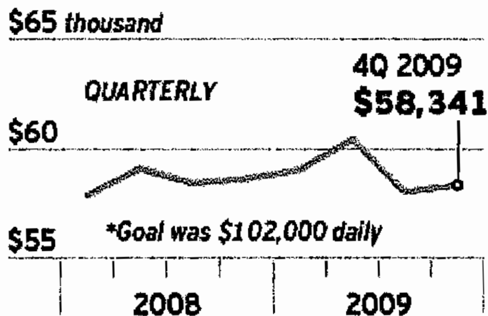
By Steve Schmidt, UNION-TRIBUNE STAFF WRITER

Originally published March 23, 2010 at 12:24 a.m., updated March 24, 2010 at 12:05 a.m.

Nelvin C. Cepeda / Union-Tribune

Motorist travel northbound on the South Bay Expressway Toll Road, 125. On Monday, the companies that built and operate San Diego Countys lone toll road, the South Bay Expressway, filed for Chapter 11 bankruptcy protection in San Diego.





SOURCE: Macquarie Atlas Roads

SHAFFER GRUBB / Union-Tribune

SAN DIEGO — What was heralded in late 2007 as the next big thing in regional commuting — a 10-mile, privately operated toll road in South County — may wind up testing the wisdom of public-private partnerships.

In its court filing this week for Chapter 11 bankruptcy protection, the company that runs the South Bay Expressway cited the ripple effects of a rotten economy. It said the collapse in home prices and the spike in unemployment have hurt its fortunes since the road opened nearly three years ago.

"What's driving this is that we've been severely impacted by the recession," said Greg Hulsizer, chief executive for South Bay Expressway Ltd. "We find ourselves in a position where in the not-too-distant future, we're going to run out of financial reserves."

On average, nearly 22,600 cars travel the road each day, far below initial projections of 60,000. Riders typically marvel at the seemingly empty stretches of pavement, even during peak traffic hours.

While revenue is steady because of rising tolls, the company is falling about $16 million short each year in what it owes its direct lenders, according to court filings.

Monday's bankruptcy move raises questions about the fate of the tollway and the private-public partnership behind the $843 million project.

South Bay Expressway built the road, and it has a long-term management agreement with Caltrans. When the deal was crafted in 1991, it was lauded as a novel way to finance public roads.

"The idea was to see if the private sector could succeed in building highways," said Marlon Boarnet, a professor of planning policy and design at the University of California Irvine. "But one thing that history is teaching us is that it is more complicated that we thought."

Hulsizer said his company intends to operate the tollway through bankruptcy reorganization and beyond, even though he doesn't expect the venture to turn a profit anytime soon. He hopes a judge will give the business some breathing room by allowing it to restructure its debts, perhaps by lengthening its loan-repayment schedule.

"As a valued customer, you will see no change in service," he promised drivers in an e-mail yesterday. "Your local toll road will still be here for you."

In a phone interview, however, Hulsizer said turning over operations to another private business or the company's lenders may be an option, depending on the outcome of bankruptcy proceedings that could last a year or more.

Many South County commuters said they weren't surprised by the bankruptcy bid and blamed the operator, saying its decision early last year to boost tolls drove away customers.

Motorists pay $2.50 to $4.50 per trip, depending on length. Those with FasTrak, an electronic tolling device, pay $2 to $3.85, or 75 cents for trips between Birch Road and East H Street.

Some customers complain that the on-ramp toll machines remain hard to use, while those with FasTrak are upset that South Bay Expressway has imposed a minimum monthly transponder fee.

Ken Monk of Bonita said his extended family was drawn to the roadway at first. "They all used it, all of them," he said.

But once the higher tolls kicked in, they stopped completely. Monk and others said many rush-hour commuters now cut through residential neighborhoods to avoid paying the higher tolls.

Hulsizer does not believe last year's toll hike was unwise. He cited company data showing only a slight decrease in traffic and an uptick in revenue following the increase. The company also noted that it has made improvements to its toll machines in an attempt to address drivers' complaints.

In 1991, Caltrans signed a franchise deal with California Transportation Ventures, the precursor to South Bay Expressway Ltd., that allowed the private outfit to finance, build and run the four-lane road. The agreement runs through 2042.

Hulsizer said the pact and subsequent amendments do not force Caltrans to assume operations if business falters. "The state has no obligation to take over the road," he said. "It's up to us to work it out."

Laurie Berman, chief of Caltrans' San Diego office, declined through a spokesman to address questions about whether her agency may need to step in to operate the road or bail it out.

In a statement, Berman said she does not expect bankruptcy proceedings to affect the public. "Caltrans is monitoring the legal proceedings closely to ensure public interest is protected," she said.

Turning over toll operations to Caltrans may hold little appeal to the agency, given its budget constraints. But a government agency takeover wouldn't be unprecedented.

In 2003, the Orange County Transportation Authority paid $208 million to buy out the developer of the state Route 91 express lanes because the agreement negotiated by the builder prevented California from widening the overall freeway.

Hulsizer said South Bay Expressway, a subsidiary of the Macquarie Infrastructure Group of Australia, owes its lenders $510 million, including $170 million to the U.S. government. He said the money is in the form of direct loans, not bonds, and does not involve an underwriter.

Based on figures provided in the court filing, South Bay Expressway would need to nearly double the number of drivers to keep pace with its long-term debts. Other toll roads across the nation, along with many freeways, also have seen a drop in commuters during the protracted economic slump.

It's not unusual for highway builders to issue rosy projections before opening a major road, said Paul Sorensen, a transportation researcher with the Santa Monica-based RAND Corp.

But that doesn't appear to be completely the case here, he said. "Definitely a lot of the problem has to do with the downturn in the economy," Sorensen said.

The tollway runs from Otay Mesa to Spring Valley. It passes through Eastlake and Otay Ranch in Chula Vista, an epicenter of the local financial meltdown.

The suburban area outpaced most of the county last year in housing foreclosures. Otay Ranch Town Center, the mall that opened in 2006, quickly failed to live up to initial sales projections.

In addition, cross-border traffic from Otay Mesa has been down 30 percent since the start of the recession, Hulsizer said.

When it opened the tollway, South Bay Expressway touted that the option would cut an average of 20 minutes off the daily commute. And at first, the numbers looked promising. Caltrans officials said the road resulted in an 11 percent decrease in morning traffic on nearby Interstate 805 during the beginning months. Average driving speeds on Interstate 805, which largely parallels the toll road, rose from 45 mph to 65 mph.

But as the economy stumbled, overall congestion dipped on South County highways, undercutting the need for the toll road.

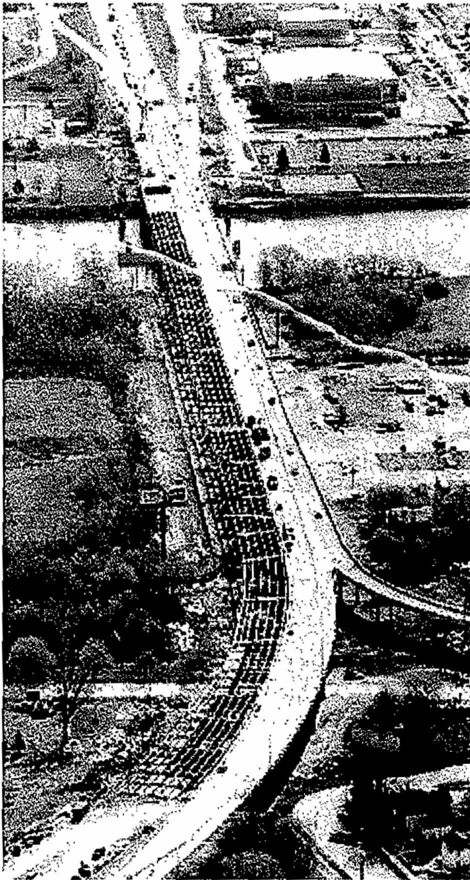
Traffic counts also have declined on the Interstate 15 express lanes in North County. Solo motorists are allowed to drive on that network of car pool lanes if they pay a toll.

Everything Michigan

More than half the state bridges in Saginaw County are 'structurally deficient' or 'functionally obsolete,' data shows

By Barrie Barber | The Saginaw News

April 25, 2010, 5:00AM



View full size Jeff Schrier | The Saginaw NewsWorkers reconstruct the Henry G. Marsh Bridge last week along Interstate 675 over the Saginaw River and M-13 in Saginaw.

SAGINAW — A year since a state road group ranked Saginaw County with the worst state bridges in Michigan, the county hasn't made much progress, statistics show.

The county had 45 structurally deficient state bridges and 11 functionally obsolete spans among 97 bridges, state Department of Transportation data shows.

Last April, the Michigan Infrastructure & Transportation Association declared the county had the worst state bridges with 49 of 97 rated in poor, serious or critical condition as of July 2008.

But that could change next year: Half of the structurally deficient bridges on the latest Department of Transportation list are on Interstate 675, where overpasses and bridges are under reconstruction or repair in a two-year, $42 million freeway rehabilitation in its final months.

Michael A. Nystrom, association executive vice president for the construction industry trade group, said the state hasn't spent enough to fix the problem.

"Since we have not found a way to invest more adequately, my sense is that the number of bridges that are in poor condition will continue to actually grow if nothing is done, and motorists will have to live with the fact that bridges they are traveling over are crumbling and bridges that they are traveling under may be dropping concrete onto their vehicles," he said.

The county also has ranked in the infrastructure group's worst pothole contest for three years in a row.
In one of the biggest bridge reconstructions this year, crews are redecking and repairing the northbound lanes of the Henry G. Marsh Bridge in a $15 million project along Interstate 675 over the Saginaw River and M-13. Workers finished the southbound side of the span last year. They continue to work on other overpasses and bridges in the first major repair and reconstruction of the freeway since it opened in 1971.
"Our aim in completing the two-year I-675 project was to improve the road and bridge conditions," said spokeswoman Anita Richardson.
State bridges aren't the only ones in poor shape.
The Saginaw County Road Commission counts 49 bridges out of 218 that are either structurally deficient or functionally obsolete. In each category, it counts 33 as structurally deficient and 16 as functionally obsolete.
"Are they a safety hazard? No, not really," said Road Commission Manager Brian J. Wendling. "But are they ... in the condition we would like to have them in? The answer is no, they're not."
The commission's total reconstruction and repair budget was about $12 million this year, the lowest since 1998. The agency closed the Fergus Road bridge in St. Charles Township out of safety concerns.
In the biggest agency road project, crews in July hope to finish the $2.6 million reconstruction of the Center Road bridge, built in 1927 over the Tittabawassee River connecting Saginaw and James townships. In June, crews will start a $2.3 million demolition and rebuild of the 52-year-old Fort Road bridge over the Cass River in Bridgeport Township.
In the next two years the Road Commission has on the drawing board plans to reconstruct four bridges: Dixie over the Cass River in 2011 in Bridgeport, and in the following year Bishop over Miller Drain in Albee Township, Merrill over the south branch of the Bad River in Chapin Township, and Frost over Swan Creek in Thomas Township.
"It all comes back to funding," Wendling said. "The bottom line is the transportation system has just been sorely underfunded for many years."

© 2010 MLive.com. All rights reserved.

http://www.crainsdetroit.com/section/c?template=profile&uid=140106&plckPersonaPage=BlogViewPost&plckUserId=140106&plckPostId=Blog%3a140106Post%3a4bddbaa1-226f-4e42-8c12-9d72459733ec&plckController=PersonaBlog&plckScript=personaScript&plckElementId=personaDest

Crain's Detroit Business Blog by Bill Shea Posted 5/3/2010 2:45 PM EDT on crainsdetroit.com

Private sector wary of tolls to finance new bridge

The private-sector companies interested in building a new Detroit River crossing are divided in their belief if toll revenue can cover the project's cost.

Some say tolls will be enough, **but most prefer direct payments from the government (or government-run bridge authority) instead. That eliminates or significantly reduces private-sector risk if the tolls aren't enough to pay the bridge -- potentially leave Michigan taxpayers (or Canadian taxpayers, or both) on the hook if a subsidy is needed.**

The Michigan and Canadian government backers of the proposed **Detroit River International Crossing** project have said since its inception that toll revenue would recoup construction financing costs, which would be assumed by private companies in a joint public-private arrangement to build and operate the span.

The bridge has an estimated $2.1 billion cost as part of the wider $5.3 billion project. Michigan is close to approving the public-private partnership (P3) legislation that's the preferred route to creating the bridge.

However, several of the firms that responded to an MDOT request for interest bids in January warn that toll revenue could be a non-starter. (**Link**)

"In the current economic environment, we believe that to develop a complex project under a public-private partnership structure, a business model with availability payments is the best solution if not the unique one," wrote Paris-based mega-civil engineering firm **Bouygues Travaux Publics S.A.** in its bid.

Bouygues Travaux has built major transit infrastructure worldwide, including the tunnel that spans the English Channel.

A P3 arrangement will sometimes use what's called an "availability payment" in which the concessionaire gets payments from the government in lieu of the toll money. Availability payments are uncoupled from demand, such as in cases where there is no user fee, or revenue from tolls is expected to be insufficient.

MDOT nor its DRIC partners (Ontario's **Ministry of Transport** and **Transport Canada**, and the **U.S. Federal Highway Administration**) haven't said if availability payments would be acceptable.

Critics, including some in the toll industry, say the traffic estimates used to justify the DRIC bridge are overly optimistic, increasing both public financial risk on the project and uneasiness by lenders in financing a toll-drive project.

A July 2008 report by the Center for Transportation Research at **The University of Texas** at Austin on behalf of the **Texas Department of Transportation** and the Federal Highway Administration, says the same thing: A majority of toll-road projects overestimated traffic levels in the first five years by at least 20 percent to 30 percent.

One of the mega civil infrastructure firms officially interested in DRIC, Australia's **Macquarie**, saw the $843 million South Bay Expressway it opened in 2007 as a part of a public-private partnership in San Diego file for Chapter 11 bankruptcy protection because traffic estimates failed to meet reality.

MDOT, which previously released DRIC traffic estimates, on Friday said a DRIC toll revenue study is still ongoing.

Bouygues Travaux also warned that lenders are wary of toll-driven projects.

"Traffic risk deals have underperformed and financial markets may not show sufficient appetite to finance this project if senior lenders have to take patronage risks," the firm wrote. "Traffic deals with patronage risk are more expensive and may even be non-financable.

The company, which would want a 10-percent equity stake in the bridge, said an alternative to availability payments would be a hybrid in which the governments would provide minimum traffic guarantees — which translate in a subsidy — that would take traffic revenue risk off lenders.

Madrid-based **Acciona S.A.**, which did a P3 project for a highway outside Montreal, is another global civil infrastructure firm that expressed its preference to availability payments, rather than a direct toll concession, in its interest bid with MDOT.

The company wrote: "Availability payments (are) the best option to achieve best value for money, and all or at least the vast majority of the payment should be availability-based. Certainty on the revenue stream will be essential to finance the project. This type of P3 structure transfers the risks of designing, building, financing and operating/maintaining a project to the private partner. Risk of volume and vehicle traffic remains in hands of public sector that is better positioned to assume the risk related to the revenues generated from the users."

Acciona offered the alternative of shadow tolls, which payments made by government (or, in this case, the public bridge authority) to the private sector operator based on the number of vehicles using the bridge.

The firm said the presence of the Ambassador Bridge and its traffic would make DRIC "difficult to finance."

Canada's **Scotiabank**, which is the financial advisor for the DRIC-related Windsor-Essex Parkway project, noted preference for availability payments in its interest bid to MDOT.

"From the prospective of a lender, credit risk is decreased if remuneration to the private partner comes in the form of an availability payment. There are many reasons for this; however, the most significant is the lack of demand risk," the bank wrote.

It also warned that toll projections make lenders wary. "Lower than projected traffic has plagued many user toll-based PPPs around the U.S., and as a result, senior lenders are more restrictive in providing credit to demand based facilities. This issue is particularly relevant for the proposed project considering the current economic climate," it wrote.

That doesn't mean tolls can't work, however.

"This is not to say that the project will not be financeable if it utilizes a demand based payment mechanism, however, any financing will require a great deal of traffic and trade volume due diligence, as well as comfort with the proposed toll setting mechanism on the part of the funders," the bank wrote.

The bank also noted that lenders will likely want a bigger debt-to-equity ratio if tolls are used as the primary revenue source: "If a demand based payment mechanism is utilized for the project or a portion thereof, a considerably larger amount of equity will be required. A D/E range of roughly 60:40 to 75:25 will likely be required to gain comfort from lenders."

That's compared to a 85:15 to 90:10 ratio under an available payment concession, the bank wrote.

Interestingly, **Scotiabank was a financial advisor on the now-bankrupt South Bay Expressway. It mentions its involvement in the bid, but the bankruptcy came after its submission — but the revenue troubles have been ongoing.**

Some civil engineering-construction firms, such as Montreal-based **SNC-Lavalin Inc.**, prefer toll revenue over availability payments.

"This real toll remuneration method is the most common, currently utilized structure for demand based transportation P3s in North America and globally. This method would benefit the public due to the private partner's motivation to market and

maintain the facility in order to encourage use by traveling motorists or freight haulers as well as avoid any penalty regimes included in the concession agreement for poor operation and maintenance," SNC-Lavalin wrote in its bid.

SNC-Lavalin built the **Canada Line Rapid Transit** system in Vancouver.

Ottawa-based law firm **Gowling Lafleur Henderson L.L.P.**, which is interested in providing legal guidance to the project, also expressed concerns about availability payments to finance the bridge — including higher tolls.

"It would shorten the amortization of the bridge to the available term of financing, which would be about 35-40 years with an amortizing bond. This would in turn result in tolls that would be higher than economically required. By assuming traffic risk, the sponsors would be taking on a very significant financial risk, as well as the political risk associated with the setting of tolls," the firm wrote.

Cintra Infraestructuras S.A.U. from Madrid, Spain favors a toll-based model.

In their joint bid, **Meridiam Infrastructure** and **AECOM Technical Services Inc.**, both of New York City, also say tolls are the way to go.

"A preliminary financial analysis based on the traffic forecasts prepared by Wilbur Smith on behalf of MDOT and a series of assumptions revealed that the project (excluding the customs inspection plazas) can be financially viable without a government subsidy under a 50-year concession. **While this analysis is preliminary in nature (revenue figures were not released as part of Wilbur Smith study), it is our assessment that toll revenues should be sufficient to cover costs for the bridge, the U.S. interchange and the toll plazas currently estimated at $1.48 billion**."

Australia's **Macquarie**, on the other hand, wrote that it's "preferred payment mechanism for this project is (to the extent MDOT and Transport Canada) wish to fund a portion of the project) a single, large construction payment at substantial completion, accompanied by availability payments through the operating period."

Without border traffic revenue estimates, and the current bridge being nearby, tolls alone are too risky, the company said.

"**As a result of these conditions, we do not believe that this project is financeable as a pure toll facility**," it wrote.

Here is how the joint DRIC partnership bills its development: "The preferred delivery mechanism for the bridge is a public-private partnership in the form of a long-term concession agreement which will seek to maximize private sector participation and financing to avoid the use of taxpayer dollars. The intent is for the bridge to be

financially self-sustaining from a reasonable toll charged to its users. It is envisioned that the owners will form a joint venture to oversee the concession contract with the private sector."

Walsh Construction Co., Chicago; **PCL Civil Constructors Inc.**, Edmonton, in a joint interest bid favor availability payments. So does interested financier **BMO Capital Markets**.

The Toronto office of Spanish civil engineering/construction firm **ACS Group** wrote in its bid that it expects the governments to subsidize the project — rather than the private sector — if traffic revenue fails to meet expectations.

"It seems according to the information that has been made public, that for the project to be feasible in case of a funding gap (traffic and other sources of revenue not enough) MDOT and TC will have to assign public funds to the project, in form of construction payments and/or availability payments depending on their accessibility to resources and budgetary constraints of time."

Comments (0) | Permanent Link

Tags: **Detroit**, **bridge**, **tolls**, **DRIC**

http://www.tollroadsnews.com/node/4547

Greenville Southern Connector SC last of not-for-profit pikes is broke
Posted on Fri, 2010-01-22 00:27

As they warned last fall the Greenville Southern Connector (GSC) tollroad defaulted on debt service due January 1. They are now in discussion with creditors as to who takes the losses, and how they reorganize the toll operation in Greenville SC - located on I-85 midway between Atlanta GA and Charlotte NC.

A statement released by the operator, Connector 2000 Association says:

"Traffic on the Southern Connector was inadequate to permit the Association to collect sufficient toll revenues to pay debt service on the Senior Bonds and Subordinate Bonds which came due January 1, 2010. The Association has been advised that the Bond Trustees have made no payment of any such debt service. An Event of Default currently exists and is continuing on the Bonds and under the Master Indenture. The Association is actively negotiating the restructuring of its bonded indebtedness with the Bond Trustees, the South Carolina Department of Transportation, and certain owners of large blocks of the Senior Bonds."

The one-third belt route pike project that opened early 2001 was based on projections of daily traffic of 28k by the end of the first year rising to 37k in 2015. That 1998 forecast has turned to be hugely exaggerated. The traffic and revenue (T&R) forecast was produced by international T&R giant Wilbur Smith Associates (WSA), headquartered not far away in Columbia SC.

GS Connector traffic should have been around 33k/day by now.

In the year just ended traffic was 15k/day or about 45% of forecast.

(Traffic is measured here by toll transactions so trip numbers are lower than 'traffic.')

Truck traffic is a lower proportion (only 4%) than expected, and so average toll revenue/transaction is lower than in the forecasts.

WSA three times too high on revenues

Revenue was therefore even further off-forecast than traffic.

WSA projected GS Connector (GSC) annual toll revenues after ramp-up in 2003 at $10m, three times the $3.34m achieved.

By 2015 tolls were forecast at $21m. To be on the WSA track they should be nearly $16m in 2009. They were one third of that at $5.25m.

A remarkable consistency in gross over-estimation.

Why forecasts failed

The GS Connector simply does not serve major commuter flows within the approx 600k population metro area.

These flows are on a southeast-northwest axis Simpsonville, Mauldin, Greenville and along US276 and I-385. This is mostly to the north and east of the Connector.

The Connector including the toll-free portion of I-185 swings too far south, southwest and west to compete for major internal metro area traffic.

It doesn't offer time-savings to most of the local traffic.

The road was located mainly to serve new development on the southern and southwest fringe of the area, not to relieve congestion. The new development has occurred, but more slowly than the tollroad promoters predicted.

The Connector route is too circuitous for through traffic and it is badly connected to I-85 at its western end for Atlanta to Columbia traffic.

The interstate designation (I-185) is ridiculous.

It is a fringe metro area development access road.

Retired Federal Highways chief the mover & shaker

Chief mover and shaker in the project was Bob Farris, a former federal highway administrator from the Washington DC area.

South Carolina state highways commission chairman at the time Buck Limehouse was a strong local supporter.

Farris formed a private company called Interwest which developed the project from permitting through design and construction.

They set up the not-for-profit Connector 2000 Association that was granted a state license to operate the tollroad for 50 years.

The Association sold some $240m of bonds which financed the $190m of construction costs and provided a cushion against a few years of losses.

Lehman Bros of Wall Street, since gone broke, was major financier.

BACKGROUND: Greenville has a city population of 56k but with Spartansburg to the east and other communities nearby forms a metro area population of 602k. In the far northwest corner of the state of South Carolina it is located about midway on I-85 between Atlanta GA and Charlotte NC.

