Triple Ps – Ripe for the Picking

U.S. real estate assets have long been considered an international darling. We are approximately 7.5 years into the post-great recession business cycle, and while the general trend lines within U.S. real estate investment are positive, the range of well-performing property types seems to be diminishing.

One asset class in particular that currently garners a lot of interest and attention is commercial property developed for use by governmental entities, more generically referred to in the marketplace as public-private partnership (P3 or Triple P) projects. Typical P3 projects may include roads, bridges, airports, water systems, pipelines, trash collection and power plants; however, stadiums, prisons, schools, municipal buildings, health care facilities, higher education facilities, welfare-oriented buildings, and a host of other urban economic development projects have also been developed through these partnerships.

The United States is positioned to become the most prominent public-private partnership market in the world for infrastructure and construction projects. A variety of factors support this notion:

- Dilapidated infrastructure: Over the last fifty to sixty years, our nation has underinvested in infrastructure, with many assets well-beyond their useful life. Nearly all states across the country are experiencing rapid deterioration among many different types of infrastructure.
- Population increase: As the population continues to grow, the burden upon existing infrastructure systems develops, as does the need for new infrastructure.
- Significant budgetary shortcomings: Federal, state and local governments are struggling to finance new projects single-handedly due to decreased tax revenue and dwindling budgets.

For these reasons, among others, we are seeing a surge of political will among elected officials, and the expectation that this will contribute to the emerging P3 market in the U.S.

Prospects for P3 developments are intertwined with geographic locales and political cultures, much like the majority of public projects. Sun Belt states with right-to-work laws are an obvious setting for P3s, given the landscape is more fertile and quicker to adopt P3s. The northern states with labor unions are also now viewing P3s as legitimate and efficient means of moving projects forward. Despite legislative challenges that may exist at the state level, the P3 movement is gaining swift momentum — today over 30 states have P3-enabling legislation, a significant increase over recent years.

With regard to the P3 movement, the U.S. should look to Canada as a stimulus. Private investment in Canada’s infrastructure is approximately $1 billion higher than all of private investment currently in the U.S., surprisingly so, seeing that the Canadian economy is marginally smaller than that of the state of California.
**Trump Administration and Current Policy Considerations**

One motif of the 2016 election cycle was U.S. infrastructure, which also happens to be one of few issues generating some bipartisan support. Trump's infrastructure plan is noteworthy in two ways: (i) it focuses heavily on private investment and (ii) it establishes an ambitious target of $1 trillion of new investment.

The pillar of the plan emphasizes the aggressive use of tax credits to attract private money. Prior to the election, a detailed proposal was authored by Peter Navarro (White House National Trade Council Chair) and Wilbur Ross Jr. (private equity investor and Secretary of Commerce). The “Navarro-Ross” plan calls for federal legislation to establish an investment tax credit for U.S. infrastructure projects sized at 82% of the invested equity. The analysis suggests that $1 trillion of infrastructure spending would necessitate approximately $167 billion of fresh equity investment, which would create approximately $137 billion in tax credits. These tax credits are then slated to be offset by increased tax revenues associated with new construction activity.

Naturally, skepticism looms over revenue neutrality. Many are unconvinced this plan will be revenue neutral because, for instance, many of the traditional investors in infrastructure are tax-exempt entities and would be unable to utilize the tax credits. Also, with the prospect of Congress lowering corporate tax rates, it is unclear whether there will be sufficient capability to absorb all of the tax credits. Although, perhaps even more fundamental to the overall debate, is the uncertainty of how these projects will be financed.

**P3 Financing/Capital Markets**

While there are existing federal credit programs within the Department of Transportation and Environmental Protection Agency, the lion’s share of the credit will need to be sourced through the private sector. As budgets shrink among municipalities and state governments and at the federal level, there is a gap to be filled: private finance being the prime candidate to bridge that gap.

Given private sector involvement, often these types of P3 projects are well-suited for taxable private placement financing rather than tax-exempt public bond financing. One specific form of taxable private placement financing that has proven to be an efficient mechanism for financing real estate projects connected to the public sector is credit tenant lease (CTL) financing. Despite its characterization, this is a vehicle that can be used to finance any type of P3 project whether it involves a lease, a license agreement, a service agreement, a concession agreement, etc. The CTL financing fundamentals center on P3 projects that enable the skills and assets of both the public and private sectors to overlap in the delivering of a service or facility for the use of the general public.

