February 8, 2017

To: Finance and Administration Committee

From: Darrell Johnson, Chief Executive Officer

Subject: Interstate 405 Improvement Project Financing Update

Overview

Over the past several months, Orange County Transportation Authority representatives have been discussing a Transportation Infrastructure Finance and Innovation Act loan for the Interstate 405 Improvement Project with the Build America Bureau Credit Programs Office. One of the requirements for the loan includes receiving investment grade ratings for the project from two of the nationally recognized statistical rating organizations approved by the Securities and Exchange Commission. During the week of December 19, 2016, Orange County Transportation Authority representatives met with five rating agencies in New York to discuss the loan. A detailed summary report on the meetings has been prepared by Sperry Capital Inc., and is attached to this staff report. Also included is a summary of the project and financing activities to date.

Recommendation

Receive and file as an information item.

Background

The Orange County Transportation Authority (OCTA), in cooperation with the California Department of Transportation (Caltrans), is implementing the Interstate 405 (I-405) Improvement Project between State Route 73 (SR-73) and Interstate 605 (I-605) (Project). The Project will add one general purpose lane from Euclid Street to I-605, consistent with Measure M2 Project K, and will add an additional lane in each direction that would combine with the existing high-occupancy vehicle lane to provide dual express lanes in each direction on I-405 from SR-73 to I-605, otherwise known as the 405 Express Lanes.

In April 2015, the OCTA Board of Directors (Board) approved the terms and conditions negotiated with Caltrans that established the roles and responsibilities related to project delivery, funding and financing, and operations for the Project.

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The Board also authorized staff to pursue financing opportunities through the Transportation Infrastructure Finance and Innovation Act (TIFIA).

In February 2016, OCTA submitted a Letter of Interest (LOI) to the Build America Bureau (Bureau) Credit Programs Office (formerly known as the TIFIA Joint Program Office) requesting a loan for the Project. In March 2016, the United States Department of Transportation (USDOT) notified OCTA that the LOI met the requirements for TIFIA participation and was ready to advance to the next phase.

The next phase involved receiving an indicative investment grade rating opinion letter on the Project's plan of finance and the feasibility of the anticipated pledged revenue stream. In June 2016, OCTA presented an overview of the Project and the preliminary financial model in San Francisco to Standard & Poor's and received notification that their Credit Committee assigned the Project an investment grade rating of "BBB-."

In July 2016, OCTA submitted a copy of the Standard & Poor's indicative rating letter, a detailed preliminary financial model, and the application fee to the Bureau's Credit Programs Office. OCTA also provided an oral presentation on the Project to Bureau representatives in Washington, D.C. in August 2016.

In November 2016, OCTA's Board awarded a design-build (DB) contract to the joint venture (JV) team, OC 405 Partners, for the Project. OC 405 Partners is a team of firms led by OHL USA, Inc. (OHL) and Astaldi Construction Corporation (Astaldi). The contract award for Project design and construction totaled $1.2 billion. The total Project cost is $1.9 billion and will be funded with a combination of local, state, and federal funds.

Discussion

Since the selection of OC 405 Partners in November 2016, significant progress has been made in delivering the project. Staff has worked diligently to execute the contract and on delivering a prudent financial plan for the completion of the Project. Biweekly conference calls began in October 2016, with the Bureau to monitor the progress of the TIFIA loan for the Project, and meetings were held with five rating agencies in December 2016. Right-of-way (ROW) activities continued, and OCTA continues to enjoy many successes related to the "Sign in 60" ROW acquisition program.

Project Status

An important element of the Project is the timely acquisition of ROW so that the design-builder can deliver the Project on schedule. While there are no residential relocations necessary for the Project, there are ROW impacts to 304 parcels. The majority of the impacts relate to temporary construction easements. As of January 30, 2017, 211 Notices to Appraise have been issued, 113 offers have been presented, 97 agreements have been signed, and 85 escrows have been closed. OCTA is utilizing a federally-approved ROW acquisition incentive program, coined “Sign in 60,” and a Board-approved modified delegation authority to expedite ROW acquisition. This program allows OCTA to provide impacted land owners with an incentive payment of 20 percent of the appraised value, up to a maximum of $200,000, if the offer is accepted and signed within 60 days of receipt. This helps OCTA to minimize legal costs and protracted negotiations with property owners that could potentially delay the project. To date, over 90 percent of all “Sign in 60” ROW acquisition offers have been accepted.

Similarly, there are approximately 120 utility conflicts requiring some level of relocation to accommodate the Project. All utility prior-rights determinations have been made, and utility relocation notices have been sent. To date, 95 percent of utility preliminary engineering agreements are executed and final draft utility agreements (UA) have been prepared with each utility owner, when necessary. The draft UAs will be finalized and a construction notice sent to each utility owner when OC 405 Partners, as the DB entity, provides their intermediate design to integrate, verify, and finalize the relocation plans.