The tollroad 26km, 16 miles in length and 2x2 travel lanes has seven interchanges, two mainline barrier plazas and two pairs of ramp tolls.

Last of a small bunch of ill-concevived no-skin-in-the-game follies

GSC is the last of a small bunch of so-called 6320 (after a clause in the US tax code) not-for-profit toll projects launched in the late 1990s, all of which have now collapsed - others being the Northwest Parkway in Denver Colorado and the Pocahontas Parkway in Richmond Virginia.

In all cases developers who made their money upfront had overoptimistic traffic and revenue projections and inflicted excessive debt on the project. Being not-for-profit they had no shareholders and hence no equity to represent a longterm interest in the project and provide a cushion against hard times.

Pocahontas Parkway and Northwest Parkway were both successfully converted to for-profit private toll concessions before they defaulted as not-for-profits. In 2007-2008 the GS Connector was studied for privatization prior to default, but the financial prospects were seen as too poor to enable it.

By the latest accounts total liabilities of the Association are $325m, about half of which are accumulated losses.

However the Association's accountants Bradshaw Gordon & Clinkscales say the accounts do not meet generally accepted accounting standards and are unaudited. They state they can't warrant them as accurately representing the true financial situation of the troubled pike.

see Jan 11 "Briefing" by the Association with accountants' disclaimer:

Roads Less Traveled
Kelly Barron, Forbes Magazine, 09.03.01

New toll roads have been a bonanza for consultants, but not for bondholders.

Florida Governor Jeb Bush's recent veto of a $1.4 million bailout of the Garcon Point Bridge spanning Pensacola Bay was the final indignity in the troubled history of the controversial toll bridge.

A pet project of former Florida House Speaker Bolley (Bo) Johnson, recently released from jail for tax evasion, the bridge was partly built on land he once owned. The builder was charged $4 million in fines and restitution for violating federal environmental laws. Adding to the folly, the toll bridge was built parallel to a nearby free bridge.

But the bridge likely would never have been built at all were it not for the seal of approval it received from URS Corp. of San Francisco, one of a handful of consultants that specialize in traffic projections for public projects. Using URS' 1992 projections that 6,500 cars would drive over the bridge daily and pay what is now a $2.50 toll, promoters flogged $95 million in bonds to finance the project. Today only 3,500 cars a day use the bridge.

"The bridge is an Edsel," sighs Joseph Mooney, a financial adviser who resigned in 1993 after a dispute with local officials over the numbers from URS, a publicly held engineering company whose largest shareholder is investor Richard Blum, otherwise known as the husband of Senator Dianne Feinstein (D-Calif.).

They should have listened. It has become painfully clear to bondholders and politicians that many of the public toll-supported projects built in the past decade, the majority blessed by URS and its ilk, have become financial albatrosses. The Garcon Point Bridge bonds, for instance, trade at 71 cents on the dollar, following multiple downgrades to junk status by the ratings agencies. Local officials will likely have to tap a reserve account next year to meet debt service.

URS defends its record in Florida as solid. But the company has overestimated revenue projections on toll roads elsewhere in the state, including the Seminole Expressway, the Polk Parkway and the Suncoast Parkway. On the 15-mile Veterans Expressway in Tampa, annual tolls are $15 million, barely half what URS projected in 1992. Tolls from the main portion of the state's profitable turnpike go to subsidize those clunkers.

"Many of these deals shouldn't even be brought to market," says Robert Muller, a managing director with J.P. Morgan Chase, who has researched toll-road feasibility studies. Muller figures that at least half of the traffic projections for toll roads--mostly performed by URS, Wilbur Smith Associates in Columbia, S.C. or New York-based Vollmer Associates--vastly overstate the potential.

But that hasn't stopped politicians, bond salesmen and contractors from relying on them. **"It's almost an accident if the projection comes in perfectly," admits Edward Regan III, a Wilbur Smith senior vice president. For its part, Wilbur Smith's initial projections in 1992 for the 15-mile San Joaquin Hills Toll Road in Orange County,**

Calif. were 40% above actual traffic counts. By 1997, $1.1 billion in bonds had to be replaced with lower-rate bonds or risk default. Still in need of riders, the local toll-road authority recently handed out discount coupons.

Despite their mixed track record, the consultants who do the traffic projections have a nice little business, yielding upwards of $500,000 per study. Although traffic studies for revenue bonds probably brought in less than 5% of URS' $2.2 billion in revenues last year, the stock is still doing better than the average revenue bond these days--it's up 239% in the past five years.

http://onlinepubs.trb.org/onlinepubs/nchrp/nchrp_syn_364.pdf

Evolution of Decision-Making Environment
Concerns regarding the reliability, accuracy, and credibility of travel demand forecasts are not new. A 1989 U.S.DOT study compared projected and actual ridership and costs for 10 heavy- and light-rail transit projects in 9 U.S. cities. The study found that the actual ridership for each of the 10 projects was significantly below the projections, whereas the actual costs were higher than the projected costs in 9 of the 10 projects. The projected ridership (i.e., benefits) and costs were used as the basis of investment decisions and of applications for federal government funding (34).

Although the study addressed only forecasts for transit, it is relevant to toll road demand and revenue forecasts because it received widespread attention in the transportation community and also because it anticipated many of the issues that have since been identified in toll road forecasts. Hence, it provides an important context for the discussion of how the decision-making environment has evolved. For example, the study explained the need for the community to understand the accuracy of the ridership and cost forecasts in three ways: the transit projects represented the largest investment ever in public works in each of the nine cities, local officials in other cities where rail projects were contemplated would also rely on similar projections to make their own decisions, and local officials typically used similar analytical processes for other public investments. To this end, the study found that these "mistakes" in ridership estimates could not be explained by differences between projected and actual values of the determinants of ridership: land use inputs (which differed little from the actual), network configurations, assumed feeder bus configurations, or downtown parking prices (which tended to be lower than those modeled). Each of the 10 projects was selected among several alternatives. The study noted that although the accuracy of the forecasts for the rejected alternatives could not be evaluated, for almost all of the projects the divergence between the projected and actual ridership and costs of the selected alternative was greater than the entire range of the ridership and costs of all the alternatives that were compared (which made it "extremely unlikely that a rail project would have prevailed in the presence of more reliable forecasts"). Rather, the study attributed the differences to the structure and nature of federal transit grant and fund programs (effectively favoring high-capital transit investments), which provided little incentive to local decision makers "to seek accurate information in evaluating alternatives." The result was a "bias" or "optimism" for rail transit (35).

These differences (and those in other areas of public policy) demonstrate a "serious ethical problem" in the use of forecasts, with occurrences noted in which modelers had been directed by their superiors (including local elected officials) to "revise" their ridership forecasts upwards, to "gain federal [financial] support for the projects whether or not they could be fully justified on technical grounds. Forecasts are presented to the public as instruments for deciding whether or not a project is to be undertaken; but they are actually instruments for getting public funds committed to a favored project." The goal of "exaggerated forecast[s] of demand and the cost underestimates" may be to "[get] the project built rather than honestly evaluating its social benefits" (34).

Forecasts have not become more accurate over time. In a multinational statistical analysis of 183 road projects (tolled and non-tolled) completed between 1969 and 1998, the "forecasts [appeared] to become more inaccurate toward the end of the 30-year period studied" (36). More recent forecasts were found to be more comprehensive than older studies; however, "this greater depth has not yet appeared to improve the accuracy of the forecasts." Newer forecasts did appear to respond to earlier concern; for example, by incorporating better methods to forecast ramp-up volumes. However, "whether this increased scrutiny has actually led to more accurate forecasts remains to be seen" (3).

The role of private provision of public services (such as privately owned tolled roads) continues to evolve. Although not specifically directed at the reliability of traffic and revenue forecasts, an article about "intellectual dishonesty" in the ongoing debate may provide some context. For example, the toll revenues for a (hypothetical) bridge that is operated by a private company must cover its capital, operating and maintenance costs, as well as depreciation, which reflects the eventual need for rehabilitation or reconstruction as a result of wear and tear. Its toll rates must be set sufficiently high to cover these costs. Because the company accounted for annual depreciation costs when it issued its debt to construct the bridge (which presumably has been paid off by the time major reconstruction is required), a one-time debt allows the construction of a bridge that "can presumably last forever." **In contrast, public authorities in the United States are not required to account for depreciation, which means—for the same tolled bridge—its toll rates could be much lower. However, it must issue new debt when the bridge is reconstructed (i.e., the public authority inevitably must account for depreciation, but does so in terms of a "perpetual debt"). This**

means that the public authority's bridge seems "less expensive," because its lower toll rates ultimately have transferred the debt from its actual users to future generations (37). The relevance to this synthesis is that the public's expectations and inappropriate understanding of the real costs of public services may affect the choice of toll rates.

TABLE 1
ACTUAL REVENUE AS PERCENTAGE OF PROJECTED RESULTS OF OPERATION

Authority/Facility	Year of Opening	Year 1	Year 2	Year 3	Year 4	Year 5
Florida's Turnpike Enterprise/Sawgrass Expressway *(6)*	1986	17.8%	23.4%	32.0%	37.1%	38.4%
North Texas Tollway Authority/Dallas North Tollway *(6)*	1986, 1987	73.9%	**91.3%**	**94.7%**	**99.3%**	**99.0%**
Harris County Toll Road Authority (Texas)/Hardy *(6)*	1988	29.2%	27.7%	23.8%	22.8%	22.3%
Harris County Toll Road Authority (Texas)/Sam Houston *(6)*	1988, 1990	64.9%	79.7%	81.0%	83.2%	78.0%
Illinois State Toll Highway Authority/ Illinois North South Tollway *(6)*	1989	**94.7%**	**104.3%**	112.5%	116.9%	115.3%
Orlando–Orange Expressway Authority/ Central Florida Greenway North Segment *(6)*	1989	**96.8%**	85.7%	81.4%	69.6%	77.1%
Orlando-Orange Expressway Authority/ Central Florida Greenway South Segment *(6)*	1990	34.1%	36.2%	36.0%	50.0%	NA
Oklahoma Turnpike Authority/ John Kilpatrick *(3)*	1991	18.0%	26.4%	29.3%	31.4%	34.7%
Oklahoma Turnpike Authority/ Creek *(3)*	1992	49.0%	55.0%	56.8%	59.2%	65.5%
Mid-Bay Bridge Authority (Florida)/ Choctawhatchee Bay Bridge *(38,39)*	1993	79.8%	**95.5%**	**108.9%**	113.2%	116.7%
Orlando-Orange Expressway Authority/ Central Florida Greenway Southern Connector *(6)*	1993	27.5%	36.6%	NA	NA	NA
State Road and Tollway Authority (Georgia)/GA 400 *(3)*	1993	117.0%	133.1%	139.8%	145.8%	141.8%
Florida's Turnpike Enterprise/ Veteran's Expressway *(3)*	1994	50.1%	52.9%	62.5%	65.0%	56.8%
Florida's Turnpike Enterprise/ Seminole Expressway *(3)*	1994	45.6%	58.0%	70.7%	78.4%	70.1%
Transportation Corridor Agencies (California)/Foothill North *(3)*	1995	86.5%	**92.3%**	**99.3%**	NA[1]	NA[1]
Osceola County (Florida)/Osceola County Parkway *(3)*	1995	13.0%	50.7%	38.5%	40.4%	NA
Toll Road Investment Partnership (Virginia)/Dulles Greenway *(3)*	1995	20.1%	24.9%	23.6%	25.8%	35.4%
Transportation Corridor Agencies (California)/San Joaquin Hills *(3)*	1996	31.6%	47.5%	51.5%	52.9%	54.1%
North Texas Tollway Authority/ George Bush Expressway *(3)*	1998	152.2%	**91.8%**	NA	NA	NA
Transportation Corridor Agencies (California)/Foothill Eastern *(3)*	1999	119.1%	79.0%	79.2%	NA[1]	NA[1]
E-470 Public Highway Authority (Colorado)/E-470 *(3)*	1999	61.8%	59.6%	NA	**95.4%**[2]	NA[3]
Florida's Turnpike Enterprise/Polk *(3)*	1999	81.0%	67.5%	NA	NA	NA
Santa Rosa Bay Bridge Authority (Florida)/Garcon Point Bridge *(42,43)*	1999	32.6%	54.8%	50.5%	47.1%	48.7%
Connector 2000 Association (South Carolina)/Greenville Connector *(3)*	2001	29.6%	NA	NA	NA	NA
Pocahontas Parkway Association (Virginia)/Pocahontas Parkway *(44,45)*	2002	41.6%[4]	40.4%	50.8%	NA	NA
Northwest Parkway Public Highway Authority (Colorado)/Northwest Parkway *(46,47)*	2004	60.5%	56%[5]	NA	NA	NA

Sources are cited in parentheses.

http://www.denverpost.com/news/ci_4263954?source=email

Revenue forecast cut for E-470
By Jeffrey Leib
Denver Post Staff Writer
Posted: 08/31/2006 01:00:00 AM MDT

E-470 expects to see about $10 million less in toll revenues this year than predicted last year by the highway's traffic and revenue consultant.

John McCuskey, the highway's finance director, said high gas prices, consumer resistance to this year's toll increase and the diversion of some traffic to the T-REX road project are the principal reasons for the reduced forecast.

A year ago, Wilbur Smith Associates, E-470's traffic and revenue adviser, said the highway should approach about $99 million in toll revenues this year, according to McCuskey.

Smith Associates' revenue forecast was given before gas prices spiked to $3 a gallon.

Smith Associates is one of only a handful of toll traffic and revenue firms in the country - an industry that has been criticized for routinely delivering inflated forecasts.

McCuskey said actual toll receipts are expected to be about $9.8 million short of Smith Associates' earlier forecast for 2006, but the road has offset part of the decline with about $2 million in payments from toll violators.

http://www.wsdot.wa.gov/NR/rdonlyres/38306964-9827-4E42-AADA-53F7CB9B52C2/0/TollRevenueProjectionsSysthesisFINALSept06.pdf

Traffic Forecasting Risk Study Update 2005: Through Ramp-Up and Beyond
World Highways
September 6, 2006
The 2005 traffic risk study update carried out by Standard & Poor's Ratings Services further supports our earlier conclusions regarding toll road forecasting performance in the first year of operations. Optimism bias—over forecasting asset use--and error remain prevalent. Beyond Year 1, our case study analysis does not support the notion of any systematic improvement in forecasting accuracy. Optimism bias and error measurement statistics remain constant through Years two to five.

Toll Road States
The following eight states had toll projects where consultant forecast estimates were inaccurate:
Colorado – C-470, estimates done by Vollmer, first year were 61.8 percent of projected.
California – Eastern Foothills Toll Road, estimates done by Wilbur Smith, first year were 78.6 percent of projected.
Florida – Florida's Southern Connector surpassed projections by 2 percent, but the Polk Parkway missed by 32.5 percent. The Seminole Parkway's first section missed its first full-year projection by more than 54 percent. The Veteran's Expressway, opened in 1955, also missed is first fullyear projection by 42 percent. Estimates for all were done by URS.
Georgia – Georgia 400, Estimates done by Vollmer, first year are 122.2 percent of projected.
Oklahoma –Cherokee Turnpike, 87.2 percent; Chickasaw Turnpike, 21.1 percent; Creek Turnpike, 49 percent; and John Kilpatrick Turnpike, 18 percent; all estimates done by Wilbur Smith. After first year, none exceeded estimates.
South Carolina – The Southern Connector – Wilbur Smith forecast that revenue in 2005 would be $13.2 million, actual collections were $4.7 million – less than 36 percent of predicted.
Virgina –Chesapeake Expressway and Pocahontas Parkway, both estimates done by Wilbur Smith. After first year Chesapeake projections were 139 percent, but Pocahontas was at 51 percent.
Texas – The Camino Colombia near Laredo, TX opened in 2000 and then was closed for five months. The revenue projections done by URS were overestimated by 94 percent. John Hancock Insurance bought it for $12.1 million at auction and closed the road. The state then bought the road for $20 million and reopened it and estimates it may take 40 years for the road to pay for itself.

Truth be tolled - pt. II

Denver and the West: No 2-way street: When landowners help pay the toll

The Denver Post, September 5, 2006

http://www.denverpost.com/ci_3876477

By Chuck Plunket

Denver Post Staff Writer

This article describes flawed projections done for the Greenville Southern Connector, in Greenville, NC. The traffic and revenue projections prepared by the nationally known company Wilbur Smith Associates helped persuade investors in 1998 to loan a newly created toll authority $200 million creating Greenville's Southern Connector.

The article states that from that $200 million, Wilbur Smith collected more than $12 million for a pair of contracts the authority promised the company if the bonds were sold. This was done as the company prepared the revenue projections that justified the loan.

http://articles.sun-sentinel.com/1998-08-04/news/9808040004_1_ridership-study-ridership-projections-wilbur-smith-associates

Report Questions Bullet Train Ridership

State Study Overestimated Projected Use, Consultant Says
August 04, 1998|BY JULIE CARR SMYTH and KARLA SCHUSTER Staff WritersState ridership projections for a proposed high-speed rail between Miami, Orlando and Tampa could be off by as many as 3 million passengers a year, a consultant hired by a state oversight panel said Monday.

The report by Wilbur Smith Associates, commissioned by the Florida Transportation Commission, said the train will attract about 5.2 million riders a year _ not the 8.2 million projected in an earlier state ridership study.

``We think these (state) estimates may be too optimistic," Robert Zuelsdorf, senior vice-president of Wilbur Smith, told transportation commission members in a workshop on Monday in Tallahassee. ``But we don't know. We're just suggesting that you make one set of (financial) projections based on the lower number..."

State transportation officials said the Wilbur Smith review is no more reliable than the original ridership study

http://www.latinfinance.com/DailyBriefArchivePrint.aspx?ID=67380

Wrong Traffic Projections. For the PPP projects in roads, most traffic projections made by the best of independent consultants have been way off the mark, and all they need are small revenue fluctuations to bring about sharp declines in their internal rates of return (IRRs). For example, in the case of the Delhi–Noida flyover, traffic was initially overestimated to the tune of 50 per cent. To be fair, overestimating traffic and revenue is a global phenomenon. For instance, traffic on the toll highway between Mexico City and Acapulco via Cuernavaca was so grossly overestimated—and actual traffic flow was so much less— that the BOT project ran on severe losses for almost a decade and needed to be renegotiated twice. The risk of overestimated traffic projections becomes extremely relevant in the case of BOT contracts, where the private developer has to bear the traffic risk, and even more so in greenfield toll projects that compete with existing free routes. In the case of expansion and upgrade projects, obviously the traffic growth is easier to forecast. Although traffic projections are difficult for roads, they are virtually impossible for ports, especially greenfield ports. Lenders tend to be over-cautious about all traffic projections and almost instinctively evaluate all projects by cutting down the revenue figures. This increases project risk, reduces the IRR and raises the cost of funding so much as to scuttle many projects. Collection Risks. The flow of funds for infrastructure projects is critically dependent on the credibility and certainty of future revenue streams, which, given the existing uncertainties in collection, remain suspect. In roads, power and water, the inability of the government to apply and recover appropriate user charges seriously hampers the viability of projects— for example, having an untolled road running parallel to a toll road, as in the case of the Mumbai–Pune Highway. In roads, such problems occur even in instances where the traffic is more or less correctly projected. They relate to cases where, because of political clout, consumers simply refuse to pay the appropriate charges. Such cases are known to have occurred in toll roads such as the Coimbatore bypass project in Tamilnadu. They also occur quite frequently in the power sector, with both State Electricity Boards (SEBs) and some groups of final consumers consistently refusing to pay their dues...

The Harris County Toll Road Authority in the Houston, Texas vicinity, a county-owned toll facility whose bonds are rated A1, recently opted to forego privatisation after considering the benefits and costs prepared by a group of three independent financial consultants. Instead, Harris County plans to retain control of its toll road asset and attempt to extract the maximum value to fund other transportation projects in its service area...

Large amount of debt necessary for some transactions poses potential challenge to concessionaires

The high degree of leverage required to obtain a winning bid on a concession may ultimately affect the government if the concessionaire is unable to make the debt service payments. The Chicago Skyway concession was sold for $1.8bn, or about 40 times pre-sale annual revenue, and the Indiana Toll Road was priced at $3.8bn, also roughly 40 times revenue. These deals relied on complex interest rate derivatives as well as steady indexed toll increases in order to support the significantly increased amount of debt. Although not necessarily true for these two deals, in some cases, excessive or poorly structured debt could cause the concessionaire financial stress, increasing the need for a

possible bailout or takeover by government if the concessionaire declares bankruptcy or otherwise defaults on the concession contract...

Non-compete clauses could create political pressure to undo concessions

Similarly, the inclusion of a non-compete clause in a concession contract can be a potential credit concern. Although the clause helps the concessionaire protect its investment, the restrictions it places on a government's ability to improve mobility can potentially create political pressure to stop the concession, as happened with SR 91. The California Department of Transportation (Caltrans) had granted a 35-year concession to the California Private Transportation Company (CPTC) to build and operate high-occupancy vehicle (HOV) lanes on SR 91, which links employment centres in Orange County with residential centres in Riverside County. The franchise included a non-compete clause that restricted the construction of roads within a 1.5-mile-wide corridor on either side of the toll lanes for the life of the agreement.

At first, drivers supported the new, privately owned lanes, which opened in December 1995 and were among the first US toll roads to implement variable or congestion pricing by time of day and day of week to maximise traffic flow and revenues. Later, however, opposition to the non-compete clause grew, especially after traffic congestion increased on the adjacent toll-free lanes. Caltrans wanted to connect the free lanes on SR 91 to publicly owned roads on the eastern transportation corridor. Caltrans argued that the connecting lanes were needed for safety reasons, one of the provisions that overrode the franchise agreement's non-compete clause. Ultimately the dispute was settled with CPTC's sale of SR 91 for $207m to theOrange County Transportation Authority (OCTA), which now operates the lanes as a standalone enterprise. Under government ownership by the OCTA, the SR-91 (rated A1) now has one of the most innovative congestion-pricing schemes and some of highest toll rates in the United States.

The Indiana Toll Road has a non-compete clause, and the long-term consequences of its inclusion remain to be seen. The clause prohibits any action by the government, the effect of which is principally borne by the concessionaire or private operator or which affects the fair market value of the toll road. Contravening the non-compete clause could result in a substantial payment from the government to the concessionaire or the termination of the concession and payment by the government of the fair market value of the concession at the time of the termination. The Chicago Skyway concession does not include a non-compete clause.

Bankruptcy of concessionaire could potentially benefit the government, but the government needs to be ready to operate roadway

A central concern seen by some in the marketplace is bankruptcy by the concessionaire. The outcome of a bankruptcy will depend on the terms of individual concessions and states' bankruptcy laws. In the case of debt-financed concessions, bondholders may have step-in rights to prevent a bankruptcy from happening. If a bankruptcy does occur, there is some possibility for the government to benefit if it can successfully terminate the concession and is allowed to lease the road again. In Moody's opinion, the government needs to be prepared to assume control of the road during the life of the concession and

have the necessary staffing and capital to ensure a smooth transition in the case of a contract termination.