Potential benefits of taxable private placement financing may include:

- Typically, a more streamlined approval process with often no taxpayer/voter involvement, e.g., many municipalities can execute leases and other similar agreements under existing legislation without additional voter approval, i.e., only city council approval required.
- A faster, more efficient execution and closing process, which proves advantageous when involved with time-sensitive projects.
- The private placement market is typically more resilient to creative structuring and more adept at evaluating both credit and asset-based lending decisions.

**Summary**

It is evident that our nation’s infrastructure is rapidly decaying, due to fiscal uncertainties and global economic challenges. Preparedness and swift adoption of the P3 model seems imperative to the future success of the nation. It is expected that the Trump administration’s focus on private investment and more frequent use of P3s will significantly increase opportunities for private sector participants and spur financial innovation.

Sources: AIG and Skadden
Market Snapshot: Middle-Market Mergers & Acquisitions

Resilience in the Global M&A Market

- Overall, global M&A value fell by 18.1% over the course of the year to $3.2 trillion, while volume declined by 670 to a total of 17,369 deals.
- Global M&A rose 8.9% in Q1 2017 with 3,554 deals worth $678.5 billion compared to the same period last year with 4,326 deals at $622.9 billion.
- North America ended its third-highest valued year on record since 2001 with 5,585 deals worth $1.5 trillion, despite being down 22.6% in value compared to the 5,983 deals worth $2 trillion in 2015.
- U.S. Q1 2017 values grew 19.4% to $300.2 billion, with 1,116 deals over Q1 2016’s 1,256 deals at $251.3 billion.

Significant Opportunities Exist to Capitalize on the Favorable Financing Environment

- Borrowers continue to capitalize on the favorable financing environment.
  - Covenant protections remain loose.
  - Interest rates remain near historic lows.
- Total leverage in Q1 2017 for middle-market issues with less than $50 million of EBITDA averaged 4.8x, which is down from a 2016 average leverage of 5.3x.
- Equity contribution for middle-market LBOs averaged approximately 43.4% in Q1 2017 maintaining 2016’s average.
- Senior stretch loans (hybrid asset-based and cash flow loans) are prevalent given current market dynamics
  - Conditions exist for debtors to cover all leverage needs with senior debt at senior debt pricing (versus higher mezzanine debt pricing).

Quarterly Global M&A Comparison

Source: MergerMarket.

Average Debt Multiples of Middle-Market LBO Loans (Issuers with Less than $50M of EBITDA)

Source: S&P Capital IQ LCD.
Market Snapshot: Municipal Bonds

Municipal Bond Fund Flows and Municipal Market Data (MMD)

Over the last several months, there has been volatility in the municipal funds markets; however, on average, there have been inflows of more than $200 million per week. The 20-year MMD continues to remain attractive on a historical basis, and has decreased since the end of last quarter. We expect future Federal Reserve and federal government decisions to have an impact on weekly fund flows going forward into the end of the year.

Credit Spreads

- Credit spreads have tightened over the quarter as municipal bond fund flows have been largely positive, stabilizing our market after the post-election re-pricing. Generally, hospital bonds tightened after the difficulties of healthcare reform and its implementation were recognized by the market. The absence of aggressive Obamacare reform was understood by the market as protecting the generous reimbursements offered by the combination of expanded Medicaid and Obamacare. We will watch as the administration makes a second attempt at healthcare reform in May.

- Tobacco bonds continued to tighten as a result of the California Golden Tobacco refunding. The market remains tight, as it prices in refunding potential for tobacco bonds.

- Puerto Rico bonds have widened modestly as a result of the government’s fiscal agency releasing an aggressive restructuring proposal on April 28th. The market is still digesting this proposal, but bond holder reaction is generally negative.

- Overall, we continue to watch bond fund flows, particularly in the context of the administration’s tax reform proposals. We expect the market to price in a fear premium as details emerge and municipal bond holders worry about the reform packages impact on the treatment of tax-exempt interest.
Market Snapshot: Corporate Debt

Corporate Debt Spreads – Finance Market Summary

- Many economists and others have predicted a rising interest environment in 2017. In fact, the thirty year treasury UST has declined 12 basis points thus far in 2017, while the 10 year treasury UST declined 8 basis points year to date (as of May 10, 2017). Credit spreads have been stable to “tightening across rating categories” during the year. These results indicate that despite the skewed perception, interest rates have actually declined in 2017.

