

North American PPP Deal of the Year 2005

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The Army Hawaii Family Housing financing is a perfect marriage of the possibilities inherent in US financial engineering and capital markets capabilities, and practices in accommodation outsourcing that have become common in the UK. It comes from a line of projects dating back to 1998, but is the most ambitious deal yet attempted.

The idiosyncrasies of the US government and construction sectors mean that this structure will not necessarily be adapted for use elsewhere. But it deserves a closer examination by government, and some of the processes involved could be adapted by roads sponsors.

Army Hawaii Family Housing consists of 7,894 military housing units at seven Army installations located on the island of Oahu, Hawaii. The sponsor of the project is a joint venture between the Army and Actus Lend Lease, while the issuer is AHFH Managing Member LLC. Actus is familiar with military housing projects – it has completed four for the Army, one for the Air Force, and two for the Marines.

But Hawaii is the largest and most complex of them to date – most previous deals have not exceeded \$300 million in size. The principle behind such projects is that the public sector client gets accommodation built faster, but the private sector has to take on a meaningful level of risk on the contract. The reason for this is that the army is unable to sign the sort of long-term leases that would normally facilitate a project financing for these assets.

Any housing project, therefore, is at the mercy of an appropriations process that will not make multi-year commitments, and may close down military facilities at very short notice. In such instances, the developer may rent housing to military personnel located elsewhere, retired military personnel, civil servants, and then the general public, in that order.

The issues for a developer to consider, therefore, are how essential a facility is to the military, and how easy it would be to rent these if a military base was closed. Desirable areas such as California or Hawaii, are thus the best locations for such partnerships. Or, as one banker familiar with the process put it, "these things tend to get done in very sunny areas."

For this transaction, the developer has a 50-year ground lease, and then carries out \$1.6 billion in works over a 10-year period, according to a pre-arranged schedule. Actus has a slight price advantage over the competition, in that it is able to conduct construction work in-house. For these developments, the developer must provide the Army with a total completion guarantee, which could only normally be accomplished by a separate subcontractor posting a bond.

The credit of the financing is based upon the Soldiers Housing Allowance, which is paid by the Army direct into a dedicated account. The special purpose vehicle is paid out of this account, thus minimising the need for the operator to actively collect rent from personnel. This allowance has recently been increased for soldiers based in Hawaii, and is equivalent to roughly \$1,800 a month.

The Army issued a request for qualifications (RFQ) for the project in September 2003, a request for proposals in February 2004, and appointed Actus in August that year. The most important challenges included dealing with land titles

that went back to Hawaii's days as a monarchy, whereby land would revert to the state if the military stopped using it. The sponsors also needed to start work on the project at commercial close, which took place four months before financial close.

This was facilitated through a roughly \$50 million bridge loan from Goldman Sachs and Bank of America, two institutions that after a competition, as mandated by procurement rules, were also selected as lead managers for the bond financing. JP Morgan is also co-manager for the offering.

Execution of the financing was structured to minimise spread, match maturities and drawdown to the construction schedule, and minimise negative cash carry on the bonds. Some of these goals could be met through approaching as many markets as possible and tranching the debt in a mixture of wrapped and unwrapped, and floating and fixed rate notes.

\$452.5 million of the bonds were floating rate, while the remainder had their rate fixed four months before financial close by means of a \$1 billion swaption underwritten 50/50 by the two leads. The main purpose of the \$50 million bridge loan was to pay the premium on this instrument. The notes have 45-year maturities, and a ten-year interest only period.

The three types of notes are Libor Floaters, auction rate securities (also variable rate) and fixed rate debt. All of the floating rate notes and roughly 60% of the fixed rate notes feature a wrap from MBIA, also appointed in a competitive process.

The choice of monoline insurer also brought its challenges – the notes launched in April 2005, just after a probe was launched into MBIA by New York State's Attorney General, Eliot Spitzer. After consulting with ratings agencies, the issuer, and MBIA, the leads went ahead with the issue, and achieved what Goldman Sachs described as "the tightest credit spreads of any military housing transaction priced to date."

The final innovation in the structure was the use of credit linked certificates (CDX) to reinvest the proceeds of the bond issue. Since the project has a 10-year lead time, the sponsors are looking to maximise the risk-free returns available on the unused proceeds during this period. Most borrowers facing such a dilemma have used guaranteed investment contracts – low-risk instruments that are bought from insurance companies and have a maturity of two years or so.

A CDX, on the other hand, has a longer maturity and offers superior returns for about the same risk profile. The structure was responsible for an additional \$10 million in savings being passed on to the client. Although not necessarily a structure for smaller deals, infrastructure projects with long construction periods should be able to benefit from similar opportunities.

AHFH Managing Member LLC

Status: Closed 26 April 2005

Size: \$1.6 billion

Location: Oahu, Hawaii

Description: Development of military housing units for the US Army

Sponsors: US Army, Actus Lend Lease

Co-senior bookrunners: Goldman, Sachs & Co and Banc of America Securities

Co-manager: JP Morgan

Monoline insurer: MBIA

Issuer's legal counsel: Thelen Reid & Priest

Underwriters' legal counsel: Kutak Rock, Nixon Peabody

Trustee: US Bank

Construction consultant: M&E Pacific

Army financial adviser: Jones Lang Lasalle

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