Contract default by government could result in substantial cash payment to concessionaire and stress to government rating

A default by the government on the terms of the concession, on the other hand, could result in a substantial termination payment equal to the fair market value of the concession at the time of the termination. In the case of the Chicago and Indiana concessions, events of default by the government include a failure to abide by the terms of the concession, payments due from an encumbrance on the toll road created or incurred by the government, or an inability of the government to pay its debt or a filing for bankruptcy protection—a remote risk in Moody's opinion. Termination payments could necessitate a use of reserves, a bond sale or both; and these actions could have a negative impact on a government's credit rating.

JAMES L. OBERSTAR, CHAIRMAN

U.S. House of Representatives
Committee on Transportation and Infrastructure
Washington, DC 20515

May 10, 2007

Dear:

We write to strongly discourage you from entering into public-private partnership ("PPP") agreements that are not in the long-term public interest in a safe, integrated national transportation system that can meet the needs of the 21st Century. Although Bush administration officials have lauded PPPs at every turn, the Committee on Transportation and Infrastructure of the U.S. House of Representatives believes that many of the arrangements that have been proposed do not adequately protect the public interest. The Committee will work to undo any state PPP agreements that do not fully protect the public interest and the integrity of the national system.

The Committee on Transportation and Infrastructure has begun work on reauthorizing the Federal highway, transit, and highway safety programs of Safe, Accountable, Flexible, Efficient Transportation Equity Act: a Legacy for Users ("SAFETEA-LU"), which expires on October 1, 2009. We believe that we must significantly increase investments in our highway, bridge, and public transit infrastructure. However, we have serious concerns about states entering into PPP agreements that improve selected segments of our surface transportation network but undermine the integrity of a national system and do not protect the public interest. Although we invite all financing options be on the table as we evaluate opportunities to increase investment in our nation's infrastructure, we strongly caution you against rushing into PPPs that do not fully protect the public interest, the integrity of the national system, and which do not constitute a sustainable national system of transportation financing.

The Subcommittee on Highways and Transit of the Committee has held three hearings since May of 2006 on PPPs to examine the policy questions surrounding increased private involvement in infrastructure project development, delivery, and financing. It will

hold another hearing on the issue at the end of the month. Our interest in PPPs is directly related to the increased involvement of private companies, both foreign and domestic, in managing and financing our nation's transportation infrastructure, and efforts by the U.S. Department of Transportation ("U.S. DOT") to strongly encourage states to utilize PPPs.

Our concern initially stemmed from non-compete clauses that are frequently included in concession agreements that make it extremely difficult – if not impossible – for public transportation agencies to address safety and congestion problems on highways and streets adjacent to private toll roads. More recently, we have become increasingly concerned with a new type of PPP agreement that was approved for projects in Chicago and Indiana. These agreements raise revenues for public entities by engaging in long-term leases of existing toll facilities with private companies. These deals make good business sense to the companies that are investing in the projects, but we have serious concerns about whether these transactions offer a net balance of benefits for the American public.

We are also very concerned about the impact that PPPs will have on our national transportation network, which is the mobility backbone that supports our economy. Our Federal-aid highway system was developed on the basis of a federal-state partnership. The need for an efficient, integrated national transportation network is even more compelling in today's global economy than when we began the work in the 1956. Shortsighted and unbalanced PPPs that mortgage our nation's surface transportation infrastructure for generations to come may favor parochial and private interests to the detriment of an improved 21st Century national transportation system.

The rush of the Administration and some states to embrace PPPs, particularly for long-term leases of existing assets, is already turning public opinion against this form of innovative financing and may hurt future efforts to positively harness private investment for the public good. PPPs that expand capacity and provide a service that otherwise cannot be provided by public resources may be a good idea. However, we need to fully examine both the claimed benefits and the potential public policy concerns engendered by this relatively new way of financing transportation projects in the United States before it is significantly expanded across the country.

The U.S. DOT is strongly encouraging states to adopt legislation allowing for PPPs. To support this endeavor, they have created "model legislation" for the states as an example of what the Administration believes should be included in any legislation proposal to authorize PPPs. To provide a more balanced discussion about the benefits and costs of PPPs, the Committee on Transportation and Infrastructure is preparing a discussion paper that outlines what we think states should consider before enacting PPP legislation or entering into PPP agreements. That document will be sent to you in the coming days.

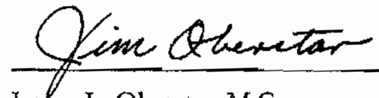
The Honorable
May 10, 2007
Page Three

As we move to reauthorize the Federal highway, transit, and highway safety programs, we look forward to working with you and other state and local officials to ensure that we significantly increase infrastructure investment while protecting the public interest in a safe, integrated national transportation system that can meet the needs of the 21st Century.

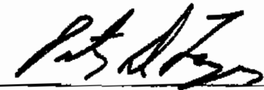
If you have any questions, please contact the majority staff of the Subcommittee on Highways and Transit at (202) 225-9989 or us.

With all best wishes.

Sincerely,



James L. Oberstar, M.C.
Chairman



Peter A. DeFazio, M.C.
Chairman
Subcommittee on
Highways and Transit

BARRON'S
http://online.barrons.com/article/SB124183159872002803.html
Monday, May 11, 2009

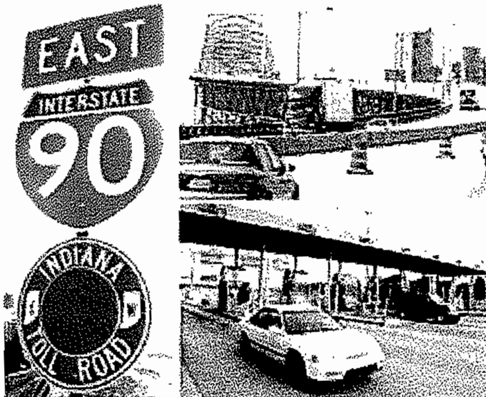
FEATURE

The Long and Binding Road

By ANDREW BARY

The Hoosier State clearly got the better end of the bargain when it sold the Indiana Toll Road to Australia's Macquarie and Spain's Cintra.

THE CREDIT-MARKET COLLAPSE AND POLITICAL OPPOSITION have all but killed the U.S. highway-privatization trend. A 2008 deal reached by Pennsylvania Gov. Ed Rendell to lease the Pennsylvania Turnpike for $12.8 billion died in the state legislature, and an initiative by New Jersey's governor, Jon Corzine, to consider a long-term lease of the New Jersey Turnpike failed to gain political traction. An agreement to sell Chicago's Midway Airport for $2.5 billion collapsed last month as the buyers, including a Citigroup (ticker: C) investment fund, couldn't get financing and ended up forfeiting a $126 million deposit to the city of Chicago.



Clockwise from left: Frank Polich/Bloomberg News; AP Photo/Ted S. Warren; Barbara L. Johnston/MCT
Indiana got $3.8 billion for its big toll road, and the Chicago Skyway, top right, also sold high. But a deal for Pennsylvania Turnpike, bottom right, was DOA.

Given the trend away from private money for public roads, politicians in cash-strapped states across the country are looking eagerly to Washington to help fund a range of transportation projects, including the repair of existing highways and the funding of new ones.

But one state, Indiana, has a leg up on its peers. Three years ago, it sold the Indiana Toll Road, a 157-mile highway that stretches across the top of the state, for $3.8 billion to Spain's **Cintra Concesiones de Infraestructuras de Transporte** (CIN.Spain) and Australia's **Macquarie Infrastructure Group** (MIG.Australia), two of the largest investors in international toll roads. Proceeds from that sale, which raised a multiple of what the state had anticipated, have financed a range of long-stalled road projects.

"It was the best deal since Manhattan was sold for beads," Mitch Daniels, Indiana's Republican governor, told Barron's recently. The Hoosier State took advantage of the global infrastructure-investing mania and the ready availability of cheap debt financing, two factors no longer present.

Indiana is looking particularly smart because toll-road revenue now seems less dependable than it appeared to be just a few years ago. "Toll-road traffic declines in this recession have been more severe than in any other post-war recession," says Peter Samuel, editor of TollRoadNews, an online

transportation Website. He says toll-road traffic is down 6% this year and revenue has been hit by recession-reduced usage by trucks, which often account for 50% or more of tolls.

The Indiana sale looks like a loser for the two buyers and a group of foreign banks that lent $3.5 billion to finance the purchase and ongoing capital expenditures. The Indiana Toll Road was leased to Macquarie and Cintra for 75 years, tantamount to a sale; the buyers also took a lot of risk in getting financing for just 10 years on that 75-year lease, leaving them vulnerable to refinancing risk in 2015.

There are merits to infrastructure investing because highways, ports, airports and even parking garages are long-lived assets with revenue that's usually fairly predictable. As with any investment, however, price is critical. Pay 30, 40 or 60 times revenue for even a great asset, and returns are apt to be poor. For the Indiana Toll Road, Macquarie and Cintra anted up a stunning 40 times trailing annual revenue, and 60 times a measure of annual cash flow called earnings before interest, taxes, depreciation and amortization (Ebitda).

It was one of the most illogical prices paid for any major piece of transportation infrastructure during the bubble period of 2005 to 2007, but it wasn't the only example. Other U.S. toll roads bought for inflated prices include the Chicago Skyway and the Dulles Greenway in Virginia, also bought by Macquarie.

Transurban Group (TCL.Australia), another Australian company, paid $611 million in 2006 for Virginia's Pocahontas Parkway -- nearly 60 times annual revenue.

To put these prices in perspective, the average company in the Standard & Poor's 500 index is valued at less than two times annual revenue and about seven times pretax cash flow.

For Whom the Debt Tolls

For highways around the U.S. and even in Canada, revenues aren't keeping up with interest expense. The most profitable road, the New Jersey Turnpike, wasn't sold.

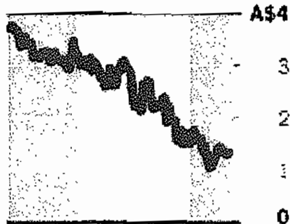
2008 Results	Indiana Toll Road	Chicago Skyway	Dulles Greenway[1]	407 ETR Toronto[2]	Penn Turnpike	N.J. Turnpike[3]
Revenues (mil)	$155	62	64	546	620	856
Operating Income (mil)[4]	$48	30	39	342	53	376
Interest Expense (mil)	$244	97	58	257	146	240
Net Profit (mil)	–$196	–67	–19	85	–93	136
Cash Flow(mil)	$117	52	47	414	247	NA
Total Debt (bil)	$3.5	1.6	0.9	4.7	3.8	4.8
Macquarie's Stake	50%	45	100	30	None	None
Other Major Owners	Cintra 50%	Cintra 55	–	Cintra 53	Pa.	N.J.

1-2007 figures. 2-Canadian dollars. 3-Includes Garden State Parkway. 4-Before interest expense. NA–Not available.
Source: Management reports

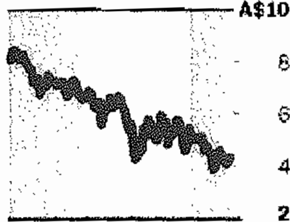
Even after a 2008 toll increase, the Indiana Toll Road is deeply in the red. Revenue of $155 million in 2008 was dwarfed by interest expense of $244 million. The highway looks hopelessly overleveraged amid disappointing growth in revenue and declines in traffic, prompted in part by the toll increases and the economy. The Indiana Toll Road is burning through an interest reserve and has a huge derivative liability of $1.9 billion for an interest-rate swap entered into in conjunction with the original debt financing to convert floating-rate debt to a fixed-rate obligation.

Amazingly, the lending agreement permits Macquarie and Cintra to take $28 million in annual dividends despite the road's heavy losses. Macquarie isn't so lucky with the money-losing Dulles Greenway, where a tighter lending agreement now prohibits any dividends.

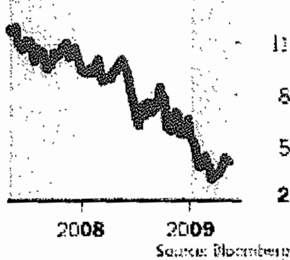
Macquarie Infrastructure (MIG AU)
Weekly close on May 7



TransUrban (TCL AU)
Weekly close on May 7



Cintra (CIN SM)
Weekly close on May 7



Source: Bloomberg

We estimate the Indiana Toll Road might be worth $1.5 billion at most, or a generous 10 times annual revenue. That suggests that the banks may take a sizable hit when their loan matures in 2015, and that the buyers could lose their equity investments.

Maquarie Infrastructure Group, however, is assuming a far rosier valuation. It values its 25% equity stake in the Indiana Toll Road at $145 million, implying a total value for the road (equity plus debt) of more than $4 billion. Essentially, Macquarie is betting that near-term losses in Indiana and other highways will be offset by big future profits, as toll increases outpace growth in operating expenses.

VIRTUALLY ALL TOLL-ROAD OWNERS focus on Ebidta, while playing down operating income after interest expense and capital expenditures, and Macquarie is no exception. The Indiana Toll Road, for example, had Ebidta of $117 million last year. The problem with this approach is that it ignores heavy interest expense and capital expenditures beyond routine maintenance. The Indiana Toll Road buyers have committed to as much as $700 million in capital expenditures for the first nine years of their lease.

Macquarie Infrastructure Group owns stakes in nine toll roads on three continents. The publicly disclosed valuations assigned by Macquarie to a range of its highway assets, including a 30% stake in Highway 407 ETR, a 67-mile toll road outside Toronto, look aggressive in light of their underlying financial performance and heavy debt loads. The Canadian road makes money, generating 414 million Canadian dollars (US$360 million) of cash flow (Ebitda) on C$546 million of revenue in 2008. But its operating income after interest expense and depreciation expense was just C$85 million.

Macquarie values its 30% stake in Highway 407 ETR at about $2.7 billion, implying a total equity value of $9 billion. The highway carries $4 billion of debt, implying an enterprise value of $13 billion (equity plus debt). This is roughly 28 times revenue, 37 times Ebidta and 180 times operating income, stunningly high values given still-depressed markets worldwide. It is true that with the 407 ETR, Macquarie has a lot of room to raise tolls, unlike the Indiana agreement, which limits toll increases. But even with that flexibility, the valuation seems high.

Given these numbers, it is no wonder that equity investors are wary and the company's shares, at 1.44 Australian dollars, trade at a fraction of Macquarie's view of its own asset value.

The Bottom Line

The money paid for toll roads at the height of the privatization rush was a boon to the states. But the deals may come back to haunt those companies that paid stunningly high prices.

In a statement, Macquarie said its discounted cash-flow approach is a commonly used method of valuing toll-road assets and that its valuations are supported by the "privileged nature" of the cash flows, which are bolstered by the ability of owners to periodically raise tolls.

Macquarie Infrastructure Group has been a controversial stock due to a hedge-fund fee structure, the payment of dividends from non-operating sources such as selling properties, asset sales to related entities and the valuation of its toll roads. The shares have fallen 50% in the past year as investors express skepticism with the company's estimated value of its highway assets, which it puts at A$7 billion ($5.37 billion), or more than A$3 a share. Other toll-road operators, including Cintra, have also seen their shares decline.

In short, for toll-road investors, what had promised to be a pleasant ride on a superhighway has turned into a painful trip.

URL for this article:
http://online.barrons.com/article/SB124183159872002803.html

http://www.thedeal.com/newsweekly/features/can-private equity-play-the-infrastructure-game.php

Can private equity play the infrastructure game?

By Vyvyan Tenorio and Christine Idzelis
Published April 3, 2009 at 1:22 PM

EXECUTIVE SUMMARY

- Faced with a moribund buyout market, PE shops are piling into infrastructure.
- Despite crumbling bridges and roads, infrastructure investment has been buffeted.
- But can PE adjust its shorter-horizen, high-fee structure to publicly sensitive projects?

Until recently, aging infrastructure assets looked about as tantalizing to private equity investors as a bunch of trees. The comparison isn't far-fetched. The long-dated, low rates of return that infrastructure assets produce may be marginally better than the low single-digit returns that timberlands might yield after 40 years. Which is why U.S. buyout executives, hard-wired for high risk-reward bets, were less than enthused.

That mindset **has changed** the past few years. Five years ago, the city of Chicago sold a 99-year lease to **Cintra, Concesiones de Infraestructuras de Transporte SA** of Spain and Australia's **Macquarie Infrastructure Group** for $1.8 billion, giving the investors the right to operate the Chicago Skyway toll bridge. Many viewed the highway and bridge as a landmark event for privatization in the U.S., which has lagged Europe and Australia. Faced with crippling deficits and budgetary pressures, federal, state and local governments have increasingly turned to private capital to fill the funding gap for much-needed infrastructure improvements.

Robust credit markets also whetted investors' appetites for steady, long-term investments that with financial engineering could yield better-than-average returns for infrastructure. Macquarie was the category killer that established the listed fund model at least a decade earlier.

Since then, the ranks of private infrastructure funds have swelled, drawing in Washington's **Carlyle Group, 3i Group plc** of London, Swedish private equity firm **EQT Partners** and several bank-sponsored and independent players. However, competition has also increased, and players have tried to boost investment returns by using more leverage.

"If you build it, they will come"

Funds raised globally for infrastructure investments

Year	Funds raised ($bill.)
2004	$2.4
2005	5.2
2006	17.9
2007	34.3
2008	24.7

Source: Probitas Partners

With the global financial crisis and credit markets effectively stalled, infrastructure dealmaking -- often complex, multiparty transactions to begin with -- has become even more complicated. Political resistance is alive and well. The Pennsylvania legislature's recent **rejection** of a $12.8 billion turnpike concession sale underscores how American communities, and entrenched interests, are not eager to just hand critical assets over to private hands.

Lack of leverage also upended the debt-equity calculus. Listed infrastructure funds that relied on excessive leverage saw value vanish, leaving at least three Australian groups in receivership and the so-called Macquarie model in tatters.

Tight liquidity has derailed fundraising, not just for infrastructure vehicles, at least for the near term, experts say. New entrants, including New York's **Kohlberg Kravis Roberts & Co.** and **Blackstone Group LP**, both in the market with their first infrastructure funds, face recalcitrant institutional investors, many of whom are constrained by the denominator effect of sunken market values.

Moreover, experts believe leveraged buyout impresarios will need to offer more than financial alchemy to compete with project finance specialists. Of particular concern to limited partners is the matter of the PE model's economics -- 2% management fee and 20% carry -- broadly at odds with the less robust, low-return risk profile that infrastructure offers, observers say. That "long-term" investments for some PE funds may mean a holding period of less than five years has not have been lost on pension funds, either.

There are tensions between the low, steady-returns profile that institutional investors are attracted to and the classic PE fund structure, say investment bankers and placement agents. Thus, the PE model needs to evolve.

To some extent, that's now happening. KKR rocked the fundraising establishment by halving its fee and carry structure to 1% and 10% when it launched its fund last year. "To me, that tells you everything you need to know about returns expectations from infrastructure and where investors stand," says one fund manager who requested anonymity.

All this suggests private capital has a way to go. To be sure, the financial crisis may have only strengthened the impetus for privatization. There are those who note that after past excesses, lack of leverage may not be such a bad thing, particularly if investors focus on improving performance and enhancing asset value. Yet it remains to be seen whether private equity can play an effective, sustainable role.

If there are two people Chicago can point to as its biggest privatization advocates, they are Mayor Richard M. Daley and John Schmidt. Longtime Daley friend Schmidt, a partner at **Mayer Brown LLP**, had championed Skyway's privatization effort since 2002. Daley had in mind a concession sale of the Skyway system similar to Ontario's privatized concession to operate the 407 Express Toll Route for 99 years.

The Skyway is an eight-mile, six-lane, elevated roadway over the South Side of Chicago that includes a small steel truss bridge over the Calumet River. Opened to traffic in 1959, it had been a financial disaster and had been undergoing rehabilitation for years. For a time it enjoyed a reputation as a choice spot for gangland-style robberies, including a picaresque extortionist who held up tollbooths using different clients' vehicles from his backyard car repair service.

The avuncular Schmidt, now in his mid-60s, was Daley's first chief of staff after his initial election as mayor in 1989. In late 2004, Schmidt, serving as Chicago's legal adviser, sat alongside other city officials and representatives of adviser **Goldman, Sachs & Co.** at the opening of bids for Skyway.

"They opened the envelopes, sort of in reverse order," Schmidt recalls. The first one, from **Abertis Infraestructuras SA** of Spain, came in at $505 million. The second, from an ABN Amro-led group, was $770 million. Both were considerably below expectations. Then the Cintra-Macquarie bid was opened; it was for $1.82 billion, $1.1 billion more than the next-highest offer. "I said, 'Let me see that. Are we reading it correctly?' " he says.

Schmidt calls it an emotional moment. "I knew something extraordinary had happened," he says.

Under the 99-year concession agreement, the winners received exclusive rights to operate and collect toll revenue from the Skyway and be responsible for maintenance. As Daley envisioned, the proceeds were to be used to pay off Skyway debt and create a reserve trust.

Even before the Skyway deal had closed, Indiana was considering a similar project for the Indiana Toll Road, a 157-mile highway linking the Midwest and East Coast, one of the most heavily traveled truck routes in the U.S. In 2006, the state awarded the same consortium a $3.8 billion concession to operate the highway for 75 years. Different deals have been struck elsewhere, including Florida's agreement in March to pay a group led by Madrid-based **Actividades de Construcción y Servicios SA** as much as $1.8 billion over 35 years to

design, build, operate and maintain new toll lanes along Interstate 595. Florida will set toll rates and pocket the revenue.

Have the floodgates opened, or are investors and advisers indulging in wishful thinking? Opinion is split. In the U.S. alone, the amount of money needed to fix public works is breathtaking. The American Society of Civil Engineers recently warned that after decades of underfunding and neglect, roughly $2.2 trillion will be needed over the next five years to improve the nation's infrastructure to acceptable standards. Globally, according to a recent Overseas Economic Cooperation Fund study, $2 trillion is needed annually for electricity transmission and distribution, road and rail transport, telecommunication and water through 2030.

The Obama administration's stimulus package and other legislative initiatives, including the creation of a National Infrastructure Reinvestment Bank, have dangled the promise of federal support, but the dollar commitments to date appear to be a trickle compared with the need.

Political resistance hasn't disappeared. In October, a much-publicized bid to privatize the Pennsylvania Turnpike for a $12.8 billion, 75-year lease, **won** by a consortium led by **Citigroup Inc.**'s Citi Infrastructure Investors arm and Abertis didn't pass legislative muster, a **major setback** for the bidders. Members of the legislature and other opponents appeared reluctant to forge ahead, partly because many were convinced the winning bidders would need to hike toll rates to recoup operating expenses and the sizable lease cost to generate a return. There was also fierce opposition from the Turnpike Commission, which has been running it for 70 years.

Citi and Abertis said they're not giving up yet and will likely try again.

"Buyout firms will have to pay careful attention to aligning their business models to public policy and community interests," says one private equity executive. Infrastructure assets are "so core to many people lives" that heightened sensitivity is essential.

Dealmaking has also slowed because infrastructure assets are not immune from a downturn, as some might want to believe. While it's unlikely that a household will cut back on its use of water, drivers might well avoid toll bridges and roads, says Ben Heap, co-head of infrastructure at **UBS**. Toll traffic has fallen by as much as 10% in some cases, he says.

Making matters worse, price hikes are based solely on inflation, which hasn't been this low in 50 years. "So there's a little bit of a double whammy," Heap says.

In the U.S., privatization of large-scale structures such as toll roads, airports, seaports and bridges has been slow to gain adherents. For much of the past few decades, government agencies relied on tax-exempt bonds to build and repair structures. Except for some municipal water supply, sanitation services and telecom that have been turned over to private contractors, these assets have mostly stayed within the public domain.

