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Five Years of Success For Rialto Water & Wastewater P3

By Megan Matson, Partner, Table Rock Infrastructure Partners

All participants in the Rialto, California, municipal water/wastewater concession came together on a panel in San Diego last month to reflect on their landmark contract, and all agree that as it approaches its five-year anniversary, the public-private partnership model is working as promised.

The panel recalled growing pains and shouting matches along the way, with plenty of advice for other cities, but there was an overriding sentiment that the Rialto P3 model is working. (To see the panel discussion, go to www.tablerockpartners.com)

Reaching financial close on November 29, 2012, the Rialto P3 was the first of its kind, followed shortly by the KKR/Suez P3 in Bayonne, NJ, and Lehigh County's public-public project in Allentown, PA. Table Rock led the $172-million investment, with the Union Labor Life Insurance Company (ULLICO) coming in as majority equity at close to make Rialto the country's single labor-owned P3.

The City's objectives included: one, a major upgrade of a long neglected water and wastewater system; two, an upfront infusion of economic development capital into the redevelopment of an old Airport property; three, rates well within affordability metrics and regional norms; and four, the ensured continued employment and comparable pay and benefits of all affected employees.

RIALTO'S CAPITAL IMPROVEMENTS PROGRAM, YEAR 4 ½

Mayor Pro Tem Scott reports: "Currently we're in our 4th year, we're rolling along pretty well with our capital projects, we've got a good relationship with Veolia, RWS and of course Table Rock, and we're getting what we need."

The Rialto P3 has a 5-year capital improvements program (CIP) funded through a "fixed flexible" CIP account, meaning the funds are exclusively set aside for infrastructure, but released project by project on a mutually acceptable basis as diligence, design, engineering, and contract bids are finalized.

Much of the joint review and decision-making has added time to execution and delivery, and caused definite hair-pulling in the early years, but it does embed continued partnership buy-in on outcomes, and transparency for elected officials and the public.

Examples of how the flexibility of the program proved beneficial include an initial 46% reduction in line replacement requirements identified post-close

Rialto Roundtable Participants

Seven of the participants in the Rialto, California, municipal water/wastewater concession came together on a panel in San Diego last month to reflect on their landmark contract. The group included:

Mayor Pro Tem—Ed Scott, City of Rialto
Utility Director—Tom Crowley, City of Rialto
Water Employee—David Terry, Rialto Water Services/Veolia
Labor Equity Lead—Jeff Murphy, ULLICO Infrastructure
Rialto Water Services/Veolia—VP Rick Smith
Debt Placement Agent—Michael Gomez, Barclays Bank
Sponsor Equity—Megan Matson, Table Rock Infrastructure Partners

through intensive field diligence of the City's flawed and absent historic system data. This freed up funds for redeployment to other needed capital projects.

Another instance of flexibility paying off for all partners was the rehabilitation of the wastewater treatment plant: The City's original 2011 concept for that project kept pricing out well over budget, with no lifecycle cost savings. At an impasse, the Partnership pivoted to a Progressive Design-Build process with AECOM/Lyles that is resulting in a streamlined design 30% lower in cost, with an estimated $500,000-plus in cash savings flowing back to the City annually post-construction.

While joint decision-making around a full table of public and private participants adds time to delivery, the project is a consensus outcome with guaranteed pricing slated for construction this year, less vulnerable to change orders and/or political reversals. Previous to this delivery process, the City—like many municipalities —had consultants drawing up various plans and reports for this same plant periodically for 25 years without moving forward. (Table Rock, which began a 100-city tour in 2013 to sell the Rialto concept, found this pattern of study and punt to be pervasive. We would attribute the country's D+ infrastructure rating more to this sort of congenital dithering, rather than to a lack of funds.)

Finally, there is an annual mandated operating repair and replacement plan and budget in the Partnership to prevent the creep of deferred maintenance from recurring.

ECONOMIC REDEVELOPMENT 4 ½ YEAR MARK

The second objective was the redevelopment of 434 acres at the former Rialto Airport, using $30 million from the P3 in an upfront payment. Mayor Scott reports that the City's ability to invest in all of the necessary support infrastructure has enabled significant activity by developers. The City has already received close to $15 million back as a result, and will receive the balance by completion in 2019. Rialto's Economic Development director Robb Steele reports that 2,800 new permanent jobs were created by this redevelopment and he expects another 5,650 will be created by completion. Due to surprisingly good pric-

PROJECT SNAPSHOT: RIALTO, CALIF. WATER & SEWER

Concessionaire: Table Rock Infrastructure Partners/Ullico

Operator: Veolia North America

Financial Close: November 2012

Owner: City of Rialto/Rialto Utility Authority

Project Need: Aging water & wastewater system + integrated goals re: economic development

Procurement: Evaluated full privatization vs. traditional delivery vs. P3; Issued RFP for P3 (30-year financing and services agreement, private equity at risk, revenue secured, public ownership)

