Raymond A. DiPrinzio's Testimony to the
U.S. House of Representatives Committee on Transportation and Infrastructure,
Subcommittee on Economic Development, Public Buildings, and Emergency
Management

Credit Crunch: A Hearing on the Effects on Federal Leasing and Construction

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Good morning Madam Chairperson, members of the Committee. My name is Raymond DiPrinzio. Thank for the opportunity to address the Committee on the impact of the current credit crisis on the development and financing of Federal real estate. I am currently Head of Project Finance for CIFG Assurance North America, Inc., a financial guaranty firm headquartered in New York. Financial guaranty providers are essentially proxies for retail and institutional investors in the capital markets (or lenders in the case of the bank loan market) since under the terms of their guaranty or credit protection contracts they are obligated to make principal and interest payments to investors and lenders in the event the borrower fails to do so. In this capacity, I am responsible for underwriting all forms of project financings for infrastructure, including transportation, energy, environmental and public use real estate facilities such as office buildings, military and student housing stadiums and arenas.

Federal project financing is a subset of the larger infrastructure market, a sector that is enjoying unprecedented levels of interest from institutional investors across the globe due to the deep levels of demand for financing infrastructure in the United States which is in need of replacement or for new facilities which must be built to accommodate growth. In my 24 years working as a finance professional, I have had the opportunity to work on Federal projects as an financial advisor and investment banker to Federal agencies as well as a provider of credit protection to investors in the capital markets. I have worked on financings for the Energy, Justice and Veterans Administration agencies in both GSA form as well as direct agency leases. Given my background, I am speaking today with the perspective of a practitioner in the capital and bank markets and more specifically, one who has perspective of the borrower as well as the lender.

Since assuming my role at CIFG, I have completed financings for the Energy and Defense Departments and have had the opportunity to review many other Federal financings. Most recently I have worked closely with the VA and their development team on an Enhanced Use lease financing of an office building and parking structure for the Louis Stokes Medical Center and with Pacific Northwest National Labs on new facilities in Washington State.

State of the Markets

The current difficulties in the financial market are unprecedented in both the breath and depth of its reach and it should come as no surprise that the market for Federal lease transactions has not escaped unharmed. While real estate projects involving Federal tenants under long term leasing arrangements are viewed more favorably relative to their commercial counterparts, the overall reduction in liquidity, repricing of risk and either the unavailability of credit protection from monoline bond insurers or the market's diminished view of the value they bring, has led to delays in completing financings, tighter credit terms and most importantly, dramatically increased credit spreads (i.e.

higher borrowing costs). Indeed, higher borrowing costs are making many transactions impossible to complete as it translates to rental rates outside of approved levels.

More specifically, financings that were able to get credit protection and complete a transaction saw spreads widen 70 to 100 basis points compared to pre-credit crisis levels. Without credit protection, spreads have widened to 200-300 basis points, levels not seen in the market for Federal leasing.

What Can be Done

While Federal lease financing is an accepted transaction type in the capital markets, in many respects, as a finance professional, I have often been struck by its obscurity and the lack of understanding of these transactions given the depth of the role of the Federal government in the real estate market and needs of the General Services Administration and other Federal agencies.

This is particularly striking given the current unprecedented levels of investor interest in public use infrastructure, one of the few truly bright spots in the current market landscape. Real estate property is a critical asset of government and we have seen strong demand in the UK and Canadian markets for public use buildings and other forms of social infrastructure under programs such as the Private Financing Initiative (PFI) and the public private partnership programs run by the individual Canadian provinces.

In many ways, Federal financing has significant untapped potential, which if properly harnessed, can result in broader market acceptance and higher levels of investor interest, lower borrowing costs and ultimately lower rental costs. In this regard I offer the following areas for consideration:

Market Education: As I've indicated, Federal financing is does not enjoy wider acceptance in the markets because it is understood by few finance professionals. Consideration should be given to increased outreach to include a wider reach of developers, bankers, financial advisors and rating agencies. Federal projects often need to tap the development and finance expertise of real estate, project finance and public finance professionals to successfully complete transactions. As with the current activity seen in financing public use infrastructure, firms in the market have responded by bring together multiple disciplines to finance transportation, energy or environmental assets. Similar approaches can be applied to Federal real estate tapping into the expertise in the markets which already understands essentially and appropriation risk (common elements present in many municipal financings), construction risk (typically found in project finance) and residual risk (a risk often found in real estate finance).

Programmatic Approach: Federal financing in its current state lacks the benefits which would flow from a comprehensive coordinated approach to the market. Viewed from the perspective of a finance professional, Federal real estate financing is notably decentralized making it difficult to understand needs of the Federal agencies. While GSA provides a level of coordination, many agencies pursue financing directly. While each Federal agency has its own needs and requirements, which should be accounted for, a coordinated approach to the market could significantly improve the level of market interest and investor demand. As a point of contrast, the Defense Department's comprehensive approach to financing military family housing, while maintaining distinctly different financing structures at the individual service level, has enjoyed wide market acceptance attracting over $20 billion in capital since its inception in 1996. The Defense Department is building on that success as it pursues programs to finance unaccompanied housing, hospitality facilities (lodging) and commercial properties through its Enhanced Use Leasing Authority.

OMB Rules: While OMB quite rightly guards the Federal budget process and balance sheet, current approaches drive up financing costs and work to ultimately diminish the credit quality of the financing. Consideration should be given to revisiting these rules with an eye to appropriate levels of risk allocation between Federal agencies and the private sector developers and financial participants as well as the ultimate impact of financing structure and costs.

Enhanced Use Leasing (EUL): EUL authority as become an important tool for agencies such as the VA and the Defense Department has in recent years embraced its potential for commercial properties and energy facilities. Consideration should be given to a form of GSA EUL authority to link the development potential of the its vast real estate holdings and private capital.

In summary, while the current crisis in the credit markets is taking its toll on all players including Federal agencies, the dislocation in the market coupled with unprecedented levels of demand for properly structured infrastructure investments also provides opportunity to move the Federal government forward in its approach to financing real estate and other essential infrastructure. Steps should be taken to broaden the level of understanding of the Federal role as a user of facilities critical to the operation of government, streamline its approach to the market and address the rules and regulation which govern its role while maintaining a careful eye on the impact on risk and return.