In Europe, pieces of infrastructure have been fully or partly privatized since the '80s. The OECD estimates that privatized assets now exceed $1 trillion for member countries. Various forms of public-private partnerships have developed. Typically, the public agency owner and provider of services becomes purchaser and regulator, while the private sector provides finance and management of assets while generating returns. In the U.K., more than 900 such partnerships, valued at £53 billion ($76 billion) have been signed from the mid-'90s to the end of 2007, the study says.

The model for infrastructure funds was pioneered in Australia by Macquarie, whose antecedents were in merchant banking. In the '90s, it capitalized on capital flows from Australia's pension schemes, known as superannuation funds, and set up infrastructure funds, many of which were publicly traded entities.

In Canada, pensions also began investing in infrastructure but went a step further, embarking on co-investments and direct investments. The **Ontario Teachers' Pension Plan** began investing in 2001, mostly as a direct investor. It had C$8.8 billion ($7 billion) in its global infrastructure portfolio as of end-December 2007, out of a total C$108.5 billion.

The **Ontario Municipal Employees Retirement System** established a subsidiary, Borealis Infrastructure Management Inc., in 1998. The unit, now with C$5.2 billion of assets, aims to have as much as $10 billion in its portfolio, with 60% of the capital in Canada, the rest primarily in the U.K., Western Europe and the U.S.

"The natural owner of an infrastructure asset is a pension or endowment fund that intends to hold the asset indefinitely," argues Leo de Bever, CEO of **Alberta Investment Management Corp.**, in a recent essay in Infrastructure Investor, a **PEI Media** trade publication.

De Bever is one of the more outspoken apostles for direct infrastructure investments, recently publishing a book on the topic. AIMCo of Edmonton, Alberta, was established in 2008 to manage C$70 billion in pension assets.

Infrastructure is only now emerging as a distinct asset class. For pension funds, it's a perfect way to match long-term funding liabilities with long-term cash flows that infrastructure assets typically generate. "Money wants to find a home, and infrastructure is one of those areas offering investors legitimate gains," says Tony Perricone, a partner at **Jones Day**.

Last year, the **California Public Employees' Retirement System**, which used to lump its infrastructure investments with other alternative assets such as private equity, said it would allocate up to 3%, or about $7.2 billion, for infrastructure, with a net target return of 5% above inflation over five years. "We hope to generate stable, attractive investment returns with low to moderate risk as we deploy capital to meet a reported need of $1.6 trillion for U.S. infrastructure projects over the next five years," Rob Feckner, CalPERS board president, said at the time.

The **California State Teachers' Retirement System** also has a new policy in place, though it has yet to make an investment. Other states including Alaska, California, Oregon, Texas and Washington appear to be diving in as well.

Despite transactions having mostly been private-to-private deals to date, the surge in interest in infrastructure has sparked a fundraising frenzy. Even with liquidity constraining many large pension funds, private infrastructure pools raised nearly $25 billion last year. The total fell short of the record $34.3 billion raised in 2007 but still outpaced 2006, according to investment advisory firm **Probitas Partners**.

About 77 infrastructure funds globally are seeking an estimated $92 billion of commitments from institutions. The pace has been glacial, bankers and lawyers say, and raising all of it isn't a sure bet. "Fundraising has slowed tremendously, though unlike megabuyouts, there's still a fair amount of money going into infrastructure," says Kelly Deponte, managing director at Probitas. "Pension funds are looking at the demand side of the equation."

Braving the economic turmoil

Top 10 infrastructure funds now in the market

Rank	Fund	Fund manager	Manager country	Size ($mill.)
1	GS Infrastructure Partners II	GS Infrastructure Investment Group	U.S.	$7,500
2	Macquarie European Infrastructure Fund III	Macquarie Funds Group	Australia	6,691
3	Macquarie Infrastructure Partners II	Macquarie Funds Group	Australia	6,000
4	Citi Infrastructure Partners	Citigroup Infrastructure Investors	U.S.	4,000
	KKR Infrastructure Fund	Kohlberg Kravis Roberts & Co.	U.S.	4,000
5	Alinda Infrastructure Fund II	Alinda Capital Partners LLC	U.S.	3,000
6	aAIM Infrastructure Fund	aAIM Infrastructure	U.K.	2,982
7	Fondi Italiani Per Le Infrastrutture	F2i SGR	Italy	2,704
8	CVC European Infrastructure Fund	CVC Infrastructure	U.K.	2,676
9	Santander Infrastructure Fund II	Santander Infrastructure Capital	U.K.	2,007
10	Gulf One Infrastructure	Gulf One	Bahrain	2,000

Fund I

Source: Preqin

Most private infrastructure funds are sponsored by large financial institutions through their investment banking units, according to industry data. Goldman Sachs completed the first bank-sponsored fund in the U.S. in 2006, raising $6.5 billion, of which $750 million came from the investment bank. It is now campaigning for a successor fund, which industry reports say is capped at $7.5 billion, though a source says the actual target is well below that mark. Goldman Sachs declined to comment on the fund.

Its first fund was used for the $22 billion LBO of oil pipeline company Kinder Morgan Inc. and to purchase seaport facilities operator Associated British Ports Holdings plc, which a Goldman-led group bought for £2.8 billion in 2006.

Morgan Stanley Infrastructure Partners began investing in 2006, closing two major investments before it wrapped up its first fund with $4 billion in May 2008. The fund, which targets transportation, energy, utilities, social infrastructure and communications assets, surpassed its $2.5 billion goal despite a difficult environment.

It has a fund life of 15 years, looking to invest in assets highly correlated with inflation that can generate returns of 12% to 15%, says Sadek Wahba, Morgan Stanely's infrastructure head.

Last year it teamed with Ontario Teachers' to **buy** Saesa Group, a Chilean electric distribution, transmission and generation subsidiary of New Jersey electric utility **Public Service Enterprise Group Inc.**, for roughly $870 million, plus debt. And in December 2006, Morgan invested in a $563 million purchase of **Chicago Loop Parking LLC**, the largest underground parking system in the U.S.

UBS **closed** its $1.52 billion infrastructure fund in October to invest in mature assets involving utilities and transportation, among others, aiming for returns of 10% to 13%, says Heap. Its first investment, in 2007, was a $348 million purchase of a 50% stake in **Northern Star Generation LLC** from another infrastructure fund, **AIG Highstar Generation LLC**. UBS was also part of a consortium that purchased British water and sewage company **Southern Water Capital Ltd.** from **Royal Bank Investments Ltd.** for £4.2 billion in 2007.

Citigroup launched Citi Infrastructure in 2007. It **lured** Felicity Gates, who previously led a **Deutsche Bank AG** affiliate's North American infrastructure business, and Juan Béjar, formerly head of infrastructure at Spain's Ferrovial Infraestructuras and former CEO of Cintra. Citi is still marketing its first infrastructure fund and wouldn't comment. Reports **pegged** the target at $5 billion.

Carlyle **joined the fray** with a $1.15 billion fund completed in November 2007. That year, it **bought** biosolid recycler **Synagro Technologies Inc.** for $772 million. And in May 2008, it **took** a majority stake in **ITS Technologies & Logistics LLC**, an intermodal facilities operator that helps move goods through North America by transferring containers from rail to trucks.

Carlyle says it aims to improve assets by making them more efficient through incentives or building them out through acquisition and expansion. Generally, "the most appropriate use of funds is for projects or assets with some level of existing operations," says Barry Gold, Carlyle's co-head of infrastructure.

What might help counter community resistance is to deploy capital into projects that benefit the public or provide "essential service" in a way sensitive to needs of all stakeholders, says Gold.

That means staying flexible, he adds.

Carlyle plans to look at the transportation, water distribution-wastewater treatment and social infrastructure sectors, which are public benefit assets that would serve users even in dire times, he says. But the firm won't rule out making greenfield investments that make economic sense, such as a shovel-ready road projects designed to relieve traffic congestion.

KKR launched its infrastructure initiative in May 2008 with a big splash. It **poached** energy investment banker George Bilicic of **Lazard** to spearhead the effort. Bilicic sat across the table from KKR when the buyout house, along with **TPG Capital,** acquired Texas utility TXU Corp., now **Energy Future Holdings Corp.**, in the

largest LBO on record. In informal discussions with LPs, KKR had talked about a $10 billion fund with limited partners, according to a source. Not long after Bilicic rejoined Lazard and assumed his old position as head of global power and utilities, KKR came out with a prospectus targeting a $4 billion fund to be led by Marc Lipschultz, who heads its energy and natural resources group.

Not to be outdone, Blackstone also aims to raise a fund reportedly targeting between $2 billion and $5 billion, though details are sketchy. Reports said the fund has not yet begun fundraising. According to **Preqin Ltd.**, the New York firm will invest in a range of developed infrastructure assets in the U.S. and Europe. The firm recently hired Trent Vichie and Michael Dorrell from Macquarie Capital in New York as founding partners of Blackstone Infrastructure Partners.

KKR, Blackstone Group executives and Bilicic all declined to comment.

The focus for many institutional investors appears to be shifting to independent funds partly because of uncertainties over continuing support from financially stressed institutions, according to industry executives.

AIG Highstar, a private equity fund that invests in infrastructure, has dropped AIG from its name, although it remains tied to the embattled insurer in so far as AIG is a limited partner.

Founded in 2000 by Christopher Lee, a former Chase Manhattan Corp. and Lehman Brothers Inc. executive, the firm is in the market for its fourth vehicle, after raising $3.5 billion for its third in 2007.

Another large group, Global Infrastructure Partners of New York, is a joint venture between **Credit Suisse Group** and **General Electric Co.**'s infrastructure division, launched in late 2006. Credit Suisse sought to capitalize on its and GE's project finance expertise, a source says. Each contributed $500 million to a $5.64 billion fund that closed last March, having the advantage of raising money before the crunch hit.

GIP's team, mostly consisting of investment bankers, is led by Adebayo Ogunlesi, chairman and managing partner and a former CS investment banking chief. The fund, together with AIG affiliate AIG Financial Products Corp., acquired London City Airport, the U.K. capital's fifth airport, in 2006 for a reported $1.4 billion in October 2006.

How has that portfolio holding performed? "Better than OK, even in this environment," says a source.

Except for energy infrastructure specialists, some of which have been very successful, most U.S. players are first-time funds, and it's too early to judge performance. Those with exits may have an edge. **Alinda Capital Partners LLC** boasts the first independent infrastructure fund in the U.S. Launched in 2005 by ex-Citigroup project finance experts led by Christopher Beale, the firm completed a $3 billion fund in 2006.

Alinda began fundraising last year for a successor vehicle with a $3 billion target and has pretty much raised that amount. It helped that it has had partial realizations, including the sale of airport assets in Australia and in the U.K. divested by portfolio holding **BAA Ltd.**, the British airports operator owned by Spanish construction group **Grupo Ferrovial SA**.

Alinda, GIP and other bank-sponsored funds now fundraising declined to comment.

Charting the risk-return profile for infrastructure and setting benchmarks remains a work in progress. Funds entering the market come up with a structure and strategy for investment vehicles, targeting returns that generally assume some leverage on the underlying portfolio. Early studies pegged net returns for most managers at between 9% and 12%. But those numbers predate the credit boom. They also vary depending on the underlying assets. According to **J.P. Morgan Asset Management**, toll roads may get 10% to 12% and airports may get 15% to 18%, against an average of 10% to 15%. For instance, Alinda Capital, focused mostly on brownfields, generally targets a base return of 12%, but it may gain a further 3% through operational enhancements and a potentially lucrative exit multiple, according to sources.

In general, brownfields investments with well-established cash flow tend to produce the lowest returns, with a target internal rate of return of about 10% to 12%. Depending on how much capital is invested, rehabilitated brownfields -- assets that are built but that may need capital improvements or expansion -- may offer 15% returns.

For greenfields, or projects that need to be built, investors may hope for 18% to 20% returns because they take on design, construction and operating risk. Most private infrastructure funds appear to have multiple investment targets, typically a combination of brownfields, greenfields and secondary investments, according to Preqin Ltd.

Even before the credit crunch, heightened competition fueled by the proliferation of funds eroded return expectations from double to single digits, the OECD reports. "The first-mover advantage typical for new asset classes has run out," it says. Macquarie's earlier funds were reporting IRRs of around 20% because "it had the market to themselves," says one New York fund manager. But as the market became more liquid and efficient, pricing has become more aggressive, with target IRRs relying on increasing amounts of debt and equity.

Critics have pointed to recent auctions such as the **concession sale**, announced in October, for Chicago's Midway Airport, the first privatization of a U.S. airport, saying bidding was quite aggressive. The winning group, Citi Infrastructure in partnership with **Vancouver International Airport Authority** and **John Hancock Life Insurance Co.**, bid a little more than $2.5 billion.

"The whole market was appalled," says a fund manager familiar with the auction. The bid was all equity, the source says, but even without debt, bidders were targeting a 15% IRR.

The unsuccessful privatization of the Pennsylvania Turnpike also drew what many viewed an aggressive bid from Citi-Abertis, whose $12.8 billion offer, said to be 60 times projected Ebitda, was well above the next highest bid of $12.1 billion from Goldman and **Transurban Group**, Australia's second largest toll-road operator. Macquarie bid $8.1 billion, which fell below the threshold, and was shut out from the final round. Citi declined to comment on the auctions.

Infrastructure assets can usually support 50% to 75% debt in the capital structure, says UBS' Heap. But using too much leverage can backfire, as it did for Australia's **Babcock & Brown Ltd.** and **Allco Finance Group Ltd.**, both of which emulated the Macquarie model and are now bankrupt. Analysts say it didn't help that some of their debt structures were provided on a short-term basis, a mismatch to the longer time frame for underlying projects.

"When times get tricky, it's possible to have plenty of breathing room at the operating level yet still be unable to meet debt service at the holding company level," says Heap. Their analysis didn't factor in the global financial crisis, which have forced such firms as Babcock to sell assets at fire-sale prices. "Infrastructure projects can handle more leverage than private equity projects in normal economic cycles, but not overly excessive leverage," says Mark Weisdorf, global chief investment officer of J.P. Morgan Asset Management, which has its own fund as well. "If a project's cash flows decline when an asset is 90% levered, it could cause problems."

The bankruptcies have hurt Macquarie, whose listed funds are down about 40% for the year amid continuing worries over asset valuation. Macquarie has considerably more resources than its bankrupt imitators, but the listed infrastructure fund model it pioneered has understandably taken some hits from critics who argue that it's "broken."

Last year, institutional advisory firm **RiskMetrics Group Inc.** issued a scathing critique of the complex structures of the model, which it argued was flawed, in part because of the danger of overpaying for assets. A spokesman for Macquarie says the firm addressed the report in detail at the time, including making various corrections. It has also made corporate governance changes in its listed funds since the report was published, he adds. In recent months, the firm has tended to take on the role of adviser rather than acquirer, sources say.

Under prevailing conditions, investors being pitched by PE-style infrastructure funds may need a lot more convincing. For one thing, the typical 2%-20% fee/carry structure is less compelling. Canadian pension funds have long argued that if infrastructure funds are pitching low- to midteen returns, the standard 2%-20% economics makes no sense, which is why they've tended to invest in assets directly. With limited leverage, there's even less justification for it, they say.

Still, most infrastructure funds retain 2%-20%, with a hurdle rate averaging 8%. There are variations: The management fee might be a sliding scale, and the hurdle rate could range anywhere from 6% to 12%. Carlyle

came in early in the cycle with a 1.5%-20% structure and a 12-year life, plus a two-year extension. The fund is targeting returns in the upper teens, a source says.

KKR's diminished rates are a big departure," says a large LP in KKR's buyout funds. "That does say that some of the pension funds aren't prepared to pay 2% to 20% on products that have a lower risk profile in a class where they are or can be more direct participants themselves."

Another concern is the risk that PE funds might stretch the definition of infrastructure. As one disgruntled pension fund manager explains: "You can have two different power plants. One fully contracted for fuel supply and providing electricity for 50 years. That's an infrastructure plant by our definition. On the other hand, another plant may buy fuel in the spot market and sell electricity in the spot market. That's a merchant power plant, and there's lots of them around. In theory, the first will have much lower returns and won't sustain a 2% to 20% structure." Says one Canadian investment officer: "If private equity looks into it, they'll start pushing into the second type. It's in their DNA."

Moreover, pension funds with long-term funding liabilities to worry about seek a very high return of capital to cover those liabilities. Buyout shops normally have a holding period of about five years, but that's not usually long enough for pension funds and other investors.

"IRRs are only one snapshot of performance," says one fund manager. "Sophisticated investors look at how much capital comes back in 10 years or more." Alinda Capital and others have a 10-year holding period, but some funds may have shorter holds and exit within five years, sources say.

Investors are also leery of the lack of infrastructure expertise among traditional private equity firms. "There are LPs out there saying that other funds might have more or deeper expertise in infrastructure than KKR or Blackstone," says one investment adviser. To be fair, KKR has been hiring project finance experts as part of the investment team, as have others, but there's a shortage of truly seasoned infrastructure executives, industry observers say.

All things considered, private equity funds with appropriate structures might still get the benefit of the doubt. For pension funds that are increasingly attracted to the asset class, the advantages of improving social and economic infrastructure assets may outweigh concerns over low returns.

At the same time, public-sector authorities will need to adapt their own management models to reward employees for efficiencies, cost savings and making the asset work better for users, says Gold. Accountability will be important, and revenue sharing is one way of achieving that, he adds.

And while financial engineering may ultimately help boost fund returns, it isn't the only factor, experts say. Fund managers can just as well focus on operational changes to get multiples of return on capital. In that respect, the LBO folks might yet make a good stab at outperforming their peers.

http://www.bloomberg.com/apps/news?pid=20601080&sid=a5LXPyRZuBeU&refer=asia

Macquarie's 'Satellite' Fund Model Questioned as Losses Loom

By Malcolm Scott

March 11, 2009 (Bloomberg) -- **Macquarie Group Ltd.'s 14 publicly traded funds have lost a combined A$4.3 billion ($2.7 billion) of market value this year, fueling speculation Australia's largest investment bank will write down assets and raise money.**

The funds had market capitalization of A$9.7 billion as of March 10, down 31 percent from A$14 billion on Dec. 31, according to data compiled by Bloomberg. Macquarie owns between zero and 26 percent of the so-called satellite funds, according to its December quarter update, and booked the value of the stakes at A$2.7 billion as of Sept. 30.

Analysts predict Macquarie may have to add A$700 million of writedowns on its listed and privately held funds on top of the A$2 billion it has already flagged, according to the median of five estimates. Investor Tim Schroeder said the credit seizure has rendered obsolete the bank's business of using debt to buy toll roads and airports and then spinning them off in funds.

"It was an unsustainable business model as it turned out, as the price of both debt and equity got re-priced in a hurry as a consequence of the global financial crisis," said Schroeder, who helps manage $2.6 billion at Pengana Capital Ltd. in Melbourne. "Where they go from here is anyone's guess."

Speculation that Macquarie would have to raise money to cover additional writedowns helped drive its shares 39 percent lower in Sydney trading this year, compared with a 14 percent drop in the benchmark S&P/ASX 200 Index.

Capital Raising Risk

UBS AG analysts led by Jonathan Mott said Feb. 26 that the value of Macquarie's equity stakes in satellite funds may be about A$1.5 billion below the firm's own Sept. 30 valuation.

Writing down the assets to reflect that gap could put Macquarie at risk of breaching capital requirements, forcing the company to raise money, the analysts said in a research note.

"Capital-raising is a real risk facing the stock," said Tim Morris, an analyst at Wise-Owl.com in Sydney. "This sort of listed funds business has to change in a way that leaves money on the table for everyone."

Macquarie's profit surged 12-fold in the past decade to a record A$1.8 billion in the year through March 2008. The gains were partly fueled by a business model Macquarie pioneered: It bought infrastructure assets including Thames Water and Sydney Airport, bundled them into funds and pocketed transaction and management fees throughout the process.

The company's debt swelled over the period to almost A$50 billion at Sept. 30, from A$1.5 billion 10 years earlier, according to data compiled by Bloomberg.

Capital 'Buffer'

Chief Executive Officer Nicholas Moore, who took over in May, has sought to play down the need for more capital and to distance the company from its satellites.

On Feb. 27, Macquarie said it had no need to raise funds after announcing earlier that month it had a A$2.9 billion "buffer" over minimum capital requirements as of Dec. 31.

The company released another statement on March 2 saying satellite funds won't be a drag on its balance sheet and detailed restructuring steps that may include "major asset sales, further debt refinancing, fund

privatization, security buybacks and capital returns." The company, which also has 30 unlisted funds, has no capital commitments to its listed affiliates and no plans to invest more in them, it said.

Spokeswoman Paula Hannaford declined to comment beyond the latest statements.

Shrinking Contribution

About 21 percent of Macquarie's operating income in the six months ended Sept. 30 came from specialist funds, the company said in November. That will shrink to less than 5 percent, before writedowns, for the full fiscal year through March 31, according to the March 2 statement.

The four funds that accounted for the biggest slice of Macquarie's equity holdings in satellites as of Dec. 31 have slumped between 31 and 54 percent in 2009.

Macquarie Airports, 23 percent owned by Macquarie, has plunged 37 percent this year. The owner of airport stakes in Sydney, Copenhagen, Bristol and Brussels halted a A$1 billion share buyback last month as the company and its partners pour at least A$870 million to its Sydney Airport unit to pay off debts maturing this year.

Macquarie Office Trust, 8 percent owned by Macquarie, has plummeted 54 percent in 2009. The manager of 42 properties lost A$1.09 billion in the six months to Dec. 31 as it wrote down the value of real estate in Australia, the U.S., Europe and Asia.

The slumping stock prices of Macquarie's satellites will hurt its chances of spinning off wholly owned funds, reducing its capacity to generate earnings, said Prasad Patkar, who helps manage A$1 billion at Platypus Asset Management in Sydney.

"If you are a fund manager and the funds don't perform well, then people don't give you funds to manage," Patkar said. "The ultimate exit strategy for the unlisted funds would have been listing them. Now, given the performance of all the listed funds, who's going to buy them in a listing?"

http://money.ninemsn.com.au/article.aspx?id=770023

BUY OR SELL-Australian infrastructure's allure faded

11/03/2009 6:25:15 PM

By Sonali Paul

MELBOURNE, March 11 (Reuters) - Australian infrastructure stocks such as Macquarie Infrastructure Group (MIG.AX

MIG.AX, 1.065, +0.035, +3.400%) and Asciano Group (AIO.AX AIO.AX, 0.570, +0.015, +2.700%) have slumped as they struggle to sell roads, rails and ports at the bottom of the market to cut debt.

Concerns about debt refinancing, further dividend cuts to preserve cash, and funding for improvements and expansions are all weighing on the stocks.

Toll roads owner Transurban Group (TCL.AX

TCL.AX, 3.970, +0.140, +3.660%), the biggest stock in the sector, has tumbled 26 percent so far this year, double the slide in the broader market.

Macquarie Infrastructure Group (MIG), which also owns toll roads has fallen about 38 percent, while Macquarie Airports (MAP.AX

MAP.AX, 1.630, +0.120, +7.950%) and toll road operator ConnectEast (CEU.AX CEU.AX, 0.305, +0.015, +5.170%), which has the newest road, have lost almost one-third.

