AMERICAN PUBLIC TRANSPORTATION ASSOCIATION

Financing New Projects in the United States

Blackhill

September 30, 2013

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Introduction to Blackhill Partners

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- Blackhill is a Dallas-based private investment bank, founded in 1995

- Principals have extensive transaction experience
  - Former officers at Goldman Sachs, CS First Boston & McKinsey
  - Variety of industries: telecom, energy, utilities, real estate
  - Over $40 billion of deals

- Specialize in solving complex transactions requiring deep analytics
  - Corporate Restructurings
  - Capital-Raising
  - International and cross-border infrastructure finance

Discussion Points

- Rail Projects: What works
- Rail Projects: What doesn't work
- An Optimum Model
- The Optimum Model in Practice
- Conclusions
- Lessons

Rail Projects: What Works

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- Critical: (i) Align private finance with government objectives
  (ii) Increase project economic base

- Government Objective: Access to transportation (road/rail/air) is an incredibly important stimulus to the production of wealth:
  - Cities and industries develop along transportation corridors
  - Produces massive efficiency and productivity gains
  - Creates strong economies and employment
  - Increases tax base

- Private Objective: Profit

- Basis for Private/Public Partnerships: Align divergent interests
  - The valuable public goods sought by government – improved economies and tax revenue – can be delivered efficiently by the private sector
  - Therefore: any project that is *a true partnership* must deliver a profit to the private sector and public goods to the government sector
  - Government needs to (a) provide profit incentives to private sector and/or (b) cost offsets . . . to deliver what government wants

Rail Projects: What Doesn't Work

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Problem: Significant wealth is generated in project "externalities," beneficial to government/society, but not shared with private sector.

- Analysis shows that 30% of more of project cost is delivered "free of charge" to government/society in the form of valuable externalities (more jobs, cleaner air, time efficiencies, etc.), resulting in better economic conditions and more government revenue
- Corridor Fare box/toll revenue does not capture the value of building the corridor
  - Industrial and property development along corridor is enhanced
  - Lifestyle and environment is enhanced
  - Overall employment is enhanced

An Optimum Model

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- Government supports the profit-making activity of the private sector in order to deliver desired social objectives
  - Takes risks
  - Shares value created through externalities

- Keys to Success:
  - Private Sector investment – real risk, significant capital
  - Government infusion of some of the value of externalities

- Result: Multiple potential sources of return to private sector – reduces risk; improves profits

The Optimum Model in Practice

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The Transcontinental Railroad, financed by the Railway Acts of 1862(3), signed by President Abraham Lincoln

Promontory Point, Utah; May 10, 1869.

The Optimum Model: Strong Mutual Interests

Transcontinental Railroad Precedent

- Ceding adjoining land to railways allowed companies to internalize some of the externalities thrown off by their investments.

- Issuance of government bonds
  - Long term, low cost interest
  - Subordinated to bonds issued by the companies

- Grants of Land directly to the companies
  - Companies sold bonds based on land granted
  - Bonds fully collateralized by land
  - Offset risk of rail operations

The Optimum Model: Economic Externalities

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Government Objectives Worth Government Investing In:

1863	**2013**
1. Safe, speedy transportation of mails, troops, and munitions of war 2. Government granted land to the railroad, but reserved land for itself; as the private land increased in value, the land reserved to the government increased in value 3. "The rails and all the other iron used. . . to be American manufacture of the best quality"	1. High congestion reduction 2. Highway fuel savings 3. Highway emissions reduction 4. Highway accident reduction 5. Highway noise reduction 6. Pavement wear savings 7. "Buy America" requirement for U.S. government loans
~ 29.0% Minimum Social Rate of Return (Fogel, 1960)[1]	~ 30.0% "Public Benefits"

(1) Fogel, R., 1960, *The Union Pacific Railroad: A Case in Premature Enterprise*, John Hopkins Press.

Conclusions

- It is in the strategic interest of the government to get these projects built
- The private sector – if it has its own capital at risk – will build them more efficiently in order to generate a return on its capital
- Government should encourage, and share in, these returns – and maximize its own economic benefits – by investing equity alongside the private sector

Lessons

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- In any Public-Private Project, the government must work with private capital to build profitability into the system.

- The government can infuse the value of social externalities into projects through:
  - Accelerated permitting (time is money)
  - Low cost access to right-of-way and land
  - Low cost, long term financing
  - Significant “in kind” equity
  - Shared mutual development via land grants

- Result: Easier to achieve rates of return and get projects built
  - Far less capital up front
  - More value in collateral
  - Other, diversified sources of return appealing to different sources of financing

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