Public Role: City retains ownership of all water rights, infrastructure and all improvements, retains control of water supply and rate-setting, maintains intensive role in decision-making

Performance, first 4 years:

- 27% above plan on performance payments to City
- Identified 46% savings in water projects to date, funds will serve other CIP
- 30% reduction in wastewater project cost, through Progressive DB process
- Anticipating 40% lifecycle savings annually after wastewater upgrade
- Fitch affirmed investment grade rating annually since close
- 2,800 new jobs in place, another 5,650 new jobs projected by 2019 through the redevelopment enabled by the P3's upfront payment

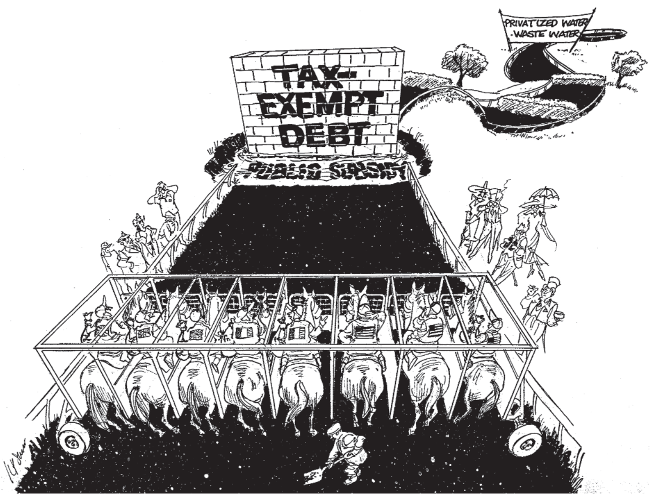
Financing: Private placement debt investors; Table Rock & Ullico buy-and-hold equity; 85% debt, 15% equity

Procurement Innovations: Used California's P3 procurement statute 5956 enabling qualifications & value-based selection; Using Progressive Design-Build within P3 ing at close, another $5 million went to restore City reserves, helping to put the budget back on sturdy footing after the wobbly years following the ’08-’09 recession.

RIALTO’S RATE INCREASES

While rates were initially anticipated to go up 100% over the first four years, the final tally is closer to 68% due to a dropped perchlorate charge and the City’s use of its surplus performance payments to defer increases.

Mayor Scott: “We’ve had some substantial rate increases but most of that is because we were way under market to begin with. Overall our water rates are competitive, probably in the middle of all of the cities around us. Our sewer rates are high right now, but we don’t see more sewer increases coming. And we’re very good about giving senior citizens and low income residents rate breaks.”



He added that over-communication to the community is the key, highlighting the numerous community meetings and mailings Rialto did to familiarize residents with the new rate structure, and to explain exactly what the investments and community benefits would be.

RIALTO’S UTILITY EMPLOYEES

While a common assumption in communities is that private sector involvement means cuts, and that profits are made on the backs of employees, Rialto Water Services’ operator Veolia retained existing employees and provided raises, and in fact brought on 30% more employees in order to meet the Partnership’s performance requirements.

Mayor Scott: “One of our main concerns was the employees that we had working for us and where they would be 5 years later. We wanted to make sure they had equal benefits, equal pay, and equal opportunities. That’s turned out to be very true today, four years later. I think frankly they have much better opportunities in the wastewater and water industry.”

Dave Terry, a project manager for Rialto Water Services/Veolia, takes it one further, contrasting his 28 years in municipal employment to his conditions under the Partnership: “The big difference is tons of resources. More than I’ve ever had in my life. And as far as salaries, as far as retaining employees, I think all of that has actually gotten better for the employees. Their salaries have gone up, they’re more conscious. And safety is big. Safety trainings were quarterly in my city job, now they’re weekly.”

He described working in a municipal setting as “working in a box, with your ability to solve a problem only as good as the resources on staff or available through consultants.”

By contrast Terry said, the resources of a global provider are a call or an email away under the Partnership when issues arise. He also sees striking differences in the depth of the asset management approach under a funded 30-year structure in contrast to his municipal experience, and finally, says he enjoys using the full range of his professional training and wearing many hats under the Partnership, where he had a more singular, limited role under city practices.

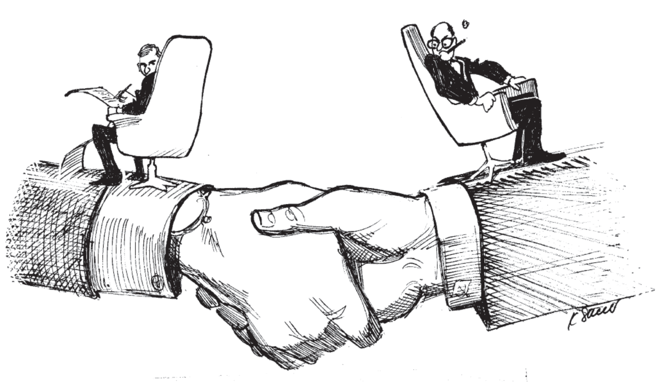
AND FINALLY, THE RIALTO FINANCIALS

In the words of Michael Gomez at Barclays, “If the job is done well and the financial architecture is well designed, you put it into place and you don’t hear much about it, and five years in, that’s where we are.” He continued, “Our investors would tell you it’s one of their best performing and favorite investments.”