HOPE FOR SOME

Will Seddon, an analyst at White Funds Management, said MIG, MAP and Macquarie Communications Infrastructure Group (MCG.AX

MCG.AX, 0.955, -0.060, -5.910%), which owns broadcast and telecommunications towers, were "heavily undervalued" and starting to look like good buying opportunities.

Seddon said the main turn off for investors looking at the Macquarie funds was the management arrangements with Macquarie Group (MQG.AX

MQG.AX, 18.260, +0.780, +4.460%) and the complex asset cross-holdings in the funds.

But he predicted all had strong enough assets to weather the downturn and would be able to handle their debt.

"And when that happens and the market becomes less risk averse, that excessive risk premium that relates to the complexity and the high levels of gearing will start to unwind and they should outperform the market," Seddon said.

Lee Mickelburough, a partner at Perennial Growth Management, said MIG was close to getting its balance sheet under control.

"The asset quality is very strong and the leverage is high, but it shouldn't bring down the company, unless the world gets even worse," said Mickelburough, adding that Transurban was the most solid play in the sector.

In reports this week, analysts at Merrill Lynch and UBS both rated toll road owners MIG, Transurban, ConnectEast, along with Macquarie Communications, as buys.

BETTER BETS ELSEWHERE

Don Williams, chief investment officer at Platypus Asset Management, said his firm was avoiding infrastructure stocks until their capital structures looked more stable.

"I'd rather own a bank even on the assumption that their dividend might go down 25 to 30 percent. You don't have the survival risk that some of these names still have," he said.

Other stocks, including retailer SuperCheap Auto Group (SUL.AX

SUL.AX, 2.260, +0.220, +10.780%), had dividend yields that provided better compensation for their earnings risk than infrastructure stocks, he added.

The companies with the weakest balance sheets are too risky to buy, including Asciano, fund managers and analysts said.

Asciano is trying to raise A$1 billion ($633 million) through asset sales to help pay down its A$4.6 billion in debt. The problem is the longer its sale process drags on, the more of its assets it might have to sell to achieve that target.

With the economic slowdown hitting rail and ports activity, Asciano's earnings face a tough quarter or two ahead.

"And it's got a gearing time-bomb ticking away. So that one is not for the faint-hearted. But there is a prize if they can get the balance sheet under control," said Mickelburough.

Merrill Lynch has "underperform" ratings on Asciano and Babcock & Brown Infrastructure (BBI.AX

http://www.theaustralian.news.com.au/business/story/0,28124,25162460-36418,00.html

Macquarie looks to ditch debt-laden UK asset

Scott Murdoch | *March 10, 2009*

Article from: The Australian

MACQUARIE is preparing one of its largest British assets for sale as the group's satellite funds move to raise cash and tackle rising debt levels.

The investment bank's funds are all examining asset portfolios for potential sales.

The jewel of the British holdings, the M6 toll road through the West Midlands, could be the first asset to be offloaded.

The road is owned through Macquarie Infrastructure Group, which is selling a range of Australian and overseas assets.

The fund, which has seen its unit price slump from $2.75 last year to just $1.04, **sold a 25 per cent interest of Sydney's Westlink M7 last month. The sale of a further stake of the same size is now up for negotiation.**

The M6, which opened in 2003, was Britain's first toll motorway. Macquarie valued it at $3.6 billion at the end of last year.

The M6 is considered the bank's most valuable British asset, along with a stake in Thames Water, Britain's largest water company.

A sale price has yet to be determined, but a significant discount is expected to secure a transaction. The first tranche of the M7 was sold at a 5 per cent discount to the most recent valuation, while Macquarie's share of Lusoponte, a Lisbon bridge operator, had a 2 per cent discount.

Thames Water is thought to be safe because it is held in the Macquarie European Infrastructure Group, an unlisted vehicle. Macquarie's asset review is understood to be confined to its listed entities.

The M6 is being touted by London investment bankers to potential buyers.

A sale would be a strong signal to the market that Macquarie Infrastructure was keen to pay down debt.

The fund is currently restructuring its capital position and has refinanced a portion of its overseas debt holdings.

It is also buying back 10 per cent of its issued securities in a bid to strengthen its capital position.

Macquarie shares have faced sustained selling pressure in the past month, amid concerns about the book valuations of some of its funds. Savage selling of the parent stock has seen it slump to $15 in recent days.

The bank has resisted adjusting the carrying value of Macquarie Infrastructure and Macquarie Airports, despite moves by similar entities across the market.

The stock finished the session flat at $17.26 yesterday.

The sell-down in Macquarie shares this year has also been accompanied by rumours of a capital raising, though the company has denied it needs to go to the market for funds.

Macquarie has had to slash its profit outlook for this financial year, which ends on March 31, and now expects earnings of about $900 million -- half the previous year's results.

After warning it was taking $1.14 billion in writedowns and loan losses in the first half, Macquarie said recently that it expected to take an extra $900 million in writedowns and other losses in the second half.

These writedowns are mostly on further falls in the value of its holdings in listed funds, including Macquarie Capital Group, Macquarie CountryWide and Macquarie Office Trust.

http://www.theaustralian.news.com.au/business/story/0,28124,25838186-30538,00.html

Macquarie's model of failure

Adele Ferguson | *July 27, 2009*

Article from: The Australian

IF there was any doubt that the debt-plagued listed external manager model was finished, Macquarie Group's decision to sell its management rights back to Macquarie Airports, albeit screwing shareholders for one last time, showed it was.

The demise of Babcock & Brown, Allco Finance Group and the unravelling of the complex structures behind the Macquarie satellites are a stark reminder that investors have had a gutful of backing a model that was good for the head stock/external manager and bad for investors.

The satellites that were once fat fee-generating vehicles for Macquarie Group are a shadow of their former selves and the chance of them returning to those halcyon days of doing an equity capital raising allowing Macquarie to inject assets -- and clip the ticket a couple of times on the way through -- is over.

A statement from ASIC late last month on "fair values", no doubt speeded up the model's demise. ASIC said "careful consideration should be given to whether assets are traded in active markets. Most ASX-listed securities are actively traded, in which case, quoted prices should be used".

This would have given the Macquarie boys some major heartburn. In its latest results, released in May, profit was down 52 per cent, as chief executive Nicholas Moore made a $2.5 billion writedown on assets such as MIG, MAP, BrisConnections, real estate equity investments, loan impairment provisions and CDO exposures.

The result would have been even worse if Macquarie had gone the whole hog and marked all of its listed funds to the current share price. Based on Deutsche Bank's calculations at the time, it would need to take a further $1.097bn writedown.

However, Macquarie's argument for not doing so was recent asset sales and discounted cashflow assessment of value-in-use justified the valuations.

ASIC's view seems to be that this should be done where the markets are inactive. The test appears to involve most importantly a view on what is an active market. It is hard to argue that a listed stock is anything but an active market, which means Macquarie will no doubt either sell out of these entities or sell the management rights to try and pep up the share prices.

Moore, the main architect of the Macquarie model of specialist infrastructure funds, now has the job of finding the next growth area. For now he is concentrating on the unlisted model, as well as using billions of dollars of the federal government guaranteed debt to make low-risk corporate loans at an estimated 200 basis point margins that it can then lever into more investment banking business.

With the financially engineered external management model kaput, speculation is turning to the remaining Macquarie funds, including Macquarie Infrastructure Group and its struggling listed property trusts.

ING may drop listed funds

THERE is also speculation that Dutch-based ING is keen to get out of the listed managed funds market in Australia. ING has five listed property funds in Australia that have ING Real Estate Management as the external manager. ING holds significant stakes in all listed entities and, until the model went pear-shaped, made a fortune ripping out fees.

ING Group is looking at asset sales to raise cash after being hit badly by the global credit crisis, which forced it into a loss in 2008 and led to the Dutch government injecting E10 billion ($17bn) into the bank. There is talk it has hired JPMorgan to advise on the sale of its private banking business in Europe and Asia, which could fetch more than $US1bn.

In Australia, the listed entities include ING Office Fund, ING Industrial Fund, ING Real Estate Entertainment Fund, ING Real Estate Community Living and ING Real Estate Healthcare Fund.

ING is believed to have approached some investors about buying out its management rights, and/or stake in the various listed ING entities.

ING Real Estate Investment Management, which is the external manager of the funds, has stakes in each listed entity. On its website it says: "ING Real Estate Investment Management Australia is a dynamic, leading real estate manager in Australia with more than $13bn of assets currently under management. We manage both unlisted and listed property trusts, with diversified Australian and global portfolios, on behalf of over 60,000 investors."

Unfortunately, this "dynamic and leading" manager has overseen billions of dollars worth of value destroyed in these listed entities.

All of the entities have been battered on the sharemarket, with four of the five in varying degrees of trouble after being geared to the hilt to buy overpriced foreign assets. As valuations fall and debt covenants are being tripped, the parent is now looking for some radical solutions.

In the case of ING Industrial Fund, it recently put out a statement saying it was trying to restructure its $1.78bn syndicated debt facility with the banks and had been granted a waiver on current June 30 covenants until August 31. Time will tell what the future holds on that entity. Its shares have had a spectacular fall from grace, falling from a high of $2.87 to a latest close of 27.5c.

In the case of ING Real Estate Entertainment, which owns pubs and clubs in Australia and New Zealand, its share price has fallen from a high of $1.35 to a latest close of 14.5c. It is not hard to see why. It has had to abandon its June 30 distribution, it is trying to sell assets, it is deferring capital expenditure on some parts of the business, and it is talking to lenders about refinancing core debt facilities in 2010. Not surprisingly, it is also looking at a number of capital raising options.

ING Office, the largest of the ING managed trusts, with assets worth $3.7bn, has been forced to tap shareholders for more than $800m in two equity issues in the past six months to strengthen its balance sheet and avoid breaching loan covenants. Its share price has fallen from a high of $1.69 to a close on Friday of 50c.

ING Real Estate Living Community Fund is also hanging by a thread. It has been selling assets where it can, it has suspended its distribution payments and has warned shareholders that the future of the fund is "heavily dependent" on the fund's ability to refinance its Australian debt facility, which matures in December this year. Its shares have gone from a high of $1.48 to 54c.

ING Real Estate Healthcare Fund, which specialises in healthcare-related properties, is in the best shape of the ING funds, but is suffering from a dramatic fall in its share price from its highs. Its next debt facility expiries are in 2010.

Its shares have gone from a high of $1.20 to a latest close of 74c.

ING Real Estate Investment Management boss Hugh Thompson expressed surprise at the speculation that ING was trying to extricate itself from the listed entities.

But he said the external manager would consider any approaches to buy out the external management rights or take a cornerstone investment. "I don't know what the future holds for the listed market in small-cap funds," he said. He also admitted that there had been discussions with third parties regarding certain aspects of the funds. "If they have value to bring to the table, that is great," he said.

For its own reasons, Macquarie has taken the lead in reviewing its external management model, but others, including ING, are following suit. Time will tell if the move to unlisted funds will bring its own problems.

http://www.theglobeandmail.com/servlet/story/LAC.20090305.RWILLIS05/TPStory/Business

Macquarie Group looks to build bridges of a different sort

ANDREW WILLIS

March 5, 2009

When Canadian investors think of **Macquarie Group**, they tend to think of infrastructure.

Stanley Hartt plans to change that view.

Mr. Hartt stepped up this week as the first chairman of Macquarie Capital Markets Canada, the domestic arm of the Australian investment bank that, through one of its funds, own a stake in Ontario's 407 toll highway.

The arrival of Mr. Hartt - well-connected former chairman of Citigroup Canada, former Stikeman Elliott lawyer and chief of staff to prime minister Brian Mulroney - marks something of a coming of age for Macquarie.

You see, the investment bank isn't all about infrastructure, or even private equity. It does run funds for outside investors, in much the same manner as Brookfield Asset Management. But at its core, Macquarie is an advisory firm, working with corporate clients on domestic and global deals: It counselled New Gold on yesterday's $280-million bid for Western Goldfields.

Since arriving in Canada a year ago, Macquarie CEO Paul Donnelly has been quietly building the teams needed to deliver its investment banking services to domestic clients, first buying energy and mining expertise by acquiring Orion Securities, then adding coverage of utilities, financial services, and engineering and construction plays.

Mr. Hartt is the life-long adviser who can open doors throughout Corporate Canada and help his new colleagues reshape perceptions.

"Stanley will be instrumental in fostering new partnerships and strengthening existing ones as Macquarie steps up to a new phase of growth here in Canada and in the region more broadly," Mr. Donnelly said.

FORTIER TO ADVISE MORGAN

Iconic investment bank **Morgan Stanley** is making a high-profile move into Quebec.

Morgan Stanley, still a global powerhouse despite Wall Street's woes, just landed one of the best-connected deal makers in Montreal, when lawyer and former federal cabinet minister Michael Fortier signed on as the firm's special adviser in Quebec.

Mr. Fortier is a partner in Ogilvy Renault, the blue-chip law firm that he rejoined after being defeated in the last federal election. His political career saw the 47-year-old serve as Minister of International Trade, Minister responsible for the Greater Montreal region, and Minister of Public Works and Government Services in the Harper government.

The newly created position sees Mr. Fortier remain at Ogilvy, but also take on a rainmaking advisory role at Morgan Stanley.

This isn't a new way of working at the law firm; senior Ogilvy statesmen such as Brian Mulroney, Yves Fortier and Derek Burney have active business lives outside their legal practices. Mr. Fortier said he and his partners agreed on a flexible structure when he came aboard. He is also joining a number of charity and corporate boards, including Groupe Aeroplan.

From Morgan Stanley's point of view, having a francophone playing a central role in the tight-knit Montreal business community fills out its domestic coverage, as the firm already has offices in Toronto and Calgary.

"Our strategy at Morgan Stanley is to have people on the ground in Canada's major financial centres, and we're thrilled to have an individual of Michael's calibre representing us in Quebec," said Dougal Macdonald, president of the investment bank in Canada.

Pitching takeovers and financings, along with the softer side of investment banking advisory work, is nothing new to Mr. Fortier. Prior to jumping into politics, he was a senior banker for Credit Suisse in Montreal, and ran the Quebec arm of TD Securities.

http://ca.sys-con.com/node/864877

Stanley Hartt Appointed Chairman of Macquarie Capital Markets Canada Ltd.

By: Marketwire .
Mar. 5, 2009 07:00 AM

TORONTO, ONTARIO -- (Marketwire) -- 03/05/09 -- Macquarie Group ("Macquarie") today announced the appointment of Stanley Hartt, O.C., Q.C., as Chairman of Macquarie Capital Markets Canada Ltd. **The newly created full-time role reflects the continued expansion and breadth of Macquarie's advisory and capital markets activities in Canada, which will benefit from Mr Hartt's depth of experience in corporate and public life.** Mr Hartt will be based in Toronto.

Prior to joining Macquarie, Mr Hartt was Chairman of Citigroup Global Markets Canada Inc. and previously served as the **Federal Deputy Minister of Finance and Chief of Staff in the Office of the Prime Minister.** As Chairman of Macquarie Capital Markets Canada Ltd., Mr Hartt will work closely with Macquarie's senior management on developing new business and providing high-level strategic advice to Macquarie's key clients.

Commenting on the appointment, Paul Donnelly, President and CEO of Macquarie Capital Markets Canada Ltd. said: "Stanley is widely recognized for his enormous contributions in both the private and public sector. His rare experience is well-suited to our range of activities and includes 20 years in legal practice, heading a major corporation, holding leadership positions in government and most recently, advising and raising capital for leading businesses."

"As Macquarie continues to expand its advisory and capital markets franchise, Stanley's diverse experience and insight will help drive Macquarie's forward momentum in Canada. Stanley will be instrumental in fostering new partnerships and strengthening existing ones as Macquarie steps up to a new phase of growth here in Canada and in the region more broadly," said Mr Donnelly.

Macquarie Capital Markets Canada Ltd. brings together Macquarie's advisory, capital markets and institutional securities' activities in Canada. The firm's advisory and capital markets teams specialize in a range of corporate advisory and capital markets services including mergers and acquisitions, capital markets, restructurings, **project and structured finance as well as tailored strategic and financial advice.** Macquarie's Canadian equities team provides clients with specialist equities research, sales and trading services across key TSX and TSX-Venture sectors.

Biographical Details - Stanley Hartt, O.C., Q.C.

Mr Hartt has spent his working life in Canada. After a legal career spanning 20 years at Stikeman Elliott, where he was Partner for 16 years, Mr Hartt served for five years in government, first as Federal Deputy Minister of Finance (1985 - 1988) and subsequently as Chief of Staff in the Office of the Prime Minister (1989 - 1990).

From 1990 to 1996, Mr Hartt was Chairman, President and CEO of Campeau Corporation (later O & Y Properties Corporation). In 1996, he was appointed as Chairman of Salomon Brothers Canada Inc. (later Citigroup Global Markets Canada), a role which he held for twelve years.

Mr Hartt has previously served as a director on several company boards, including: Sun Life Financial Inc., O & Y Properties Corporation, Gulf Canada Resources Ltd., Ultramar Corporation, Abitibi-Price Inc., Hong Kong Bank of Canada, Quaker Oats, Co. Canada, Beatrice Foods Inc., and Oshawa Group Limited.

About Macquarie

Macquarie Group (Macquarie) is a global provider of banking, financial, advisory, investment and funds management services. Macquarie's main business focus is making returns by providing a diversified range of services to clients. Macquarie acts on behalf of institutional, corporate and retail clients and counterparties around the world. Macquarie Group Limited is listed in Australia (ASX: MQG) and is regulated by APRA, the

Australian banking regulator, as the owner of Macquarie Bank Limited, an authorized deposit taker. Macquarie's activities are subject to the regulation by over 100 agencies around the world.

Founded in 1969, Macquarie operates in more than 27 countries and employs more than 12,000 people. Assets under management total more than $US171 billion (as of December 31, 2008).

Macquarie has had a permanent and growing presence in Canada since opening its first office in 1998. Macquarie employs more than 400 people in Canada with offices in Toronto, Vancouver, Calgary, Montreal and Winnipeg.

http://www.journalofcommerce.com/article/id32788

Canadian Union of Public Employees

CUPE study finds P3s more expensive

RICHARD GILBERT

staff writer Journal of Commerce March 2, 2009

A recent study found that construction costs for P3 projects in B.C. are substantially higher than using traditional procurement methods, but some claim the study is flawed.

"The difference in the actual cost between a publicly procured project and a P3 (public private partnership) can be substantial," said forensic accountants Ron Parks and Rosanne Terhart with Blair Mackay Mynett Valuations, who were hired by the B.C. division of the Canadian Union of Public Employees (CUPE) to undertake the study.

Parks and Terhart performed a cost analysis of the Abbotsford Regional Hospital and Cancer Centre, the Sea-to-Sky Highway Improvement, the Academic Ambulatory Care Centre (Diamond Centre) and the Canada Line, using material accessed by the union under Freedom of Information provisions.

"We conclude, based on available evidence and the application of more appropriate discount rates, the cost of P3s exceeds traditional procurement methodology for the projects referred to above," they reported.

The pair used a financial calculation called the discount rate, which is used by Partnerships BC to compare P3s to publicly procured projects.

Partnerships BC is a private company, wholly owned by the provincial finance ministry.

Its mandate is to facilitate the development of public private partnership infrastructure projects, to advise the government on whether to use these partnerships and to evaluate their value for money.

A formula is used to calculate the nominal cost of each project by determining the cost that these assets will generate over their lifetime.

According to the study, Partnerships BC creates a bias toward public private partnerships by assuming a borrowing cost (the discount rate) that is much higher than what the government would be able to secure.

As a result, the value-for-money reports conclude that public private partnerships are more affordable than they really are, in comparison to publicly funded projects.

For example, the nominal cost of the Diamond Health Centre as a P3 was $203 million, as compared to $89 million for public procurement.

This is a difference of $114 million or nearly 130 per cent.

The study calculates the extra cost to the public for the Abbotsford Hospital at $377.9 million and for the Sea-to-Sky at $434 million.

The study didn't provide an estimate for the Canada Line.

"It's a taxpayer rip-off, plain and simple," said Barry O'Neill, president of the B.C. division of CUPE.

"The hundreds of millions of extra dollars we pay in what amounts to privatization premiums should be used to improve roads, transit, schools and health care."

The CEO of Partnerships B.C. rejects the idea that his agency has a bias toward P3 projects and argues that the study produced by Park and Terhart is seriously flawed.

"In all our modeling and for every project, we have always hired the big four auditors Deloitte, PricewaterhouseCoopers, Ernst & Young and KPMG," said Larry Blain.

"The auditor general has looked at the Sea-to-Sky, Canada Line and the Abbotsford hospital and reviewed our methodology.

"He has attached a message to the value-for-money reports that said our methodology is fair and reasonable."

Blain said the reason the CUPE study concludes that P3 projects are more expensive is because the discount rate does not factor in the risks that come with financing a project.

"Our view on the discount rate is we use a rate that reflects the way the private sector would look at the project," explained Blain.

"If you lend money to a project, it (the discount rate) is not the cost of raising debt, it is also the risk involved in the investment you are making. If you believe there is no risk, then his (the study's) conclusion is correct."

Under the P3 model, the private sector is taking a risk.

This is because the project needs to be designed well and the government doesn't pay for the project until it is complete.

There are also fixed maintenance costs and provisions for handing the project back.

The CUPE study also concludes that Partnerships BC has denied the public access to critical information and documentation.

"I think our level of disclosure exceeds that of traditional procurement," said Blain. "When a contract is finalized we release all the documents. The only time documents are not released is when the information is commercially sensitive."

Blain said Partnerships BC has a fairness advisor, who attends all meetings, as well as a conflict of interest adjudicator.

"We go out of our way to make sure the process is fair and open," he said.

"We are trying to make it an attractive market for contractors to bid."

http://www.journalofcommerce.com/article/id32884

Port Mann P3 deal falls through as province turns to design-build contract

RICHARD GILBERT

staff writer Journal of Commerce March 2, 2009

The B.C. government made a huge policy u-turn on the new Port Mann Bridge project by changing from a public-private partnership to a more traditional procurement model.

The province will now fully finance the design-build construction contract for the 10-lane super bridge.

The decision was announced after the government failed to finalize a deal with the lead proponent for the P3 contract.

For several months, Macquarie Group was having difficulties securing financing.

The global economic slowdown was behind the financing difficulties.

The government expected to reach a deal, but was forced to announce last week that negotiations between the province and MacQuarie collapsed.

The MacQuarie group was part of the Connect BC Development Group, which also included Transtoll Inc., Peter Kiewit Sons Co. and Flatiron Constructors Canada Limited.

"Over the past several weeks, negotiations continued in good faith with Connect BC Development Group," said Larry Blain, Partnerships BC CEO in a letter dated Feb. 24 to Transportation and Infrastructure Minister Kevin Falcon.

"Despite these proceedings, a mutually satisfactory agreement could not be reached and more time will not alter this. Therefore, I recommend that this negotiation be concluded."

The government announced on Feb 27 that it is entering into a fixed-price contract with a joint venture of Peter Kiewit Sons Co. and Flatiron Constructors Canada Limited.

The group will design and build the new, 10-lane Port Mann Bridge and Highway 1 widening at the previously agreed upon cost of $2.46 billion.

"The Port Mann/Highway 1 project has always been a certainty, but what was to be confirmed was the best way to finance it," said Falcon.

"We have determined that a traditionally financed arrangement is the better way to proceed at the current time."

The B.C. government reached an agreement-in-principle with Connect BC Development Group on Jan. 28, for construction of the project.

