U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

NORTHEAST CORRIDOR FUTURE: OPTIONS FOR HIGH-SPEED RAIL DEVELOPMENT AND OPPORTUNITIES FOR PRIVATE SECTOR PARTICIPATION

TESTIMONY
OF
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Good morning, Mr. Chairman, Congressman Rahall and members of the Committee. It is my pleasure to be here this morning.

My name is Perry Offutt. I am a Managing Director in the Investment Banking Division of Morgan Stanley and am the Head of Infrastructure Investment Banking for the Americas Region. My group works with both public and private sector clients seeking opportunities for private capital to finance or invest in infrastructure projects. Many of the transportation projects on which I work are structured as public-private partnership ("P3") transactions, as defined below. For example, I recently advised on the following transactions:

1. Bid to acquire RailAmerica (operator of short-line and regional railroads in the US); represented the cover bid on this transaction (closed in 2012)
2. Sale of Landmark Aviation (third largest FBO in the US) to The Carlyle Group (closed in 2012)
3. Monetization of The Ohio State University parking system via a long-term lease to an Australia infrastructure investor (public-private partnership closed in 2012)
4. Bidder on the concession of Puerto Rico's Luis Munoz Marin International Airport (public-private partnership expected to close in Q1 2013)
5. OHL Concesiones / Morgan Stanley Infrastructure Partners on their bid for the concession of Puerto Rico's PR-22 and PR-5 toll roads (public-private partnership closed in 2011)
6. City of Indianapolis on concession of City metered parking system (public-private partnership closed in 2010)
7. City of Pittsburgh on $452 million proposal for concession of City parking system (public-private partnership suspended after a city council vote in 2010)
8. Citizens Energy Group on $1.9 billion acquisition of Indianapolis water and wastewater system (closed in 2011)

9. Morgan Stanley Infrastructure Partners on its acquisition of NStar's district energy operations (closed in 2010)

As a financial advisor focused on P3 transactions, I appreciate the opportunity to share my perspective on some of the key considerations that could affect interest from the private sector (including financial investors, construction companies and rail operators) in participating in the design, construction, operation, maintenance and financing of a high-speed rail project along the Northeast Corridor (the "Project").

Public-Private Partnerships

A P3 involves a long-term lease (not a sale) of municipal assets (the "Concession"). The specific operating standards and business terms (e.g., duration of the lease, fare schedule) are included in a contract between the public agency/government and a private sector entity (the "Concession Agreement"). The government retains ownership with a right to reclaim the assets if the private investor does not meet certain operating standards. Such an arrangement transfers significant risks and responsibility from the government, as well as make great use of private sector expertise.

Due to the many safety and security concerns associated with high-speed rail, it is essential that all potential private partners undergo an extensive evaluation of their qualifications. Such an evaluation is typical in P3 processes. Traditionally, the procuring government entity will issue a Request for Qualifications ("RFQ") that requires private bidding groups to submit a response listing their qualifications in the areas of design, construction, operations and maintenance, as well as describing their ability to finance construction and improvements, as necessary. In order to be considered as a bidder for a P3, a private party needs to pass all criteria in this qualifications phase. Consequently, the government controls which private bidding groups are able to submit a final bid for a P3 project.

How could a P3 work for high-speed rail?

P3 structures have been used for new construction projects (i.e., "greenfield" projects). The private sector can often build a project more quickly and at a lower cost; drive efficiencies over time by introducing technology solutions; and develop incremental revenue sources by delivering additional services.

In the case of the Project, the government entity would enter into a Concession Agreement with a private entity with the skills to design, build, operate, maintain and finance the proposed Project. Given all of these requirements, the private entity is typically a consortium of various corporate and financial entities.