- The demand for taxable fixed income products is robust across the credit spectrum. U.S. corporate issuances are also surging with volume: “Up over the prior year by 30% as investment grade volume was up by 25%, while speculative grade issuance was up 84% from prior year.”

Strategic Opportunities Involving Real Estate Are Worthy of Consideration Given Favorable Market Conditions

Opportunity continues to knock:

- Structuring subordinate debt tranches on a zero amortizing or partially amortizing basis continues to enable borrowers to realize greater proceeds from those generated historically. This has increased transaction volume over the past few years, with the trend continuing, given stable to increasing real estate valuations. In fact, “lower rated categories have contracted more rapidly as investor risk aversion has waned.”

- Many corporations are considering sale-leaseback opportunities due to favorable real estate valuations, leasing terms and strong demand for all financing capital tranches.

- Capital availability on favorable terms for acquisitions and refinancing of strategic properties remains robust for involved borrowers.

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Featured Mesirow Financial Deals

**Construction Take-Out Financing for Under Armour’s Northwest Regional Headquarters**

Mesirow Financial successfully structured and arranged for a two-tiered credit tenant lease (CTL) and structured debt package for Under Armour’s corporate regional headquarters located in Portland, Oregon. The project is part of a strategic initiative to expand Under Armour’s presence in the footwear sector. The client redeveloped an existing YMCA facility situated next to Duniway Park into a creative open office space, which will be used for product development and testing. The financing structure consisted of two pari passu tranches, with a portion of the credit-backed income supporting a conventional self-liquidating note. The remaining cash flow was allocated to an alternative instrument involving the combined support of both the underlying credit, as well as the real estate. The structure satisfied a number of client objectives, including raising 100% of take-out debt plus remaining project costs, locking in attractive long-term permanent fixed-rate pricing and accommodating future pari passu indebtedness associated with future building expansion rights. Mesirow worked on the transaction for nearly two years, and in doing so worked closely with all transaction participants at early stages, to ensure that the lease was structured in a manner that allowed for the type of subject financing consummated.

**M&A Advisor on the Sale of Trinity Packaging Corporation**

Mesirow Financial acted as the exclusive financial advisor to Trinity Packaging on its sale to ProAmpac LLC, a company majority owned by Pritzker Group Private Capital. Trinity is a leading flexible packaging company specializing in large format packaging for the lawn and garden, food and specialty industrial markets. The company is headquartered in Armonk, New York, with operations in Rocky Mount, Virginia and Buffalo, New York. ProAmpac and Trinity serve a wide variety of end markets including food, pet care, healthcare, lawn care, retail and secure packaging for the transport of cash and valuables. The combined company will have 22 manufacturing sites and 3,000 employees, supplying more than 5,000 customers in 90 countries. This transaction is yet another example of the strength of Mesirow Financial’s relationships with key strategic acquirers in the packaging industry.

**Senior Manager for Urban Residential Finance Authority, Atlanta**

Mesirow Financial served as senior manager for the $63,685,000 Taxable Revenue Bonds (Housing Opportunity Program), Series 2017A, on behalf of the Urban Residential Finance Authority of the City of Atlanta, Georgia (the “Issuer”). The Series 2017A Bonds were issued to refund the outstanding Series 2007A Bonds and provide additional funds to implement the Housing Opportunity Program. The Issuer will loan the proceeds of the Series 2017A Bonds to the Atlanta Housing Opportunity, Inc., which is a housing corporation created to act on the city’s behalf. The City of Atlanta provides a general obligation pledge of the loan payments due to the Issuer, resulting in the Bonds rated “Aa1” by Moody’s and “AA+” by S&P. Pre-marketing efforts created sufficient investor interest, tightening some of the spreads by approximately 3 basis points, prior to the initial order period. During the initial order period, strong institutional demand ensued, and the financing was 2.4 times oversubscribed. Mesirow Financial was able to reprice the transaction and further lower yields by 3–5 basis points. This transaction gave further evidence of Mesirow Financial’s banking and underwriting capabilities in the municipal market.
Capital Markets

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- Board of Directors Advisory
- Fairness and Solvency Opinions
- Restructuring and Special Situations
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About Mesirow Financial

Mesirow Financial is an independent, employee-owned firm founded in 1937. As specialists in investment, risk management and advisory services, we are committed to helping our institutional, corporate and individual clients achieve their objectives. Our professionals are inspired by an entrepreneurial desire to develop tailored solutions designed to deliver measurable results. To learn more, please visit mesirowfinancial.com.