A few weeks before this, Macquarie was granted a one month extension to get their financing finalized.

The deal and final costs for the project should have been finalized in March.

The financial arrangements for the project, which were supposed to take the form of a public-private partnership, were originally scheduled for completion in early January.

Despite this, the government insists that the financial arrangements were not the problem and the negotiations broke down due to a lack of agreement on final terms.

"We said from the beginning that this was a very challenging capital market environment and that executing the project would involve complex negotiations," said Falcon.

"Unfortunately, the parties could not agree on final terms. Partnerships BC recommended not to proceed, and the province and Connect BC have mutually agreed to end the P3 procurement process."

Even though the parties were unable to agree on final terms, the government has retained Macquarie to provide advisory services including financing and tolling operations.

Despite the lack of arranged financing, an official ceremony unveiled the bridge's new design and marked the start of construction. Earlier plans had called for the twinning of the existing bridge.

During the ceremony Falcon and Campbell talked about the benefits of using a private public partnership, such as the transfer of risk, innovative design, financing and the maintenance of the project over its life.

The project was supposed to be financed entirely by Macquarie, which is Australia's largest investment bank.

However, construction on the new bridge actually started in August with geotechnical work, drilling, planning, detailed design, utility works and environmental permitting.

The fixed-price contract with Kiewit-Flatiron is designed to ensure cost overruns or construction delays are the responsibility of the contractor.

The 40 kilometre Port Mann Highway 1 project consists of the construction of a new Port Mann Bridge and widening Highway 1, as well as upgrading interchanges and improving safety and access between McGill Street in Vancouver and 216th Street in Langley.

The project should be complete by 2013 and is expected to create 8,000 jobs.

http://www.theglobeandmail.com/servlet/story/RTGAM.20090227.wportmann0227/BNStory/National/home?cid=al_gam_mostemail

B.C. on the hook for $3.3-billion Port Mann bridge

- WENDY STUECK

From Saturday's Globe and Mail

February 27, 2009 at 10:04 PM EST

VANCOUVER — Just weeks after hard-hatted politicians kicked off construction of a new, 10-lane Port Mann bridge, the province of British Columbia announced Friday that it will be on the hook for the entire cost of the $3.3-billion project after failing to reach a deal with private-sector partners.

The new financing arrangement reflects tough conditions on global capital markets, but will not change the planned schedule or design of the project, provincial Transportation Minister Kevin Falcon said.

“If we can't get the value we need to have in a deal like this through the private financing arm, we have the option of moving forward ourselves, and that's exactly what we have done,” Mr. Falcon told reporters at a news conference in Vancouver.

The province now intends to borrow capital to build the project on its own. Previously, costs were to be shared by the province and Connect BC Development Group, a private-sector consortium that includes engineering firm Peter Kiewit Sons Co. and the **Macquarie Group, an Australian investment bank.**

The collapse of the Port Mann partnership raises questions about the viability of the project and about the province's support for public-private partnerships, or P3s, said New Democratic Party finance critic Bruce Ralston.

“If you can't get financing for this kind of a project, where there is a guaranteed source of revenue over a lengthy period of time, what project can you get financing for?” Mr. Ralston said to reporters after the news conference.

The new Port Mann bridge is to be financed through commuter tolls of $3 each way for cars. The planned completion date is 2013.

The existing span, a 45-year-old structure that links Surrey and Coquitlam, has been the scourge of commuters and truckers for years because of congestion and bottlenecks.

Plans to update the bridge date back to at least 2006, when Liberal Premier Gordon Campbell announced a twinned Port Mann bridge as part of a $3-billion Gateway Transportation Program.

Earlier this month, that plan gave way to the current concept: a new, 10-lane bridge that, including operating and maintenance costs, would ring in at $3.3-billion, more than double original estimates.

Mr. Falcon and Mr. Campbell launched construction earlier this month, wearing hard hats and trumpeting a “first-class, state-of-the-art connector.”

Under a fixed-price deal, the contractor will be responsible for any cost overruns in the project, Mr. Falcon said, adding that the province can take on the financial burden without putting other projects or its own credit rating at risk.

However, taxpayers will be exposed to potential shortfalls in toll revenues – a risk previously shouldered by the private-sector partners.

“Where we have now taken on risk is on the revenue side through traffic forecasts,” Mr. Falcon said, saying he was “very comfortable” with traffic forecasts.

The province remains committed to P3s as a way to build major projects such as bridges, roads and hospitals for financial and operating reasons, Mr. Falcon said.

Mr. Ralston, however, said the collapse of the Port Mann P3 suggests the **P3 model is “virtually dead” in current economic conditions**.

http://www.bclocalnews.com/news/40445278.html

Province jettisons P3 model for Port Mann Bridge rebuild

By Jeff Nagel - Surrey North Delta Leader

The province's plan to rebuild the Port Mann Bridge and widen Highway 1 through a public-private partnership has collapsed.

Transportation minister Kevin Falcon said B.C. will now directly and fully finance construction of the new 10-lane bridge and recoup the money through the $3 tolls to be charged to cross it.

The proposed partnership had been led by embattled Australian infrastructure firm Macquarie Group, which has seen its stock price plunge as the global credit crunch deepens.

"We have determined that a traditionally financed arrangement is the better way to proceed at the current time," Falcon said.

"With P3s, every deal has got to stand on its own merits. If we can't make a deal that makes sense for us and for taxpayers, we don't do it."

He said the province will sign a fixed-price contract with two of the remaining partners – Peter Kiewit Sons Co. and Flatiron Constructors Canada – to design and build the bridge at a previously agreed cost of $2.46 billion.

It's a reversal from just a month ago when Victoria pledged to put up $1.15 billion of its own money, with an equal amount to be bank financed and another $1 billion in equity coming from Macquarie to cover what was pegged as required borrowing of $3.3 billion.

The move would have kept the privately financed partnership afloat.

But Partnerships BC recommended not proceeding with the Jan. 28 agreement-in-principle.

Falcon said the province and the partnership, known as Connect BC Development Group, mutually agreed to end the procurement process after they were unable to agree upon the terms.

"It wasn't a question of them not being able to do a deal," Falcon said.

"We were not prepared to sign off on the deal with the terms that were going to be necessary for Macquarie and the banks and equity partners to do the deal."

He denied the partnership's failure is a bad sign for the government's preferred method of building major projects.

"As a province, we remain committed to using P3 arrangements where they prove to be in the best interests of B.C. taxpayers."

Critics have long said P3s bring higher finance costs because corporations must pay more interest than governments to borrow in order to offset the higher risk.

Partnerships BC CEO Larry Blain said that was a factor in the decision not to proceed.

He estimated $200 million in financing costs will be saved by switching from private to public borrowing.

That pushes the total estimated cost over the life of the project – once financing and maintenance costs are included – down from $3.3 to $3.1 billion.

Falcon said cost overruns or construction delays will be the responsibility of the contractors under the new structure.

The province now assumes the risk if traffic levels and the resulting tolls don't meet projections.

When the province picked Connect BC as the preferred proponent last August, it reserved the right to cut individual deals with whichever partners it wanted in the event the financing side couldn't be finalized.

The province has hired Macquarie to provide advice on the project and the firm is to remain "directly involved" in the project.

Falcon said the province will seek new bids to collect tolls for the bridge, rather than hiring Transtoll Inc., one of the other firms in the now collapsed partnership.

NDP transportation critic Maurine Karagianis said she suspects the change to public financing means a better deal ultimately for taxpayers.

"Those tolls were going to go all for the life of that contract into private shareholders' pockets and not into reinvestment here in British Columbia," she said.

But Karagianis said the failure of the P3 model for the Port Mann doesn't bode well for Victoria's attempts to finance other infrastructure projects.

The $1-billion South Fraser Perimeter Road does not yet have a deal with private partners that would finance about a quarter of the cost of the truck freeway between Deltaport and Highway 1.

And the ministry is still looking to a possible private partnership to deliver a remaining $173 million for the promised $1.4-billion Evergreen Line.

Karagianis predicted the province won't be able to self-finance everything it wants to build and the result will be lengthy postponements of some projects.

But Falcon said the Port Mann project was in a challenging class of its own because of its huge size.

He said no decision has been made yet on whether the Evergreen Line will proceed as a P3.

The new Port Mann is still slated to open in 2013 – and some work has already begun.

"There's 400 people currently at work on the project," Falcon said. "It doesn't change one iota."

The project, which includes widening Highway 1 for 37 kilometres from McGill Street in Vancouver to 216 Street in Langley, along with multiple interchange upgrades.

The project is to create 8,000 construction jobs.

http://www.businessspectator.com.au/bs.nsf/Article/Macquarie-$pd20090302-PR6J4?OpenDocument&src=sph

Business Spectator

COMMENTARY

Tony Boyd

Macquarie's short circuit

3:33 PM, 2 Mar 2009

Macquarie Group today made an attempt to short circuit the concerted market attack on itself and its satellite funds with the release of a statement making reassuring noises about reducing the discount to net assets in the listed Macquarie funds.

The statement was significant for two reasons. It showed Macquarie was willing to get on the front foot and it gave the first hints of a new capital repayment strategy for its satellite funds.

But shares in Macquarie kept falling after the announcement was made at 10.22 am (AEDT). The stock hit a low of $15.05 before rebounding to trade around the $15.65 this afternoon. Turnover has been double the average daily level of 1.5 million shares. Five of the eight listed Macquarie funds also fell in value today.

The sell-off came amid reports that investment banks are actively circumventing the government ban on the shorting of financial stocks through the use of over-the-counter derivatives. Charlie Aitken at Southern Cross Equities told clients banks are using "forward sales agreements" to short Macquarie.

Aitken says the short sellers are trying to force Macquarie to raise capital and when that occurs they will cover their shorts and complete a profitable trade.

The Australian Securities and Investments Commission will decide this week whether to continue its ban on short selling of financial stocks.

Tony D'Aloisio, ASIC chairman, told a media briefing in Sydney this afternoon that ASIC was looking into whether there are ways to circumvent the ban on short selling.

"I think you can assume that we are looking at whether there are ways to circumvent the bans that we have in place and the exceptions we have in place," he said.

"I don't agree that it (the ban) can be easily circumvented and we are looking at whether or not it can be, and how, and we will deal with those. But I certainly don't agree that it can be easily circumvented."

If Macquarie is being short sold that activity is being helped by market questioning of the bank's capital position. A particularly persistent critic is Jonathan Mott, analyst at UBS.

He says the "significant and prolonged" fall in the value of Macquarie's holdings in its listed satellite funds, especially Macquarie Infrastructure Fund and Macquarie Airports, means Macquarie needs to make impairment charges of $1.5 billion.

Mott says if further impairment charges of $700 million against other unlisted assets and other assets held by Macquarie are made then the group's capital in excess of its minimum requirement in its non-banking group could be eliminated.

Other analysts have highlighted Macquarie's ability to handle further write-downs. Craig Williams at Citi said Macquarie could accommodate write-downs of $2.5 billion a year without impacting existing Tier 1 capital levels.

Williams said this assumed Macquarie would scrap its dividend and effectively raise $800 million.

However, Macquarie made it clear last week that it does not need more capital and is not planning a capital raising.

What's new today is that, Macquarie is no longer leaving it to its satellite funds to individually reassure investors that they are doing something about the discount to net assets.

The crux of the Macquarie statement was that Macquarie expects to receive "a return of capital from the listed funds over the next six months".

This was an attempt to shift the market focus away from the potentially damaging impact upon Macquarie from writing down its listed funds and highlighting the potential capital inflow from the funds selling assets and cashing up.

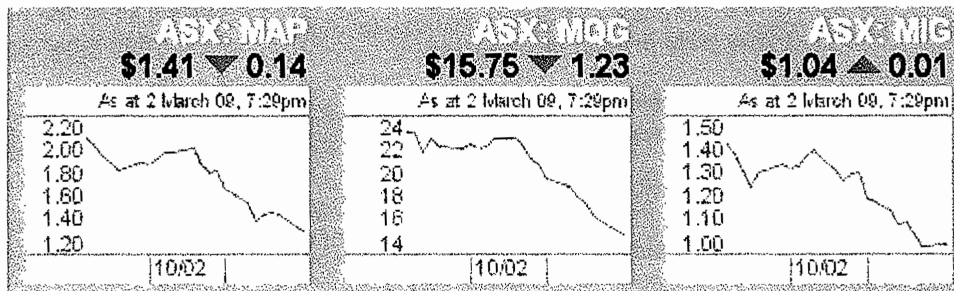
MIG announced on Friday that it had $1 billion in cash following the sale of a 25 per cent interest in the Westlink M7 toll road in Sydney for $402 million, a 5 per cent discount to the June 2008 director's valuation.

The statement today reiterated all the recent debt reduction strategies by the listed satellite funds and noted that its major specialist funds were reviewing a range of options for closing the gap between market prices and net assets, and achieving appropriate capital structures. Macquarie also repeated that its funds have no recourse to the Macquarie balance sheet.

The options, while incomplete and confidential, may include assets sales, more debt refinancing, fund privatisation, buybacks and capital returns.

The prize for slashing the discount to net assets is great. MIG and MAP are trading at 70 per cent discounts to net assets.

But experience with other funds that have tried to close the discount is that the process is lengthy and messy. Also, it tends to attract hedge funds specialising in discount arbitrage.



http://business.watoday.com.au/business/macquarie-slumps-as-satellites-sputter-20090302-8m57.html

Macquarie slumps as satellites sputter

March 2, 2009 - 2:12PM

Macquarie Group shares tumbled for a record 10th day on speculation it may book losses on stakes in some funds.

Macquarie's shares, down 84% since a May 2007 peak, slumped $1.23, or 7.2%, to close at $15.75, the lowest since December 1998.

The investment bank released a statement today saying it has no outstanding commitments to provide capital to its listed funds.

Chief executive Nicholas Moore, confronted with plunging asset prices, is seeking to sever links to the satellite funds that helped drive a ninefold increase in profit since 2000.

Macquarie shares have fallen 46% this year, forcing Mr Moore to reassure investors that the funds wont be a drag on the firms balance sheet and that it doesnt need to raise capital.

"If the satellites don't perform, or even worse fail, it will be read as a damning indictment of the Macquarie model," said Prasad Patkar at Platypus Asset Management. "They will reinvent themselves over time, but for the moment the golden goose of specialist funds may be dead."

Today's statement said the company has no capital commitments to its listed funds and **no plans to invest more in them**. The funds will likely contribute less than 5% of operating income before impairments this fiscal year, Macquarie said.

Potential write-downs

The market value of Macquarie's interest in its listed funds has fallen by about $1.4 billion since the end of September, representing about half the companys valuation of those investments as of September 30, said Brett Le Mesurier, an analyst at Wilson HTM Investment Group.

"The potential for writedowns and the adverse impact on earnings is weighing on the shares, said Mr Le Mesurier, who has a "hold" rating on Macquaries shares.

The company said last month full-year profit will plunge 50%, snapping 16 years of rising earnings, as investments slump and trading losses mount. Macquarie had $2.9 billion of capital in excess of minimum requirements as of December 31, it said in a statement last week.

Macquarie Infrastructure, the world's biggest owner of toll roads, reported a first-half loss of $1.3 billion last month as it wrote down the value of its road assets.

In today's note, Macquarie said restructuring steps by its funds may include "major asset sales, further debt refinancing, fund privatisation, security buybacks and capital returns". None of the businesses within Macquaries Australian listed specialist infrastructure funds has any uncovered refinancing requirements for 2009, it said.

For Macquarie Office Trust and Macquarie CountryWide Trust, the 2009 refinancing requirements "are currently anticipated to be covered by initiatives already completed or announced", it said. Macquarie Office shares have tumbled 52% in 2009, while Macquarie CountryWide shares have lost 41%

http://www.bclocalnews.com/surrey_area/surreyleader/news/37602249.html

Highway 1 partners blow deal deadline

The deal to twin the Port Mann Bridge and widen Highway 1 was to have been finalized last fall.

Published: January 14, 2009 3:00 PM
Updated: January 15, 2009 1:45 PM

A missed financing deadline has raised doubt over whether the twinning of the Port Mann Bridge and widening of Highway 1 will proceed as a full private-public partnership (P3).

Connect BC Development Group was picked as the preferred bidder over rival groups last summer and a final contract was to have been signed with the province last fall.

But the banks lined up by the Macquarie Group, the Australian financing partner in the consortium, have so far refused to sign off on the project loan, which was to have been finalized Jan. 8.

Transportation minister Kevin Falcon, in a statement issued Wednesday, said the province has agreed to Macquarie's request for a one-month extension to complete the loan.

"This is in response to the current challenges facing capital markets," Falcon said.

"Macquarie advised government that they remain confident that they will be successful in completing lending syndication. The Province of B.C. will wait and see the results of the proponents' effort, but regardless remain committed to the Port Mann project utilizing alternative means of financing should that be necessary."

Falcon wasn't available for an interview and ministry staff say he's not speculating on whether the province might borrow money directly and terminate the financing component of the project.

The initial concept was for the partners to finance, design, build and then maintain the twinned bridge and widened 37-kilometre highway corridor.

The group would be repaid and make a profit from tolls charged to cross the bridge over the next 35 years.

There are also indications the cost of the project has ballooned again – from $1.7 billion to as much as $2.3 billion.

That's the amount of financing sought by the partners, according to British industry journal Project Finance, which reported the failure to finalize.

Ministry officials say they can't comment on the cost of the project, adding that's part of the negotiations.

The other partners in the preferred bid group include Pieter Kiewit and Sons – which is upgrading the Sea-to-Sky Highway – as well as U.S.-based Transtoll Inc. and Flatiron Constructors Canada Ltd.

NDP finance critic Bruce Ralston said the turmoil around the project's financing means it almost certainly won't meet Falcon's previous target of having pilings rising from the river before this May's provincial election.

"This project is going to be delayed even further," he predicted.

Ralston noted partner Macquarie is itself embattled due to the global financial crunch, and has been forced to sell off assets to shore up its balance sheet.

The firm borrowed on the strength of rising infrastructure asset values and was able to attract investors by offering big dividends.

But some analysts have likened the model to a pyramid scheme that has now begun to collapse.

Ralston said the provincial government's P3 model for building infrastructure is now in jeopardy because it also failed to anticipate potential trouble.

Any major delay in the Port Mann/Highway 1 project could push back the flow of jobs that would provide a much-needed employment boost in the region to stimulate the economy.

Gateway program opponent Eric Doherty, of the Livable Region Coalition, said no details have been made public on the structure of the proposed deal or what kinds of guarantees the government offered to the partners.

He said Victoria's method of winnowing multiple bidders down to one final preferred group may be problematic.

"They've only got one bidder," Doherty said, adding Connect BC may have bid low to become the preferred group but now be seeking to renegotiate.

Such a scenario can put political pressure on the government to agree to steeper terms in order to get a deal done on deadline, he said, pointing to Vancouver's financing of the Olympic village construction as an example.

Doherty says the reported loan cost of $2.3 billion also raises big questions, noting the project was originally was based on a $1.3-billion price tag.

"It seemed at that time like it was a stretch for the tolls to cover a $1.3-billion project," he said. "Now you're looking at a $2.3-billion project and you're looking at lower expected traffic volumes in the first few years because of the economic downturn.

"You add those two things up and there's no way they could possibly pay for this whole project with tolls."

The Port Mann twining promises to reduce congestion and travel time, improve safety and accessibility and reopen the bridge to an express bus service planned to connect northern Surrey and Langley to Burnaby.

HOV lanes are to be extended east to the Langley border.

The bridge will include access for cyclists and pedestrians, and will be built to accommodate future light rapid transit.

Critics of the project say the freeway expansion will fuel sprawl and undermine efforts to fight climate change.

http://www.canada.com/vancouversun/news/westcoastnews/story.html?id=4c063eef-8e64-47d7-875b-51b9bfc18b0d

Port Mann Bridge financing thrown into question

Private builders struggling to raise money, ask Victoria for more time

Jonathan Fowlie and Lori Culbert
Vancouver Sun

Thursday, January 15, 2009

The private consortium chosen as the best suited to twin the Port Mann Bridge is struggling to raise money for the project, and has told the B.C. government it needs more time before it can finalize a deal.

The deal -- a public-private partnership or P3 -- was supposed to be completed earlier this month, but on Wednesday, Transportation Minister Kevin Falcon confirmed the deadline has been extended to early February.

"Obviously, it's a difficult market out there," Falcon said, referring to constraints in the global credit market.

However, he said he remained confident the deal will go ahead.

"What they tell us is, they remain confident that they can pull it together, but they needed more time," he said.

The project to twin the Port Mann bridge is already behind schedule, as construction was initially supposed to start last fall.

Under the proposed arrangement, the consortium would build the bridge and widen parts of Highway 1, and then be paid through tolls after everything is complete.

The consortium chosen to enter final negotiations was selected in August. Called Connect BC Development Group, it includes Australian-based Macquarie Group, an international toll road operator and investor.

But Macquarie, which operates more than 30 roads worldwide, has been hit hard by the financial meltdown.

The value of the company's toll-road portfolio fell by a third in the last four months of 2008. In a statement issued by Macquarie, it blamed "the recessionary environment" and "higher assumed financing costs."

NDP finance critic Bruce Ralston said he believes the government should rethink its approach on the deal.

"Whether [Macquarie] is able to be in a position to actually provide the kind of capital that is necessary to make a project like this work is something I hope and expect, on behalf of

British Columbians, is being thoroughly investigated," he said, pointing to recent problems with Fortress Investment Group in connection with the Olympic Athletes' Village.

He said the B.C. Liberals have been "ideologically resolute in refusing to acknowledge any weaknesses in [the P3 model], and I think at this point it's pretty clear there are some serious problems," Ralston said.

Because negotiations are not complete, Falcon would not say how much the project will cost or what institutions are on the list of major lenders.

Project Finance Magazine, a U.K.-based trade publication, has reported more than two dozen banks met last month to assemble $2.3 billion in debt for the project. It said the deal was supposed to close by Jan. 8.

This week, the magazine said the banks were attributing the delay to credit constraints associated with the global crisis.

The magazine said a rumour in the market suggested another reason for the delay: that the banks no longer like the pricing structure of the debt.

The magazine went on to identify the four lead international banks in the financing deal -- BNP Paribas, Caja Madrid, Royal Bank of Scotland, and Société Générale -- each of which has struggled recently because of the economy.

Falcon acknowledged the current difficulties in the markets, but defended the P3 model and said he will not let the Port Mann project stop if the consortium can't find the money it needs.

"We've got other options that can allow us to move it forward."

While Falcon would not go into specifics, Ralston pointed out one obvious solution would be to abandon the public-private partnership, and build the project with public money.

"When capital markets are as volatile as they are now, there's a real advantage to having public funding," he said.

http://dcnonl.com/article/id32211

January 23, 2009

Consortium wins extension of financing deadline for Port Mann bridge project

RICHARD GILBERT, staff writer

The private consortium that was selected by the B.C. government to twin the Port Mann Bridge and widen Highway 1 in Metro Vancouver has asked for more time to put the financing together for the public-private partnership.

The government announced in August that the Connect BC Development Group would enter into negotiations for the construction of the project.

The group team includes the Macquarie Group, Transtoll Inc., Peter Kiewit Sons Co. and Flatiron Constructors Canada Limited.

Macquarie, which is Australia's largest investment bank, has not been able to arrange the financing for the $1.6 billion project.

