Baltimore's Seagirt Concession: it's all about "jobs, jobs, jobs", according to Maryland Governor Martin O' Malley, pictured (right) next to Highstar founder Christopher Lee (left)

Yes, we can

As 2009 draws to a close, several deals are demonstrating that private equity firms can play a constructive role in public-private partnerships. Highstar Capital's recently-awarded 50-year concession for the Seagirt Marine Terminal in Baltimore illustrates why, writes Cezary Podkul

MUCH HAS BEEN written this year about the role private equity can play in infrastructure. Worries about misalignments of interest, huge piles of debt and "quick flips" of vital infrastructure assets have naturally made many observers wary about the pools of private capital building up to invest in the asset class. "Can private equity play the infrastructure game?" asked the April 2009 cover of *The Deal* magazine, followed by the semi-skeptical answer, "with buyouts moribund, new players have poured into some of the longest-term, low-return, politically sensitive assets out there. This will be interesting".

Interesting it has been, certainly, with high-profile collapses of deals such as Midway Airport and anti-climactic conclusions of sales processes such as Florida's 78-mile-long "Alligator Alley" toll road.

But as 2009 draws to a close, it is also possible to point to a number of successes in how private equity has constructively engaged with the public sector to build public-private partnerships that make sense to both sides.

The Carlyle Group's agreement to upgrade and manage 23 highway stops in Connecticut, profiled in detail on page 11, is one such example. Another is Highstar Capital's contract award for a 50-year concession on the Seagirt Marine Terminal at the Port of Baltimore in Maryland.

It is important to note that Highstar's deal had not yet been approved or reached financial close at press time. And the Maryland Port Administration will ultimately judge the success of Highstar's partnership not on promises made but promises kept - just as Highstar's shareholders will judge the success of the transaction by returns realised, not returns promised.

Nevertheless, at the outset, there are several aspects of this deal worth highlighting as reasons why private equity can indeed play the infrastructure game.

SOLVING A PROBLEM

Solid public-private partnerships ideally solve a problem – not just for the public sector, but for the private sector as well. In the case of Baltimore, the Maryland Port Administration wanted to build a new, 50-foot-deep berth for larger container ships that are due to start arriving at the port once the Panama Canal finishes its widening project in 2014. The problem? "There is no money," says James White, executive director of the Maryland Port Administration. "The state is not getting the gas tax revenues it had in the past," he explains, "and therefore we were challenged on how to get ready and be prepared for when the Panama Canal project . . . is completed."

So port officials, who had observed various other port deals led by Macquarie, Deutsche Bank and the Ontario Teachers' Pension Plan, decided to look into funding the berth through a partnership with the private sector. "We were a little reluctant in the beginning," admits White, but the quality of the companies that responded to the port's request for qualifications, including Highstar-backed stevedore Ports America, made the port more confident in moving forward with the process.

The Port Administration eventually hired Public Financial Management, a Philadelphia-based financial advisory firm, and Laurie Mahon, independent infrastructure adviser, to run a competitive bidding process for the berth financing and terminal concession. In June, New York-based Highstar Capital and cross-town rival Alinda Capital Partners were shortlisted to bid. Alinda dropped out of the bidding in August and Highstar didn't find out it was the only remaining bidder until late September. In retrospect, Highstar had high praise for the way the process was run.

Now, after several months of negotiation, the berth will indeed get built: a Highstar affiliate has committed to fund the estimated $105 million cost of building the berth in exchange for a 50-year concession, or right to collect all the revenues, from the Seagirt Marine Terminal, where the new berth will be located. The berth will be financed with private equity from Highstar's third fund, which closed on $3.5 billion in 2007. Private Activity Bonds – municipal securities which can be used for private sector-backed projects – are also being considered for the berth financing, according to White.

Emmett McCann, one of the Highstar executives in charge of the transaction, said the berth will be finished before the Panama Canal widening is scheduled to complete. So, if everything goes to plan, Baltimore will be able to compete with other ports for freight from the larger-sized ships of the future.

The deal also solves a problem for Highstar. The private equity firm wants to switch Ports America's portfolio of contracts from outsourcing arrangements to concessions. "Concessions are the most desirable way to operate the port for a private sector operator," explains Christopher Lee, Highstar founder and managing partner. "When you're the concession holder, you have total discretion on how to operate the port," he says, as opposed to an outsourcing arrangement, where "you're just a vendor working for someone else". When Highstar bought Ports America in 2006, approximately 25 percent of its revenues came from concessions. "Our goal was to make it two-thirds concessions," explains Lee, and with the recent successes at the Port of Oakland, where Ports America scored a similar deal last year, and the Port of Baltimore concession, he hopes to hit the 70 percent mark by 2012.

LABOUR BUY-IN AND JOB CREATION

Infrastructure assets are often heavily unionised businesses, so it is crucial to get buy-in from labour leaders, many of whom fear anything branded as a "privatisation" due to the potential for job losses and wage cuts associated with the word.

In Baltimore, Highstar successfully avoided that pitfall by promising to create union jobs. Lee says that approximately 5,700 jobs will result from the concession, including 3,000 one-time construction jobs and 2,700 permanent jobs. As a result, the port's chapter of the International Longshoremen's Association, the largest union of maritime workers in the country, supports the deal.

"They saw this as job security [and] additional cargo coming through the marine terminals," says White. So did Maryland Governor Martin O'Malley, who said, "this public-private partnership is about three things: jobs, jobs, and more jobs," according to a press release announcing the deal.

SHARING IN THE UPSIDE

Equally importantly, a good partnership gives both the public and private sectors a share in the upside of deals. This is important not only to align interests but also to help the public sector avoid the appearance of giving away the proverbial "family jewels". That is, detractors can easily attack the size of any upfront payment and say the public sector got ripped off; add a revenue sharing agreement for the most optimistic scenario and all of a sudden, that argument becomes much more difficult to make.

In Baltimore, as with many concession deals of the past, the port will receive an upfront payment "somewhere north of $100 million", according to White. The money, which Highstar may cover by a combination of equity and third-party debt, will go toward making improvements in the state's infrastructure, such as roads and bridges. "We're calling it a 'capital reinvestment fee'", says White. There's ongoing sources of capital on the table, too: Ports America will give the port an annual rent payment of $3.2 million, adjusted for inflation, plus a $15 fee for each cargo container moved at the terminal above a 500,000 threshold.

White estimates that threshold won't be reached until 2014, when the Panama Canal widening is complete. "We wanted an incremental revenue stream if our expectations on the Panama Canal are correct," he says. If they are indeed correct, and the terminal becomes much more profitable after the canal is widened, the public sector will benefit from the upside, making it much more difficult for anyone to say that they left money on the table. Plus, it will be Ports Americas' responsibility to attract the customers to the terminal and grow the revenues. So the risk has been transferred, but the rewards are shared.

White believes these arrangements make the deal stand out from other public-private partnerships. "I think in a lot of these deals in the past someone has thrown the keys to someone else and said, 'it's yours to run'. That's not our intent and that's not Ports Americas' intent," he says.

Lee agrees: "Here is a deal where the private sector is investing private sector dollars to make critically needed public sector improvements. They're getting huge benefits as opposed to if we just came in and privatised the toll road and all you're doing is increasing tolls," he says.

"That's not privatisation in my book. That's just indirect taxation," Lee adds. ■