Reviewed and affirmed as investment-grade every year by Fitch, the Rialto P3 structure has been described as the bones of a project financing, with a muni heart. The debt is secured by a lien on utility revenue, with no reach through to the infrastructure assets or general fund. Returns are fixed and flat for the life of the agreement, but risk-protected against unanticipated drops in revenue or cost spikes through a muni-like rate covenant.

All essential expenses and services required to sustain the utility receive first priority at the top of the monthly cash flow waterfall, and both public and private eyes review and approve cash movements. The City receives an equity-style performance payment semi-annually, with any surplus above plan flushing annually.

The first four years produced 27% above-plan cash flows back to the City, which it used to defer its 2016 planned rate increase, invest in projects, and hire in key capacity on its side of the Partnership table. Sustained reductions in California water use and associated revenues for Rialto however do indicate these extra surpluses on the water side won't continue. The City's upside on the wastewater side should continue and increase as the lifecycle savings from the Capital Improvement Program begin to kick in.



In closing, Table Rock's main takeaways from an overall win-win experience to date are:

~One, the City needs a strong, seasoned Utility Director on their side of the table to run the contract as a counter-party and make decisions in the Partnership. Too much reliance on outside consultants or overburdened City staff weighs down the joint decision-making processes.

~Two, the operator/contractor needs to be prepared to meet the larger obligations of a concession as contrasted to a contract ops arrangement. More reporting, more financial acumen, more extensive planning and asset management are in play under a P3 than under an ordinary engagement.

~Then three, no matter how transparent the structure is, no matter how solid the contractual language, any successful transition period should include an open, dedicated on-boarding process where all players on both sides train to understand and meet the daily, weekly, monthly and annual interactions of the partnership.

Finally, as Veolia's Rick Smith says, "To cities out there not quite sure whether P3 makes sense for them, come visit us! Talk to the City, talk to us – there's no need to make assumptions when you can come and get the facts." ■

First, Build A Framework For Productive Asset Reycling

by Peter Luchetti

Asset recycling in the context of a national P3 investment strategy follows an international trend largely considered to be a success, and would theoretically be a good concept for the U.S., but it runs into the fundamental American barrier of fragmentation and deeply localized governance, varying by degree across sectors and jurisdictional levels. While asset recycling would theoretically raise a large amount of capital without impairing the national debt, and could create the opportunity to reinvest this capital in our nation's infrastructure, three primary areas of challenge for asset recycling exist:

First, as stated above, the vast majority of the nation's infrastructure is owned and managed at the local level–80% according to a 2016 Aspen Institute/Duke Nicholas Institute report. For the federal government to lead any effort identifying assets for recycling would be a highly charged endeavor requiring resolution of state and local governance and decision-making across the U.S. The diverse and decentralized nature of U.S. infrastructure assets and their governance has proven to be very challenging in the implementation of P3 in the past.

Second, tapping the equity embedded in existing infrastructure, considering the D+ grade given to that infrastructure, is a dubious value proposition. The D+ indicates a depreciation bill come due, not a wealth of equity to unlock. The idea of exploiting what value (equity) there is in those often degraded assets, for deployment not into the overhaul of the asset in question, but into other infrastructure, may create follow-on ills as their deferred maintenance compounds unchecked.

An alternative view would suggest tapping the "equity" embedded in the annual O&M expenditures surrounding the assets. $130 billion is the estimated annual expenditure by local water and wastewater entities nationwide, for example. If lifecycle financing and delivery plus the implementation of data-rich preventive asset management can take a 15-25% bite out of that $130 billion, you "unlock" a far more productive cash flow than would the one-time asset sale.

A key focus going forward, therefore, should be incentivizing and supporting local authorities in the embrace of procurement innovation that supports lifecycle investment and asset management benefits, primarily through expert partnership implementation.

If you were able to resolve political will and decision-making deficits at the local/regional level nationally, it would be realistic to expect that the whole of the country could achieve a 15% to 30% reduction in life-cycle cost and thus access capital that is now tied up in the inefficient management of the nations existing stock of infrastructure.

Third, it is critically important that any asset recycling that does take place be directly tied to re-investing in the nation's infrastructure. The country needs a disciplined framework and plan for any asset recycling that takes place to ensure there is no leakage of capital to other uses of funds, outside of a strict adherence to reinvestment. Any leakage should come at a high cost to the governing entity. Additionally, the quality of the reinvestment process should be next generation, eschewing our low-bid-DBB-change-order past in favor of best value for money and total factor productivity defined by the life-cycle cost and sustained performance of the asset. ■

Peter Luchetti is managing partner, Table Rock Infrastructure Partners, and & Vice-Chair of the California Infrastructure & Economic Development Bank.