The project is of particular interest as another Fraser River crossing, the 72-year old Pattullo Bridge, was recently damaged by fire and will remain closed for an estimated four to six weeks, as a section of the bridge is fixed. The entire bridge is only expected to last for another 10 years.

The lead proponent on the project, Macquarie Group, has asked for and been granted a one-month extension to get their financing finalized, said Dave Crebo, communications director with the B.C. Ministry of Transportation.

"The lead proponent has been in negotiations to secure financing, but due to the economic times we are in right now, they are experiencing challenges in getting their financing."

The financial arrangements for the project, which take the form of a public-private partnership or P3, were supposed to be completed in early January. Macquarie has been granted an extension to early February in order to complete the task.

The project was originally planned to start construction in fall 2008 and is already behind schedule.

Crebo said Macquarie is confident they can complete a deal to finance the project, but the government is taking a wait and see position.

Sharp fluctuations in the price of Macquarie stock in September 2008 have raised doubts about the long-term viability of the company's investment banking model.

On Sept. 18, Macquarie stock suffered its biggest one-day loss falling 23 per cent to $26.05, its lowest close since May 2003.

The next day Macquarie stock increased by $9.85 or 37.8 per cent to close at $35.90, after having leapt by as much as 50 per cent around midday.

Analysts say Macquarie has suffered from the perception of being too risky and over-reliant on debt to grow its business.

The 40-kilometre Port Mann Bridge/Highway 1 project consists of the construction of a new bridge, widening the highway, upgrading interchanges and improving safety and access between McGill Street in Vancouver and 216th Street in Langley.

http://www.bclocalnews.com/surrey_area/surreyleader/news/38232499.html

Surrey North Delta Leader
Financing tougher, but still viable, says P3 boss

By Jeff Nagel - Surrey North Delta Leader

Published: January 23, 2009 11:00 AM
Updated: January 23, 2009 11:44 AM

The province's chief architect of public-private partnerships (P3s) admits private financing of infrastructure projects has grown tougher but he remains confident a deal will be reached to twin the Port Mann Bridge.

Partnerships BC CEO Larry Blain was responding to this month's failure of the preferred Highway 1 corridor partner to get its $2.3-billion bank loan in place on time, raising questions about the viability of the project.

"We are optimistic that we are going to close on our new schedule," Blain said, referring to a new February deadline for financing.

In an interview with Black Press, Blain said both the Port Mann/Highway 1 project and many other big infrastructure projects find themselves in a more challenging environment to raise money.

"These are difficult financial markets and the banks are doing more due diligence than they used to," he said. "They're examining their investment opportunties more carefully. They're being more selective."

He said the Port Mann project, which will see the private operator repaid through bridge tolls over 35 years, remains very attractive.

Transportation minister Kevin Falcon has said other options are possible if private financing falls through, but Blain wouldn't discuss what they are or whether the province might borrow the money itself.

The Connect BC Development Group, which includes troubled Australian infrastructure firm Macquarie, is **the lone preferred bidder** for the project but has yet to sign off on a final deal.

It faces a $15-million penalty if it backs away, Blain said.

A group of anti-Gateway demonstrators protested Thursday at Macquarie's downtown Vancouver offices.

Critics of P3s have long argued private borrowers must pay much higher interest rates than if government borrowed the money – a differential that must, along with profits to the partners, be repaid through user fees.

But with the global credit crunch now underway, the spread between corporate and government borrowing has widened still further because investors in corporate bonds consider them riskier than before and demand they be compensated with higher interest rates.

Corporate long-term borrowing rates are now running three to five per cent higher than what the triple-A rated provincial government pays.

That translates into an extra $30 to $50 million per year in debt servicing costs for every $1 billion borrowed.

"In this environment the financing cost is higher," Blain said.

"There can be a tipping point where there are rates of financing that would not be attractive – that's entirely possible," he said. "In the current range, we're still achieving value for money."

He said that assessment must take into account all facets – financing, construction and maintenance of a project over the length of the agreement.

Blain said although interest rates are higher now private partners are expected to bid on the basis of lower rates in the future after initial borrowing is refinanced.

"Some of this current market financing uncertainty can be transferred to the bidders."

Blain said there's a good array of bidders negotiating to build the South Fraser Perimeter Road, and proposals are expected soon on a new hospital for Fort St. John.

He defended the decision for the province to take on preloading of the perimeter road itself – critics say that means B.C. may get stuck with liability for any soil stability problems the private builders encounter.

"You have to assess each risk and make sure it warrants the cost of transferring," Blain said, adding the move also allowed work to start sooner.

NDP transportation critic Maurine Karagianis said the province has banked too heavily on "privatization schemes" to build new infrastructure.

"We've continued to see lots of promises," she said. "But very little real substantial proof that these projects will get underway."

http://www.drive.com.au/Editorial/ArticleDetail.aspx?ArticleID=60415&vf=26

$1b tunnel-bridge plan 'needs work'

AAP, January 27, 2009

The NSW government says it's considering a proposed tunnel to link Sydney's Warringah Freeway to a new, elevated Spit Bridge, but needs more information.

The NSW government says it's considering a proposed $1 billion-plus tunnel to link Sydney's Warringah Freeway to a new, elevated Spit Bridge, but needs more information.

Macquarie Bank's toll road arm Macquarie Infrastructure and community group Sensible Transport Action Group have been discussing the project with the Roads and Traffic Authority (RTA) for several months, Fairfax reports.

The tunnel would start at Cammeray and end just before the Spit, with the private sector to mostly fund the project, with a toll to recoup costs.

Acting Roads Minister David Campbell said he was considering the proposal, aimed at easing traffic congestion on Sydney's northern beaches.

"The NSW government welcomes all suggestions on ways to ease congestion on Sydney's major road corridors and we are committed to investigating all proposals put forward," Mr Campbell said in a statement on Monday.

However, he said the RTA indicated the proposal was short on detail, "and they believe it would require a substantial government contribution of between $500 million and $1 billion."

Concerns have also been raised over projected traffic forecasts, which assume vehicles currently using main routes to Sydney's northern beaches would switch from the existing free road to a new tollway.

"The RTA will be asking the group for further detail and will review the proposal in full before providing the Minister with formal advice on the proposal," Mr Campbell said.

The NSW Greens have labelled the project another potential financial burden for the state.

"Macquarie Infrastructure's giant motorway plan for Sydney's northern suburbs would quickly become a white elephant and a financial burden for the people of NSW," Greens MP Lee Rhiannon said in a statement.

Ms Rhiannon pointed to failed motorway projects started by "greedy corporate interests" which had not attracted projected traffic numbers.

"These projects are in financial trouble because traffic numbers fell well short of what was predicted."

Ms Rhiannon said improved public transport was the solution to traffic congestion on the northern peninsular.

http://www.vancouversun.com/Port+Mann+Bridge+project+proceed/1228185/story.html

Port Mann Bridge expansion to proceed, with B.C.'s help

By Jonathan Fowlie and Lori Culbert, Vancouver SunJanuary 28, 2009 3:45 PM

British Columbia will put up one third of the money needed for the twinning of the Port Mann Bridge and expansion of Highway 1, Transportation Minister Kevin Falcon announced Wednesday.

He said the province has reached an agreement in principle with Macquarie Group, which he said should be finalized by March. Under the original plan, Macquarie was to raise the entire financing for the project.

Falcon said the province had not planned to finance any portion of the Port Mann project, but this intervention "made sense" given the state of the financial markets.

Falcon said this new arrangement was reached during a "tough negotiation process" while the capital markets are in "turmoil."

He would not reveal the final cost of the project until the deal is signed, but the private financiers have reportedly been seeking $2.3 billion in debt financing.

Falcon has said in the past the project is B.C.'s most expensive P3, at more than $2 billion.

Falcon said B.C.'s one-third share will be provided under the same terms and conditions as the banks.

All costs will be recovered by electronic tolls, which remain the same as previously indicated, approximately $3 for cars on opening day.

The project will create about 8,000 construction jobs and remains on schedule for a 2013 completion.

In August, a consortium called Connect BC Development Group was selected to enter final negotiations with the province on the project to twin the Port Mann Bridge and expand Highway 1.

That consortium featured Australian-based Macquarie Group, an international toll road operator and investor that has encountered serious financial difficulty.

The value of Macquarie's toll-road portfolio fell by a third in the last four months of 2008, and in a statement the company blamed "the recessionary environment" and "higher assumed financing costs."

Macquarie had been struggling to arrange funding for the Port Mann project and had been given an extension by the province.

The stated reason for the delay was credit constraints, but Project Finance Magazine -- a U.K.-based trade publication -- reported that "market rumours" suggest some banks were uncomfortable with "the debt's pricing structure," meaning they could be looking to renegotiate the terms.

In an interview earlier this month, Partnerships B.C. CEO Larry Blain said he was confident funding for the Port Mann would still be arranged by February -- although he added it is conceivable the deal could take until March to finalize. "We gave one extension to Macquarie because the markets are difficult, banks are doing more due diligence, they are more picky about projects," he said in an interview. "[But] the fact that Macquarie Bank's stock prices have gone down does not change its commitment to the project."

http://www.vancouversun.com/news/projects+immune+world+financial+meltdown/1211646/story.html

B.C.'s P3 projects not immune to world financial meltdown

By Jonathan Fowlie and Lori Culbert, Vancouver SunJanuary 23, 2009

The Golden Ears Bridge, an $800-million crossing between Langley and Maple Ridge.

Vancouver SunIt was early in the morning of Dec. 16 when teams of German prosecutors descended on the offices and residences of some of their country's highest-flying banking executives. The raids were by no means the first sign of trouble, but they served to underscore the gravity of the financial crisis.

Top executives of Germany's Hypo Real Estate had been insisting they were sheltered from the worsening financial storms — that the worldwide credit crisis had in fact "emphasized the particular strength and sound nature of our business model," Georg Funke had said at the end of 2007, while still CEO.

But all was not well.

As investors were finding out, a multi-billion-dollar arm of Hypo Real Estate, Depfa Bank, was being suffocated by a lack of cash.

That problem has proved near fatal, dragging the stock of Hypo Real Estate — an international provider of infrastructure finance — down by about $60 per share to just under $3.

But more than just producing an army of irate investors — and sparking an investigation to determine if former members of the bank's board had intentionally misrepresented the financial health of the company, and whether there was any evidence of insider trading — the continuing problems at Depfa have spread uncertainty around the world, including here in B.C.

As Hypo Real Estate negotiated an $80 billion bailout last year, workers in British Columbia were pressing to finish the Golden Ears Bridge, an $800-million crossing between Langley and Maple Ridge.

While the workers knew the importance of their deadline, what they likely didn't know was that the financial foundation of the project relied in large part on a bank struggling to stay alive.

Golden Ears is not the only public-private project Depfa is bankrolling in B.C. It is also a partial lender on the $282.5 million Royal Jubilee Hospital being built in Victoria and of Surrey's new $239 million outpatient hospital.

Provincial officials said this week they remained confident those projects will be unaffected by the crisis, primarily because the contracts remove significant risk from the government and place it on the private consortiums in charge of delivering the projects.

But a review by The Vancouver Sun has shown several of B.C.'s privately financed public infrastructure projects — both those under construction, and those about to begin building — are connected to international lenders facing serious problems due to the world financial meltdown.

With even the smartest economists scratching their heads about the future, an obvious question comes to the fore — are these new, popular P3 (Private Public Partnership) projects truly sheltered from the economic storm?

A Port in the Storm

Since its inception in 2002, Partnerships B.C. — an arm's length government agency — has overseen 25 infrastructure projects worth $10 billion in capital value. A half dozen are complete, and the rest are either under construction or in the procurement stage -- potentially exposed to the world financial storm.

But many politicians, high-ranking officials and business leaders argue private financing is still the way to build expensive new infrastructure projects in B.C. Critics are less convinced.

Certainly, in better times, the P3 model seemed like a sure thing.

In Australia, the high-flying Macquarie Group was dubbed the "Millionaires Factory" because the company made gobs of money investing in and operating toll roads.

Like so much else in the recent financial crisis, the never-ending growth projections and the success those projections delivered turned sour almost overnight.

About one week after attending a lavish $500,000 office Christmas party in late November, Macquarie's well-paid staff were shell-shocked to see the company hand pink slips to an estimated 1,000 employees.

Despite the shock, there had been warning signs trouble was looming.

Macquarie, which operates more than 30 roads worldwide, slashed the value of its toll-road portfolio from $10.2 billion to $6.5 billion in the last four months of 2008, according to Australian newspapers.

In a statement, Macquarie blamed "the recessionary environment" and "higher assumed financing costs."

Like Depfa Bank, Macquarie is involved in infrastructure projects in B.C. — including the upgrades to the Sea-to-Sky Highway.

It is also leading the consortium chosen to twin the Port Mann Bridge and expand Highway 1. Macquarie is struggling to arrange funding for that project and was given an extension by the province, which has insisted the financing should now be secure by February.

But on Friday, Transportation Minister Kevin Falcon was poised to make a sudden, late-day announcement about the Port Mann. Then, 18 minutes before the press conference, it was cancelled with little explanation.

The strange on-again, off-again skirmish may be indicative of the ongoing challenges behind the scenes trying to secure funding for B.C.'s largest privately financed infrastructure project.

NDP finance critic Bruce Ralston showed up at the cancelled event, and said he could only speculate about what was going on.

"One of the areas of speculation is what seems to be on the minister's desk — the financing question," he said.

Like Falcon, Partnerships B.C. CEO Larry Blain was not commenting Friday.

But in an interview earlier this week, Blain said he was confident funding for the Port Mann would, indeed, be arranged by February — although he added it is conceivable the deal could take until March to finalize.

"We gave one extension to Macquarie because the markets are difficult, banks are doing more due diligence, they are more picky about projects," he said. "[But] the fact that Macquarie Bank's stock prices have gone down does not change its commitment to the project."

Blain won't reveal from whom Macquarie is trying to secure the money, but trade magazine Project Finance identified four lead financiers who met with two dozen banks last month in an attempt to assemble $2.3 billion in debt that it could lend.

According to international news reports, all four of the lead lenders — BNP Paribas, Caja Madrid, Royal Bank of Scotland, and Societe Generale — have been hit by the credit crunch.

British Prime Minister Gordon Brown recently approved a $525 billion bailout for the Royal Bank of Scotland. He said he was angry it had come to that.

The official reason for the delay in financing for the Port Mann project was credit constraints, but Project Finance magazine reported that "market rumours" suggest some banks were uncomfortable with "the debt's pricing structure," meaning they could be looking to renegotiate the terms.

The Truth About Risk

What all this means for projects in B.C. depends on who you ask.

Eric Doherty, a transportation planner, opposed the Port Mann project from the start, fearing it would increase congestion in his East Vancouver neighbourhood as more cars headed to an expanded Highway 1.

Then he became frustrated when he tried to follow the money trail in the financing deal.

"Macquarie's business model seems to be falling apart, and as a bank they seem to be in real trouble," said Doherty, a member of the Livable Region Coalition, which staged a protest outside Macquarie's Vancouver offices on Thursday.

He noted the Sydney Morning Herald reported last week that Macquarie's toll road project in Brisbane "became the butt of jokes in the finance sector" after it appeared the project may need a bailout.

Doherty wonders what will happen if fewer people than anticipated pay tolls to use the Port Mann expansion.

The final details for toll revenue expectations for the Port Mann are not yet finalized, though Blain insists the province is not exposed to any risk if traffic volume is lower than expected.

It is a different story for the Golden Ears Bridge.

In the final deal for the Golden Ears, TransLink — which now means the provincial government — has agreed to pay the private consortium $316,198 for operation, maintenance and rehab each month once the bridge is open.

TransLink will collect the tolls from bridge users. Should the toll revenue fall short of projections, TransLink remains on the hook for the full monthly payments. That part of the risk remains with the taxpayers.

In the agreement, the government will start paying $500,000 per month in 2009, with payments rising to about $4 million per month in 2011, and then topping out at $4.8 million in 2015.

The payments stay steady at $4.8 million until the contract ends in 2041.

If not enough cars cross the bridge, the government will have to make up the difference, meaning it is shouldering the risk.

Translink spokesman Ken Hardie said Thursday he had confidence in the model.

"You go into this knowing exactly what kind of traffic you can reasonably expect," he said, adding that the model is essentially the same as the Canada Line's, which relies on ridership projections to be accurate. (If they're not, TransLink will have to pay the builder-operator to make up for the revenue shortfall.)

"We're pretty confident we're going to do OK," Hardie said.

With the Port Mann Bridge, some have asked what will happen if the traffic is not as expected.

Will Macquarie turn to Victoria for help? Will it be able to raise tolls until it reaches profitability?

Partnerships B.C. says no.

Blain said there is no volume guarantee, and so the risk lies entirely with the private consortium.

Partnerships B.C. added that tolling will have to comply with provincial guidelines, and that the province will always be responsible for setting the maximum tolls.

While Blain is duly cautious in his account of the financial landscape, he says he remains confident the P3 model — and its ability to shift risk away from the government — can help ensure B.C.'s major projects come in on time and on budget.

Perhaps so.

But a look around the world suggests that in the new reality — in which several governments have already agreed to billion-dollar bailouts to keep banks from failure — anything is possible.

In Britain, the government this week announced it was cancelling an $8.75 billion plan to widen a series of major highways in time for London's 2012 Summer Olympics. The Guardian newspaper reported in October the government was struggling to raise private financing for the project because banks were reluctant to lend money.

In Manchester, new financing is being sought for a $1.3-million waste incinerator plant after four banks bailed out of the funding deal in December.

In Florida, officials are investigating whether they can salvage a plan to build a $1 billion Port of Miami tunnel after killing the project in December when the lead financier, Babcock and Brown, began to teeter on the edge of bankruptcy.

Babcock, an Australian-based investment firm, lost 98 per cent of its market value due to the credit crunch, and since Jan. 8 has temporarily halted the trading of its stock while determining how to repay its sizable debt.

A response from Babcock's creditors is expected this Monday, a company statement says.

The troubled Australian investment firm is the parent company of London-based Babcock & Brown Public Partnerships Ltd., which the B.C. government announced Jan. 12 was an equity partner in one of three consortiums shortlisted to build the $1-billion South Fraser Perimeter Road P3 project.

That isn't the only project Babcock and Brown was looking to fund in B.C.

Babcock was also initially the equity partner in one of two consortiums short-listed last year to build the $268-million Fort St. John Hospital P3 project. However, Blain told The Sun this week Bilfinger Berger now has joined that project — essentially bailing out Babcock — and many Babcock employees in Vancouver are now working for Bilfinger.

The second consortium bidding for the Fort St. John Hospital includes South African investment bank Investec, which is ensnared in a multi-million-dollar lawsuit that alleges wrongdoing in the selling of shares by an associated company, whose CEO was later murdered, according to a Johannesburg newspaper.

There are problems with consortiums vying to build the South Fraser Perimeter Road as well.

One group includes a Spanish company that needed a loan last year to refinance debt stemming from another road project, and the other involves a Texas company that is a defendant in a $160 million lawsuit alleging fraud in the way a highrise was built.

Blain reiterated that he remained confident, emphasizing the province does extremely thorough checks before finalizing any deal. Plus, he said, all three consortiums bidding on the South Fraser Perimeter Road are "led by very, very strong international developers" who would have been subjected to "extreme financial scrutiny"

Unyielding Support

When Prime Minister Stephen Harper was in Surrey Jan. 12 to support the South Fraser Perimeter Road, The Vancouver Sun asked if his confidence in P3 projects had been shaken by the credit crisis.

"I would actually say it's actually the contrary," Harper replied. "I would say that projects like this, with the involvement of both levels of government and the private sector, are exactly the kind of thing our economy needs, and our private sector and our financial sector needs, to bolster confidence."

Harper has been touring the country to support "shovel-ready" projects, and next week's federal budget is expected to include funding for infrastructure as a means to spur on economic growth.

News reports Thursday suggested his government could be considering running deficits of $64 billion over two years to pay for this spending.

Premier Gordon Campbell, Vancouver Mayor Gregor Robertson and Surrey Mayor Dianne Watts were in Ottawa this month looking for chunks of that funding for local projects.

Campbell, who has been a major supporter of P3s, said he also was not concerned about the economic stability of B.C.'s privately funded projects.

"I have no doubt there are additional challenges. But I also believe these are exactly the kinds of projects that financial institutions look for . . . long-term returns that are secure in terms of their support."

Finance Minister Colin Hansen agreed, though he did leave a window open for flexibility given current markets.

"I think there are both the pluses and minuses in terms of the times that we're in today, but I think ultimately what we always look at when any of these issues come for a decision is, is there risk transfer?" Hansen said. "It just simply wouldn't make sense to proceed with a P3 if risk transfer was significantly diminished."

The fact that a P3 consortium in financial trouble can either refinance a project or lose its stake is the beauty of a P3, said Tim Philpotts, a senior vice-president at Ernst & Young in Vancouver and a director with the Canadian Council For Public Private Partnerships.

"Governments are very protected in these transactions if anything did go wrong," he said. "I think the government is a lot more secured in these than people might at first think."

At Partnerships B.C., Blain continued to back the P3 model, but did acknowledge the current credit crunch may require some new approaches.

"Definitely in the marketplace today, the banks have equity constraints and they are not as actively lending as they were before," he said. "Our view is that we should continue on and be flexible."

He insists his projects do not present the same kind of risk to taxpayers as the beleaguered and high-profile Vancouver Olympic Village, which is not a P3.

In that project, the City of Vancouver signed a completion guarantee that exposed it to significant risk if the $875-million project ran into trouble — as it did when Fortress Investment, the project lender, backed away from the deal.

To save the project, Vancouver put up an initial $100 million loan, and now is considering a deal to finance the remaining $458 million.

In a P3, Blain said those problems would never have touched the government, or the taxpayer. Instead, the consortium would be faced with a simple choice: refinance the project on its own and shoulder the associated costs, or lose its stake in the entire deal.

Others are more cautious about P3s.

Thomas Ross, a senior associate dean at the University of B.C. with an extensive knowledge of P3 projects, said the current economic crisis — and the higher cost of borrowing that accompanies it — should spark a rethinking of how big public projects are financed.

"What's kind of happened is a concern for some existing deals that might come unravelled because everybody thought the banks that were lending the money were fine, and now it turns out the banks that were lending the money aren't fine," he said, citing the Port Mann Bridge as a possible example.

"It may be that some of them are difficult to finance in these times, and it may be that the only people that can really borrow are governments, and so we go back to the more traditional model of procurement until financial markets settle down."

Ross, who Blain has described as being “in the middle on the issue,” made it clear he thinks this is not a flaw in the P3 model, and that he is optimistic an improvement in the markets will return P3s to being the leading way to finance many large projects.

The NDP’s Ralston wonders how the P3 model will affect the future of government spending, pointing out that P3 deals usually entail 30 or more years of government payments after the project has been built. “It commits a government long-term in a way that is very difficult to foresee at a time when economists are saying, ‘I can’t tell you what’s going to happen next year.’”

http://www2.canada.com/vancouversun/news/westcoastnews/story.html?id=cb2d14d3-8c02-4d1f-a930-85c467cbf3aa

Port Mann bill could hit $3 billion

Premier Campbell to unveil design for the new crossing today

Vancouver Sun

Wednesday, February 04, 2009

The Port Mann Bridge and Highway 1 expansion project could cost as much as $3 billion, double the announced cost of $1.5 billion in 2006, Premier Gordon Campbell said Tuesday.

In a speech at the B.C. Economic Summit, Campbell said the Port Mann Bridge will be a "$2- to $3-billion project."