For example, when the state of Florida considered a P3 procurement for the Tampa-Orlando phase of the Florida High-Speed Rail Project, the following consortia formed to respond to an RFQ:

- Bechtel, Amtrak and SNCF
- Siemens, Veolia, Global Via, FCC, Granite, Jacobs and Skanska
- Soares de Costa, Ferrovial Agroman, Talgo, Cintra, Prince and Invensys Rail
- Parsons, Samsung, Korail, KRTC, GRDC, KRRI, Korea Railway Association and Hyundai Rotem
- Balfour Beatty Rail, HDR, Parsons Brinckerhoff, PCL Civil Constructors, Lane Construction, Mitsubishi International, Central Japan Railway Co., Sumitomo Corp. and Japan Bank for International Cooperation
- ACS Infrastructure Development, Dragados, T.Y. Lin International, GE Transportation, TSDI, CSR SF China, CRCC China and Odebrecht

• Alstom, Vinci Concessions, OHL PBS&J, AECOM, Hubbard Construction, Archer Western Contractors, Virgin Group and Virgin Rail Group

As demonstrated above, there are many entities interested in high-speed rail in the U.S. given their existing experience operating high-speed rail systems internationally such as in Europe and Asia. In addition, many U.S. and international construction firms will have interest in partnering with high-speed rail operators; such firms would play an integral role in the design and construction of the proposed rail line and could also be equity investors in the Project.

While there has not been a P3 involving a U.S. high-speed rail project, there are many examples of successful P3s for greenfield projects. For example, in Florida the State has entered into a P3 to reconstruct the I-595 toll road and a P3 to build a new Port of Miami Tunnel. Analyzing these and other similar U.S. greenfield P3s can help provide guidelines for a P3 for the Project.

Private Capital Available for P3s

Morgan Stanley estimates that over $200 billion of private equity capital has been raised to invest in infrastructure projects. This capital is attracted to these investment opportunities given the potential to achieve long-term stable cash flows and attractive risk-adjusted returns for the project. Many of these funds (typically pension or infrastructure funds) have the ability to invest in various geographies around the world and across various infrastructure verticals (e.g., transportation, regulated utilities and energy). As mentioned above, besides typical financial investors, many of the potential operators and construction companies also may be willing to make an equity investment given the high profile nature of the Project.

Given that private capital can focus on a variety of areas outside US transportation infrastructure, it is important to demonstrate that a project is commercially/financially viable and has political support. Attracting the private sector as a partner can both leverage public funds and deliver a superior outcome for the project. However, it is worth noting that the equity contribution from private investors tends to be approximately 10-15% of the total project cost given its cost of capital. Grant and low-cost funding sources (e.g., RRIF and TIFIA loans), if available, are utilized first. For example, The Port Authority of New York and New Jersey recently issued an RFQ to the private sector to design, build, operate, maintain and finance a new central terminal at LaGuardia Airport. In this document, The Port Authority mentioned that the equity investment could be as low as $200 million despite a total project cost of over $2.5 billion.

If the Project generates enough operating cash flow, the private partner would be compensated over time by receiving the revenue generated by fares from passengers. These revenues might also include ancillary revenues from advertising, food/beverage service and real estate rents.

If the Project does not generate enough annual revenues to cover operating costs (which is true for most passenger rail projects), consortiums will require a revenue guarantee or an ongoing revenue supplement from a government entity (know as an "Availability Payment") to ensure that they are able to cover their costs and earn an adequate return on investment. Of course, bidders will not include any positive externalities associated with passenger rail (e.g., lessening airport/highway congestion to improve regional/local commerce and environmental impact) in their analysis. Therefore, consortiums would be asked to submit the lowest required ongoing Availability Payment to design, build, operate and maintain the Project.

If the ridership revenue reaches a certain level immediately or over time, the Availability Payment could go away and the Project revenues would go directly to the private investor. As a result, the Availability Payment could be structured as a floor to support an investment-grade financing base case and attract maximum private investor interest.

For example, the Florida government was able to complete the following P3 transaction utilizing an availability payment structure:

> In October 2009, the Florida Department of Transportation ("FDOT"), in conjunction with the City of Miami and US DOT, reached financial close for the Port of Miami Tunnel and Access Improvement Project. This P3 project involves the construction of a tunnel under the Port of Miami at an estimated project cost of approximately $900 million (financed with public and private capital). The winning bidder (Meridiam and Bouygues) proposed providing $80 million in equity upfront plus helped arrange $342 million of senior financing with project finance banks. Other funding was provided by a TIFIA loan. In addition, FDOT pledged to make "milestone" payments throughout the construction process, followed by Availability Payments following completion. These payments from FDOT helped provide the winning bidder with comfort that, despite uncertainty around the total traffic in the tunnel, the government was willing to serve as a 'buffer' for future traffic risks. Depending on the specific projected cash flows of the project, this may or may not be needed.