An execution version of the DB contract was sent to OC 405 Partners for signature in January 2017. Per the Instructions to Proposers, OC 405 Partners had ten days to return the signed DB contract to OCTA. The signed contract was received from OC 405 Partners and was executed by OCTA’s Chief Executive Officer (CEO) on January 31, 2017. Notice to Proceed (NTP) No. 1 was also issued on the date the CEO executed the agreement. As required by the Instructions to Proposers, OC 405 Partners agreed to provide an opinion of counsel regarding, among other matters, the due authorization and enforceability of the contract and parent guarantees. The opinion of counsel has been provided to OCTA.

OC 405 Partners Update

On November 16, 2016, two days after the Board action on the contract award, Moody’s Investors Services downgraded the parent company of one member of the JV team, OHL, from B3 to Caa1, with a negative outlook. On

November 28, 2016, Fitch downgraded OHL to B+ from BB- with a negative outlook. The rationale for the ratings downgrades is driven by a further slump in earnings of OHL's core engineering and construction business in the third quarter of 2016. This decline in the third quarter follows other declines in the previous four quarters that translated into negative free cash flow generation and rising debt levels. It was also noted that OHL's weaker performance was driven by negative margins in legacy projects, the delay in the launch of construction projects for their own concessions, as well as increased exposure to the U.S. market with generally lower margins.

Despite the relatively low ratings for OHL, one of the elements that provided assurance to OCTA's financial compliance review team was that the other JV partner, Astaldi, demonstrated a higher degree of financial strength. Since both partners provided parent guarantees and liability is joint and several, having Astaldi as part of the team was viewed as extremely favorable. Astaldi is rated B2 by Moody's with a negative outlook, B by Standard and Poor's with a negative outlook and B+ by Fitch with a stable outlook. The current ratings for the two JV firms are listed below:

	OHL	Astaldi
Moody's Investor Service	Caa1	B2
Standard & Poor's	N/A	B
Fitch Ratings	B+	B+

As part of the review of the Project proposals, all bidders had to submit financial information for each member of the JV team and all proposed guarantors, in their proposals. This included current financial statements, rating reports, report of any material financial changes, and any off balance sheet items. In addition, OCTA's compliance teams reviewed Dun and Bradstreet reports. The purpose of the review was to confirm that the teams could demonstrate the financial capacity to carry out their obligations under the contract. In the case of the Project, the JV teams are being asked to perform DB services to construct the project, not provide any equity or their own long-term debt financing to get the project built. As such, so long as the vendor provides an adequate monthly invoice, OCTA will pay that invoice within 30 days so there is no material, long-term cash flow responsibility being placed on the JV team. However, in order to ensure the Project gets completed, the security package is a critical part of the contract.

Security Package in DB Contract with OC 405 Partners

In general, the security package OCTA has obtained from OC 405 Partners includes 5 percent retention on each monthly invoice, as well as payment and performance bonds of 5 percent of the contract amount at contract execution, that increases to 50 percent of the contract value at NTP No. 2 to be issued for commencement of major construction activities. In addition, OCTA has received guarantees from the parent companies of both members of the JV team (OHL and Astaldi) and confirmation of the joint and several liability for the JV team members and their parent company guarantors, meaning that both firms and their parent companies are wholly responsible for completing the contract independently, even if one of the firms is unable to perform their duties.

The ability to acquire the required bonds was a critical element in determining the JV team's financial capacity to deliver the job. The sureties have made their own assessment of the JV team's financial capacity and ability to deliver the project or they would not have provided the associated bonds. In this case, the sureties are: Liberty Mutual Insurance Company, Zurich American Insurance Company, Berkshire Hathaway Specialty Insurance Company, and American Home Assurance Company. Under California law, in order for these sureties to operate and provide bonds in California, each must demonstrate its financial stability, reputation, and integrity to the California Department of Insurance, while adhering to specific solvency standards established under the California Insurance Code. They each must also maintain defined minimum capital and surplus reserves at all times. All sureties are issued a letter grade from A++ to F, and a roman numeral ranging anywhere from I (less than $1,000,000) to XV (greater than $2,000,000,000). These ratings evidence the surety's financial strength and ability to pay claims. These ratings are published by the A.M. Best Company. For this procurement, each surety was required to possess a rating of A- VIII in order to provide bonds for this project.

The DB contract provides various rights and remedies in favor of OCTA, if OC 405 Partners fails to comply with its obligations. These rights and remedies comprise the "security package" and, in part, include the following:

Proposal Bond – At the time of submission of their price proposal, OC 405 Partners provided a bond, in the amount of approximately $61 million (5 percent of contract amount), to secure their obligations to sign the DB contract based on their financial and technical proposal. The proposal bond is currently held by OCTA.

Payment and Performance Bonds – At the time of execution of the DB contract, OCTA returned the proposal bond to OC 405 Partners and received payment and performance bonds each in the amount of approximately $61 million (5 percent of contract amount). The bonds each contain a rider pursuant to which the bond amounts will be increased to approximately $609 million (50 percent of contract amount) at the issuance of Notice to Proceed No. 2, which authorizes the commencement of construction activities.