When announced by Campbell in January 2006, the project was estimated to cost $1.5 billion. Accounting for general inflation, that would now be between $1.6 and $1.7 billion, although there were industry estimates as early as 2006 that construction costs would go up by 50 per cent or more by 2010.

Campbell, who was scheduled to officially unveil a design for the new bridge today in Surrey, did not elaborate Tuesday on any reasons for the change.

There has been speculation that instead of adding a second span for additional lanes, the province will build an entirely new bridge. It was not clear what effect that would have on the cost of the project.

New Democratic Party finance critic Bruce Ralston said Tuesday the apparent escalation in costs raised serious concerns, especially since the province has recently agreed to put up one-third of the financing.

"We could be talking as big as a $3-billion project. So the provincial contribution, if you do the simple math, could be up to $1 billion," Ralston said in an interview.

The B.C. government said last month it was coming to the rescue of its private partners in the deal, agreeing to lend one-third of the entire budget to the consortium selected as part of the public-private partnership.

Until last month, the deal was meant to be financed entirely by the consortium, Connect BC Development Group, a group that features Australian-based Macquarie Group. An international toll-road operator and investor, Macquarie has encountered financial difficulty as a result of the global credit crisis.

Macquarie was struggling to raise money for the project, and had missed initial deadlines to close the deal. Trade magazine Project Finance had suggested Macquarie was trying to raise $2.3 billion in bank debt, but did not give a full price tag for the project.

Partnerships B.C. CEO Larry Blain said Tuesday many of the details of the deal were still being negotiated, though he was able to outline the broad strokes of how the arrangement will be structured.

Blain said Macquarie would likely be obliged to put one-third of the overall budget into the project as equity. He said that amount will be put in first, and will be used before the province begins making its contributions.

He said the government will borrow money to raise its share, which it will in turn lend to the consortium.

Payments from the province are expected to begin around 2010, he said.

Transportation Minister Kevin Falcon said in a recent interview this financing structure ensures the consortium shoulders a significant portion of the risk.

"This is a huge position," he said, speaking of the one-third equity stake.

"They're not going to walk away from that lightly."

This structure also means B.C. has the option to sell its stake to another entity.

"We have a provision that allows us to be taken out in 2010 by other private-sector banks if we decided we wanted to do that," Falcon said.

Falcon added that the province can borrow money more cheaply than commercial lenders, meaning the government stands to profit from the arrangement. He could not be reached on Tuesday.

Blain said the main risk with toll revenues being used to pay for the bridge remains with Macquarie, because its equity stake will be the last to be repaid.

"The various lenders, including the province, will be paid first," he said.

"It's typical that the debt stands ahead of the equity, so it gets paid first."

Blain said there was no specific closing date yet for the deal, but that all parties were targeting a finish sometime in March.

http://www.theaustralian.news.com.au/business/story/0,28124,25013981-36418,00.html

Macquarie Group's write-downs double to top $1.5bn

Scott Murdoch | February 06, 2009

MACQUARIE Group is losing hundreds of millions of dollars on investments in its own funds.

The diversified investment bank, which yesterday confirmed it had sacked more than 1000 staff in the past four months, will take a $2 billion hit, one of the largest ever, on bad loans and poor assets as the global financial crisis ravages its fortunes.

The worst of the write-downs will centre on Macquarie's investment in its own listed infrastructure funds, which have been smashed by the current market turmoil.

Macquarie had expected to lose $680 million on the funds, and broader equity investments, but the potential loss has now more than doubled to $1.5 billion in a number of months.

The most severe loss is expected from Macquarie's stake in its media and communications funds, which could cost up to $200 million.

The bank will also book a substantial loss from its equity investments in projects such as Japan Airports and Spirit Finance.

The loan impairment provisions, predominantly for Macquarie's real estate assets, have also doubled from $145 million to $300 million. The declines mean Macquarie will book its first annual profit fall in 17 years, with the dour outlook that the 2009 result will be $900 million.

The prediction is well below the analysts' consensus forecast that Macquarie's profit would be at least $1.2-1.5 billion.

Macquarie chief executive Nicholas Moore told an investor briefing that the bank's operating income would be down by 15 per cent, but the balance sheet remained strong.

However, for the first time, Macquarie revealed how many staff had been sacked as the bank shut down businesses and sold domestic and foreign assets within the bank.

The job losses totalled 1047 in just four months, with the size of the global workforce now pared back to 12,851.

There are expectations in the market that another 1500 Macquarie positions would be scrapped, as the bank shields itself from the worsening fallout.

The effective profit warning from Macquarie came as the bank also refused to rule out a significant cut to its full-year dividend payment.

But Mr Moore did his best yesterday to be positive as the markets move against Macquarie.

"We have $32 billion in cash on the balance sheet, that is a very, very strong place for us to be," Mr Moore said.

"We are in quite volatile markets, but we think we are well positioned for opportunities in the medium term and the year to come."

Mr Moore said merger and acquisition opportunities were emerging for the first time in more than a year.

Macquarie chief financial officer Greg Ward said a decision on whether to reduce the dividend, as now seems likely, would be left to the board.

"It is too early to say on the final dividend, and the board will do this with the finalisation of the accounts," he said.

"It was our policy to pay out 50-60 per cent of earnings. That would suggest a cut in the final dividend.

"That is something the board will consider. We have more than ample capital, so capital would not be an issue in dividend policy."

Macquarie has been one of the most active Australian banks in making use of the Government's guarantee, and has raised more than $10 billion over the past few months.

Mr Moore said the debt raising was undertaken with additional fund raisings worth a total of $21 billion.

The investment bank said it now held nearly $3 billion worth of capital above government and regulatory requirements.

"The main concern for financial institutions is what is happening with our balance sheet," Mr Moore said.

"Last year we thought we were in a strong position, but we have improved our position, we are very solid."

The Government's move to guarantee bank deposits had led to a 27 per cent increase in the bank's retail deposit base, which was now worth $18.1 billion.

The bank's funds under management had lost 10 per cent in value in the past year and the bank said there had been a sizeable shift in its flagship cash management trust, which was not covered by the guarantee.

Despite the negative outlook, shares in Macquarie jumped by 5.5 per cent.

http://business.smh.com.au/business/mig-takes-a-nosedive-back-to-earth-20090205-7yyx.html

MIG takes a nosedive back to earth

Scott Rochfort

February 6, 2009

A HORROR operating update from Macquarie Group yesterday fuelled concerns the company's stable of listed real estate and infrastructure satellites could soon report larger than expected write-downs to their asset portfolios.

Following Macquarie's warning that the "unprecedented market conditions" made it extremely difficult to forecast the coming year, securities in the toll-road group Macquarie Infrastructure fell 7.5c to $1.29, their lowest close since 2000.

In response to an ASX price query later in the afternoon, MIG reiterated the warning given in mid-December that it expected to write down its toll-road portfolio from $8.6 billion to $6.5 billion. This is well down from the $10.2 billion it valued its assets at the start of 2008 - which include stakes in the Indiana Toll Road, France's APRR, Britain's M6, Toronto's ETR 407 and Sydney's M7.

"As a result, it is expected that the operating profit will contain a substantial revaluation decrement, although this will not match the change in portfolio valuation due to the way in which accounting standards operate," MIG said in response to the query.

In the December update, MIG blamed the looming writedown on the "current dislocation" in the global economy. The revaluation will take MIG's net asset backing per security to $3.02. This is more than double their current share price, suggesting the market is not confident in how MIG values its assets. This was also shown recently when its co-owner of the M7, Transurban, declined to exercise its rights to buy out MIG's stake in the road on valuation grounds.

The future of the toll-road group will become clearer when it reports its results on February 19.

Meanwhile, shares in Sydney Airport owner Macquarie Airports fell 6c to $2, amid concerns the continued slowing in air traffic could have on the airport owner's cash flows and asset valuations. The announcement by the carrier Scandinavian Airlines System this week that it was planning to cut capacity has heightened worries the MAp-majority owned Copenhagen Airport could suffer more traffic declines following last year's collapse of Denmark's Sterling Airlines. The SAS cuts are expected to be the start of a scaling back of capacity across Europe.

Shares in Macquarie's shopping centre fund, Macquarie Countrywide, fell 1.5c to a new low of 16.5c. The fund listed at $1 in 1996. Given the slump in retailing in the United States and in Australia, investors fear Countrywide could soon announce a write-down to the more than $3 billion of assets on its balance sheet. The fund is selling assets in an attempt to keep lenders at bay. It recently sold 30 shopping centres in the US.

http://www.theglobeandmail.com/servlet/Page/document/v5/content/subscribe?user_URL=http://www.theglobeandmail.com%2Fservlet%2Fstory%2FLAC.20090205.LPICARD05%2FTPStory%2FNational&ord=9856705&brand=theglobeandmail&force_login=true

In this PPP, taxpayers are the ones who paid
A report by the Ontario Auditor General on the Brampton Civic Hospital project shows the pitfalls of this kind of financing

ANDRE PICARD

February 5, 2009 at 10:00 AM EST

To P3 or not P3, that is the question.

Public-private partnerships (P3s) are an increasingly popular method for financing the construction of public works projects, from sewage systems through to hospitals.

But a recent report by the Auditor General of Ontario should give pause.

Auditor General Jim McCarter examined in detail the deal that saw a private consortium build Brampton Civic Hospital and lease it back to the province.

Using the ever-cautious words of an accountant, his bottom line was: "Our work indicated that the all-in cost could well have been lower if the government had built the hospital itself."

Put more bluntly: Taxpayers got screwed.

On paper, P3s look good. The idea is that private business will use its acumen and access to capital to build facilities quickly and cost-effectively. Cash-strapped governments, for their part, are able to invest in much-needed infrastructure now while repaying investors over the long term - as individuals do with a mortgage.

In theory, this allows both public and private partners to focus on what they do best.

But let's take a look at what happened in practice at Brampton Civic Hospital.

In November, 2001, the Ontario government approved the development of new hospitals using the P3 approach.

In August, 2003, a deal was signed between William Osler Health Centre (the health corporation that runs Brampton Civic) and The Healthcare Infrastructure Company (a consortium of private-sector companies) to design, build and finance a new hospital. The consortium would also provide non-clinical services such as laundry, housekeeping, security and maintenance over a 25-year period.

The Auditor General found that, when all was said and done, going the P3 route cost Ontario taxpayers $194-million more than if the hospital had been built and run publicly.

Financing the construction cost added a further $200-million in interest charges because government can borrow money at a lower rate than private business.

As much as we love to complain about the presumed inefficiencies of government, this is not capitalism's shining moment of glory.

Paying $394-million too much for a $614-million hospital is pathetic - with a capital PPP.

So how did the money-saving P3 idea unravel? Again, the Brampton Civic story is informative.

The Auditor General points to several key problems:

In 2001, a consultant pegged the cost of a new 716-bed hospital at $381-million. By 2004 - after the province embraced P3s - that estimate jumped to $525-million for a smaller, 608-bed hospital, but the discrepancy was never justified. (The hospital opened with 479 beds operating in October, 2007);

The cost of a government-built hospital was overstated by a whopping $289-million, making it look like a totally unaffordable option compared to a P3;

For example, when estimating the cost of a government-built hospital, William Osler Health Centre added $67-million, assuming a 13-per-cent cost overrun. In reality, cost overruns are about 5 per cent;

The province spent $28-million on consultants working on the P3 project but didn't include that in the P3 costs; nor did it factor in all the time government employees spent on the project;

During construction, $63-million in modifications were made that were attributable to lack of planning and rushing the project.

While those numbers are damning enough, Mr. McCarter notes, more fundamentally, that the province never conducted a formal analysis to determine if the market was sufficiently large and competitive to justify a P3 arrangement.

In this instance, the answer is clearly "No." Because so few construction contractors are able to undertake a project as large and complex as building a hospital, they would end up being involved whether the facility was built by government or a consortium. So all that going the P3 route does is pad the bills.

In his report, the Auditor General makes a series of recommendations to avoid the Brampton Civic debacle and notes that the Ontario government has already implemented many of the changes.

There is no doubt P3s can be done better. But no one is asking whether they should be done at all.

As the federal government embarks on a plan to spend its way out of a recession, it has created a new Crown corporation, PPP Canada Inc., and given it $1.3-billion to "spearhead the promotion of public-private partnerships."

Taxpayers deserve more than P3 boosterism. And they deserve more justification than a fallacious premise that governments are incapable of efficiency.

Our much-needed public works projects, from hospitals to bridges, should be built and operated as efficiently and cost-effectively as possible and, so far, P3s have not proven their mettle.

As Canadian comic and aspiring politician Greg Malone has said bitingly: "P3s should be called P12s - Public Private Partnerships to Plunder the Public Purse to Pursue Policies of Peril to People and the Planet for all Posterity."

http://www2.canada.com/vancouversun/news/westcoastnews/story.html?id=97eb16b8-6685-4e50-bf81-3ee33ab07fd3

Total Port Mann cost always near $3 billion, official says
$1.5 billion figure announced was capital cost in 2005 dollars

Jonathan Fowlie
Vancouver Sun

Saturday, February 07, 2009

The B.C. Liberal government has long assumed it would cost close to $3 billion to build and finance the project to twin the Port Mann Bridge and expand portions of Highway 1, a senior government official said Friday.

"We had a number that wasn't that far off from $3.3 billion," Frank Blasetti, assistant deputy minister of transportation, said in an interview.

"We were around $2.8 billion."

As he unveiled the design Wednesday for a new single-span bridge, Premier Gordon Campbell said the entire project will cost $2.46 billion to build, and close to $3.3 billion including the cost to maintain, operate and finance the project between now and 2013, when construction is expected to be complete.

The announcement came as a surprise to a public that in January 2006 heard Campbell announce the project's estimated price tag at $1.5 billion.

On Friday, Blasetti insisted that other than an anticipated overrun, and some additional project features, not much has really changed.

He said the $1.5 billion was the capital cost, which was stated in 2005 dollars and did not include the cost of financing.

He added the government used $230 million last year from a project-related contingency fund to account for overruns, bringing the declared price tag to $1.73 billion.

On top of that, the winning consortium, Connect BC Development Group, opted to make upgrades in its final proposal.

During the bidding process, Blasetti said, two out of the three consortiums proposed scrapping the two-bridge idea and building a single 10-lane span. This would cost more, but would also allow the winning consortium to avoid having to maintain the existing structure.

The winning bid unveiled this week comprised a single span, but also added other upgrades, such as dedicated lanes for local traffic and a more advanced system to lessen the risk of lost toll revenue.

These upgrades helped the consortium win the bid, but are also expected to translate into higher toll revenues.

When these upgrades and inflation are taken into account, Blasetti said, the final price reaches $2.46 billion.

But that's just the cost of construction.

Behind that number, the province has always made assumptions about factors such as what it would cost to finance the project.

Blasetti said he didn't want to get into specifics about the government's estimates and assumptions, fearing that might give an advantage to consortiums bidding for future projects. But he acknowledged that even before the upgrades, the total number, including financing and inflation, has been close to about $2.8 billion.

Add the new bridge features, he said, and that number gets pretty close to the $3.3 billion announced this week.

Blasetti said it is this $2.8 billion figure -- and not the $1.5 billion -- that the province has used to set the $3 starting toll rate. Tolls, which will pay for the entire project, will begin at a maximum of $3, and are allowed to rise 2.5 per cent each year to account for inflation.

The one element Blasetti said remains to be finalized is the financing.

He said the financing was originally supposed to close last October or November, and that it was planned to be spread across a syndicate of about five to seven banks.

Then global credit markets were hit with an unprecedented crisis.

"The reason we're still trying to finalize the financial terms is the bids were due about a week after the second major bank failed in the United States," he said, explaining that markets at the time "went crazy."

"Banks are not willing to put big numbers into an individual project right now," he said, adding that the consortium is now trying to spread the financing across about 13 to 15 banks.

This, of course, is after the province stepped in with the promise of a $1.15-billion loan to help finance the project, effectively cutting in half the amount needed from the banks.

Blasetti said it was still not clear what the final bank financing rate will be from the banks, but said the $3.3-billion price tag was calculated using the highest anticipated rate.

Another concern raised recently is that Connect BC includes the Macquarie Group, an international toll-road operator and investor that has encountered financial difficulty as a result of the global credit crisis.

Media reports this week said Macquarie will like take writedowns of $2-billion Aus, or $1.6 billion Cdn, this year.

Macquarie is expected to put up $1 billion in equity for the Port Mann project, with the remaining $1.15 billion coming from a syndicate of banks.

Blasetti said the province was convinced the company can make good on all of its commitments.

"We are confident they can come up with the money," he said.

http://online.wsj.com/article/SB121930613738559945.html?mod=googlenews_wsj

Shaking Up the 'Macquarie Model'

Babcock's Woes Cast Clouds Over Infrastructure Funds; Debt Burdens Exact a Toll

The global credit crunch may be claiming another victim: the listed infrastructure fund.

The chairman and the chief executive of Australia's Babcock & Brown Ltd., one of the largest managers of such funds, stepped down Thursday after a 30% drop in first-half profit and a share price that has fallen 92% since the beginning of the year. Babcock is expected to sell assets to help pay back 9.6 billion Australian dollars (US$8.38 billion) in parent-company debt and billions more in debt at various funds, according to people familiar with the matter.

It also expects to cut head count by about 25%, or about 300 positions. Its shares Thursday fell 36% to a record low of A$2.22.

The biggest operator of infrastructure funds by market capitalization, Australia's Macquarie Group Ltd., is considered much healthier by analysts, but it faces its own investor skepticism. Many of its publicly traded infrastructure funds are buying back shares they consider undervalued and selling assets. Some also have reined in deal making; one Macquarie-managed fund dedicated to airports said this week it won't participate in some investment opportunities it had been expected to look at. **The parent company's shares have fallen 38% this year**.

The moves mark a sharp turn in the fortunes of a business structure that has come to be known as the "Macquarie model." Dominated mostly by a clutch of Australian companies, these publicly traded products hinge on buying staid assets ranging from toll roads to airports to power plants, and piling on debt to extract juicier returns.

Both Babcock and Macquarie have defended their structures as solid. A Babcock spokesman Thursday said the company sees its unlisted funds as an important source of new growth. In the past 20 months, the company says, it has raised €2.2 billion ($3.24 billion) for an unlisted European infrastructure fund.

A Macquarie spokesman said the investment bank is committed to its listed funds and that the firm will look for ways to deliver value to investors, a process that could include divestitures, on a case-by-case basis. The company also points to continued outside investment totaling to A$22 billion so far this year, mostly into unlisted funds, as proof that investors still see appeal in its funds.

Many publicly traded funds have been hit by the seizing up of global credit markets and a subsequent drop in asset values. With cheap debt no longer readily available, listed infrastructure funds, like other companies, wound up having to refinance at higher interest rates. Compounding the problem, listed funds saw their shares dive as jittery investors

feared the worst, sparking concern and skepticism among lenders. Unlisted funds, by contrast, have been spared the equity-market turbulence and drawn less skepticism.

Thursday, Babcock's long-serving chief executive, Phil Green, and its chairman, James Babcock, who founded the company in 1977, stepped down. Chief Financial Officer Michael Larkin will succeed Mr. Green, and Deputy Chairman Elizabeth Nosworthy was elected chairman. The company is now undergoing a strategic review by Goldman Sachs JBWere and Deutsche Bank AG to get a handle on its debt, while UBS AG is advising specific funds.

The move capped a tumultuous two months for Babcock and its funds, which own everything from wind farms in the U.S. to Australian power stations. In June, a selloff caused the company's market capitalization to fall below a threshold set by creditors for triggering a review. Though the creditors didn't take action at the time, Babcock began looking to unload funds.

"Just when it should be taking advantage of lower prices to find bargains for its funds, the company has to sell its own assets at fire-sale prices," says one person familiar with the matter, adding that Babcock "went into this credit crisis with too much debt."

Under the listed-fund model, a company like Babcock buys highly regulated infrastructure assets with generally predictable revenue streams and packages those assets into funds it manages for a fee. Many of the publicly traded funds loaded up on debt to jack up returns.

Macquarie, which is credited with coming up with the infrastructure model, designed these products specifically for Australia's ballooning pension assets and pitched them as investments that provide stable returns without falling victim to the vicissitudes of the global economy. Other Australian companies, including Babcock, Transurban Group Ltd. and Asciano Group Ltd., adopted forms of the model,

The publicly traded funds drew investors world-wide.

The Macquarie model soon came under fire from skeptics. Critics say the funds have often relied too heavily on cheap debt and soaring asset prices and pay high fees to the management companies. Dean Paatsch, a Melbourne analyst at RiskMetrics Group, calls the funds "governance Frankensteins." Babcock, Macquarie and others dispute that characterization, saying their structures are transparent and their fees disclosed to investors.

One of the biggest criticisms involves how the funds raise capital to pay investor dividends. By adopting a structure whereby Sydney-listed funds also register securities in Bermuda, they are able to skirt laws in Australia that require corporations pay dividends solely out of profits and sometimes have paid them partly out of loans. For the fiscal year ended June 30, profit covered 54% of the dividend paid by Macquarie Infrastructure Group. Macquarie has defended the practice, saying it disclosed where the funds came from and cited its overall financial health.

Babcock's performance was strong as this year began, and the credit-market issues hurting the U.S. seemed remote. The company reported net income last year of A$1.94 billion.

About A$600 million came from management and performance fees generated by its funds.Babcock & Brown Power, a listed fund, surprised investors Monday with a A$410 million write-down on its Alinta retail-energy business, just a year after purchasing it. In addition, Babcock Power revealed plans to sell its Tamar Valley Power Station, still under construction, to the state government of Tasmania at a loss of A$42 million.

http://www.businessspectator.com.au/bs.nsf/Article/Macquarie-Infrastructure-posts-126bn-half-year-los-$pd20090219-PDTNG?OpenDocument

Macquarie Infrastructure posts $1.26bn half year loss

Macquarie Infrastructure Group Ltd (MIG) says it is considering asset sales as difficult economic conditions continue to impact traffic performance, as the company swung to a $1.27 billion half year loss.

MIG delivered a $1.27 billion loss in the six months to December 31, well below the $1.03 billion profit a year earlier, reflecting revaluations of the company's road businesses.

"MIG and road management will continue to focus on activity that ensures the delivery of both revenue and EBITDA (earnings before interest, tax, depreciation and amortisation) growth during the second half of FY2009 (fiscal 2009) as difficult economic conditions continue to impact traffic performance," MIG said.

"MIG will continue to consider sale opportunities to realise current value in the portfolio and deliver that value to security holders."

http://www.moneymanagement.com.au/article/Macquarie-Infrastructure-posts-223-per-cent-decline/468164.aspx

Macquarie Infrastructure posts 223 per cent decline

19 February 2009 | by Mike Taylor

Another Macquarie division has taken a major hit to its bottom line – this time Macquarie Infrastructure Group, which has a 223 per cent drop in net profit attributable to security holders largely as a result of major downward revaluations.

The group announced to the Australian Securities Exchange today that its net loss attributable to security holders was $1,269.9 billion – a result it said predominantly reflected the impact of revaluations of the road businesses in the portfolio.

It stressed, however, that revaluations have no impact on the group's operating performance, current cash flows or distributions.

MIG chief executive John Hughes said the group's road portfolio had actually delivered an increase in proportionately consolidated actual revenue and earnings before interest tax of 9.4 per cent and 8.3 per cent respectively.