Given the existing passenger rail footprint in the Northeast and high population density in key urban areas, the Project would likely generate significant interest from many private entities and should be a profitable operation. Private investors would particularly like the fact that there is significant historical information on passenger traffic due to the existing rail traffic in the Northeast Corridor area and flight traffic between Boston/New York and New York/Washington, D.C., which will allow them to make better estimates about potential ridership.

As I previously mentioned, one of the primary reasons to enter into a P3 for the Project is to transfer risks of construction and operations to the private sector. However, private investors will also expect some comfort from the government on a few large risks associated with the Project.

First, private bidders will need to understand exactly how any cost overruns will be addressed in the Concession Agreement, especially if they result from events over which the bidder has little to no control.

Second, private investors will carefully evaluate the ridership estimates and ongoing cash flow potential to ensure that it will allow for an adequate return on their investment. If the revenue projections are not adequate, many private bidders may look for a form of Availability Payments to help ensure that they are not losing money by operating the Project. Having a compelling investment-grade traffic study from a reputable source will be critical to help the private sector assess this risk.

Third, private bidders will want to understand key policy considerations. For example, the choice of station locations and plans for competing transportation infrastructure will affect the feasibility of the business plan. Potential investors will be focused on the "non-compete" provisions in the Concession Agreement which will dictate what parties to the contract can do in terms of competing actions (e.g., funding improvements to alternative modes of transportation along the Northeast Corridor).

Fourth, investors will also be very focused on the risks associated with the environmental studies and the required permitting. To the extent that these risks can be mitigated before a P3 procurement, this would materially improve the procurement process.

Fifth, convincing the private sector that there is political will to complete the P3. Given the high costs to reach a binding bid (i.e., significant due diligence costs), private capital focuses early on the regulatory/political approval process. Any additional Federal/State/local support (both monetary and political) would be very helpful to minimize this risk.

Thank you very much for the opportunity to testify here this morning on this very important topic. I would be glad to answer any questions that you may have.

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
Truth in Testimony Disclosure

Pursuant to clause 2(g)(5) of House Rule XI, in the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include: (1) a curriculum vitae; and (2) a disclosure of the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by the witness or by an entity represented by the witness. Such statements, with appropriate redaction to protect the privacy of the witness, shall be made publicly available in electronic form not later than one day after the witness appears.

(1) Name: J. Perry Offutt

(2) Other than yourself, name of entity you are representing: Morgan Stanley & Co. LLC

(3) Are you testifying on behalf of an entity other than a Government (federal, state, local) entity?

YES

If yes, please provide the information requested below and attach your curriculum vitae.

NO

(4) Please list the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by you or by the entity you are representing: None

Signature

12/4/12

Date

Short bio:
Mr. Offutt is a Managing Director at Morgan Stanley and started at the firm in 1994. During the past 18 years, he has focused on executing M&A/infrastructure transactions totaling over $160 billion across various industries (transportation, power/utilities, renewable energy, and water/wastewater).

- Mr. Offutt heads Morgan Stanley's infrastructure investment banking practice for the Americas and was the lead financial advisor in the following announced transactions: cover bid on the sale of RailAmerica, Landmark Aviation on its sale to The Carlyle Group, Ohio State University on its parking privatization ($483MM), MSIP and OHL Concesiones on its bid for the PR-22/PR-5 toll roads in Puerto Rico, Citizens Energy on its acquisition of the Indianapolis water and wastewater systems ($1.9 billion), qualified bidder on the Puerto Rico airport privatization, the City of Pittsburgh on the proposed monetization of its parking assets ($450MM), , the City of Indianapolis on its parking concession, $600MM bond financing for Chicago metered parking, Highstar Capital on its investment in Caiman Energy and MSIP on its acquisition of NStar's district energy operations.

He testified before the U.S. Senate Commerce Committee on July 20, 2011; hearing was entitled "Building American Transportation Infrastructure through Innovative Funding". He has also published three articles in the *Journal of Applied Corporate Finance* regarding public-private partnerships.

Mr. Offutt received his BA in Economics from Duke University and graduated magna cum laude. He also holds an MBA in finance from The Wharton School, University of Pennsylvania.