Retainage – OCTA retains 5 percent of each monthly invoice from the DB team. Joint and Several Liability of the JV Members – As part of their proposal, OHL, and Astaldi provided OCTA with a signed joint venture agreement that included a statement acknowledging that the JV members were jointly and severally liable for the obligations of the DB team under the contract and that each would be responsible for continuing work under the contract regardless of internal disputes between the JV members.

Parent Guaranties – As part of their proposal, each of the members of the joint venture agreed to provide a parent guaranty in the form required by the contract. The parent guaranties from OHL and Astaldi acknowledge the joint and several liability of each of the members of the joint venture and guaranty those obligations. The signed parent guaranties have been provided to OCTA.

Partnering and Dispute Resolution - Disputes between the parties are to be resolved first through informal partnering processes, followed by review by a dispute resolution board. The next step is mediation, followed by court action.

Limit of Liability – Consistent with other projects of this type, the DB contract includes a $125 million limit of liability; however, the following are not included in the limit of liability:

- Insurance proceeds
- Claims under the payment bond
- OCTA’s cost to complete and/or correct the work
- Fraud, gross negligence, or criminal conduct

Liquidated Damages – The DB team is charged $140,000 for each day of delay in achieving substantial completion (defined as 2,049 days after NTP No. 2). The DB team is charged $30,000 for each day of delay in achieving Project completion (defined as 120 days after substantial completion). The DB team is charged $20,000 for each day of delay in achieving final acceptance (defined as 120 days after Project completion).

Financing Update

OCTA began biweekly conference calls in October 2016, with the Bureau to monitor the progress of the TIFIA loan. The calls include OCTA staff from the Capital Projects Division, Finance and Administration Division, OCTA's Project team including Sperry Capital Inc., Nossaman, Bank of America Merrill Lynch, Stantec, Woodruff, Spradlin & Smart, and representatives from the

Bureau. Over the past few months, the discussions have revolved around the traffic and revenue study and the financial model.

In early December 2016, Bureau staff requested 15 separate sensitivity scenarios of the Project traffic and revenue model. These were extensive scenarios requiring weeks to complete. Stantec, OCTA's traffic and revenue consultant, ran those scenarios and completed the analysis in mid-January 2017. The results of these 15 scenarios were each entered into the financial model and were provided to the Bureau.

In order to close on the TIFIA loan, OCTA will need to provide two investment grade ratings to the Bureau. On December 20, 2016 and December 21, 2016, OCTA's Chair and Vice-Chair from 2016, along with OCTA staff, and consultants met with five ratings agencies in New York to discuss the Project and TIFIA loan. OCTA met with Standard and Poor's, Moody's Investment Service, Fitch Ratings, Kroll Bond Rating Agency, and DBRS.

During the meetings, OCTA representatives discussed the background and importance of the Project, TIFIA loan, and the current schedule for Project funding. The meetings focused on risk mitigations, ROW acquisition, utility relocation, design-build selection, toll operating agreement, a review of the traffic and revenue study, and the financial model used to forecast future revenues and operations.

A detailed summary report on all the meetings has been prepared by Sperry Capital Inc. and has been included as Attachment A. The report provides an account of the meetings and the participants. A copy of the New York presentation book is provided as Attachment B.

Next Steps

As OCTA staff has stressed in the past, the timing of the TIFIA loan is dependent upon the Bureau staff and their outside consultants completing their credit/due diligence review of the project before major structural terms and the loan agreement can be negotiated. Over the next 45 days, the Bureau and their financial advisor will be preparing and submitting an initial Project report to their Credit Review Team. To facilitate the drafting of this Project report, OCTA representatives will be traveling to Washington, D.C. during the week of February 20, 2017, to discuss and negotiate commercial terms and conditions for the TIFIA loan. Final terms and conditions would be subject to OCTA Board approval. If the Credit Review Team provides an initial approval, they will invite OCTA to submit a formal TIFIA application.

After the formal TIFIA loan application is submitted, Bureau staff will prepare a final Project report and make a second presentation to the Credit Review Team and seek another approval. The next step would be a USDOT Credit Council recommendation to the Secretary of Transportation (Secretary). The Secretary makes the final determination on awarding the loan. Although originally anticipated to close by the end of first quarter of 2017, OCTA is anticipating a financial close for the Project during the second quarter of 2017. This is a more reasonable timetable given the length of time it took to determine which traffic and revenue model sensitivity testing the Bureau wanted OCTA to perform.

Also, over the next 45 days, OCTA will continue to engage all five rating agency firms and select two agencies to provide the two investment grade ratings. OCTA representatives will be traveling to New York to meet with the selected firms to discuss the negotiated TIFIA loan terms and conditions. The rating agencies will take approximately four to six weeks to complete the investment grade ratings.

Summary

Staff is providing the Board of Directors a summary of the project and financing activities to date for the Interstate 405 Improvement Project. A summary report of the most recent rating agency meetings in New York is provided as an attachment along with the presentation update materials.

Attachments

A. Sperry Capital Inc. Letter dated January 27, 2017, to Kirk Avila on OCTA's December 2016 New York Meetings.
B. Orange County Transportation Authority I-405 Improvement Project Rating Agency Update dated December 2016.

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