REAL ESTATE AND VALUE CAPTURE IN TRANSPORT PPPs

Financial Solutions for City Resilience | Presenter: Amitabh Barthakur

Bangkok, July 2018
At **HR&A**, we empower urban communities to address pressing resilience challenges by leveraging urban assets to create value.
We have supported the Rockefeller Foundation’s 100 Resilient Cities Program and led resilience strategies for cities across the U.S.
The Infrastructure & Environment dimension represents many of the types of projects that cities at this conference are seeking to finance.
• Real Estate and Land Value Capture in Transport PPPs

• Case Studies:
  • Parque Berrío Station, Medellín

• Lessons Learned and Conclusions
PPPs can present many known benefits to the regional and local governments and transportation agencies:

For municipalities and transportation agencies that lack capacity to finance and operate public infrastructure projects, a PPP offers a solution that:

- shifts construction and operation risk away from the public sector;
- relies on private sector capacity to raise debt and equity;
- could potentially use real estate revenue and land value capture tools to minimize overall project costs.
There is a wide range of **PPP options** that transit agencies can use to develop and maintain transportation infrastructure.

**CAPITAL IMPROVEMENT PPPs**
- Design Build (DB)
- Design Build Finance (DBF)
- Design Build Maintain (DBM)
- Design Build Operate Maintain (DBOM)
- Design Build Finance Operate Maintain (DBFOM)
- Design Build Finance Maintain (DBFM)

**REAL ESTATE PPPs**
- Joint Development
- Air Rights
- Station Access
- Long-term Lease
- Easements
- Vending and Retail Concessions

**MARKETING AND TECH AGREEMENTS**
- Marketing
  - Sponsorships
  - Naming Rights
  - Advertising
- Innovative Tech
  - Energy Technology
  - Fare Payment
  - Wi-Fi and Wireless Service

Source: National Academy of Sciences; HR&A Advisors
In this session, we will cover how to leverage real estate and land value capture revenues to support transportation PPPs.
In urban development, value is created through multiple stages, but is often realized only after vertical development is completed.
The public sector, through planning, entitlement, and infrastructure provision is normally responsible for a sizeable portion of the value created.

Source: HR&A Advisors
The value that the public sector creates through the project can be monetized and converted into revenues using several mechanisms.

<table>
<thead>
<tr>
<th>MECHANISM</th>
<th>DESCRIPTION</th>
</tr>
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<tbody>
<tr>
<td><strong>ONE-TIME REVENUE</strong></td>
<td></td>
</tr>
<tr>
<td>Land/Assets Disposition</td>
<td>Public sector sells land or asset to private developer/operator after the infrastructure investment at a profit.</td>
</tr>
<tr>
<td>Density Bonus and/or Rezoning</td>
<td>Additional density allowed in exchange for public amenities or payments. Can be used in conjunction with Land Readjustment (LR) where land owners contribute land to the government or other project initiators in return of smaller serviced plots with potential for higher density.</td>
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<tr>
<td>Impacts Fees</td>
<td>Fees collected from developers to fund infrastructure improvements related to real estate development.</td>
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<tr>
<td>Negotiated Exactions</td>
<td>Developer builds/funds specific improvements in exchange for zoning approval or other support.</td>
</tr>
<tr>
<td>Sale and/or Transfer of Development Rights (TDR)</td>
<td>Sale of unused air rights on public property, often to realize newly-created development potential. TDRs can be used to protect environmental resources and prevent development in areas susceptible to natural hazards that grant or sell rights to areas where development wants to be incentivized.</td>
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<td></td>
</tr>
<tr>
<td>Leases and Concessions</td>
<td>Long-term lease of land and/or space in public assets (stations, parks, etc.) to a private developer/operator.</td>
</tr>
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<td>Joint Development</td>
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<tr>
<td>Land Value Taxation</td>
<td>Property taxes based only on the assessed value of land to incentivize development. Can be effective in areas affected by disasters.</td>
</tr>
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<td>Special Assessment Districts (SAD)</td>
<td>Annual assessment, above property taxes, to fund specific costs for projects within a district.</td>
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<tr>
<td>Tax Increment Financing (TIF)</td>
<td>Incremental tax revenue pledged to support the cost of infrastructure projects and to finance risk reduction and disaster recovery.</td>
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Some **mechanisms** can also be used even when the public sector does not control any land or assets.

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The **adequacy of a mechanism** depends on a number of key factors, which should be aligned with the specific project needs.

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<thead>
<tr>
<th>REVENUE MAGNITUDE</th>
<th>REVENUE STABILITY</th>
<th>SUPPORT POLICY GOALS</th>
<th>EASE OF IMPLEMENTATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Collecting Revenue</td>
<td>Predictability of Revenue Stream</td>
<td>– Provision of Affordable Housing</td>
<td>Community Support</td>
</tr>
<tr>
<td>Expected Financing Costs</td>
<td>Ease of Earmarking</td>
<td>– Creation of Jobs</td>
<td>Private Sector Appetite</td>
</tr>
<tr>
<td>Timing of Revenues</td>
<td>Cannibalization of Other Revenues</td>
<td>– Provision of Public Facilities</td>
<td></td>
</tr>
</tbody>
</table>

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A number of **external factors** may also influence land and real estate values and represent an opportunity or a challenge to the use of value capture mechanisms.
Developing countries, particularly middle-income cities, tend to render favorable macroeconomic conditions with high population growth and economic prospects.

MACRO CONDITIONS

• Demographic & Economic Growth
• Urbanization Patterns
• Real Estate Market Demand & Supply

Normally favorable macro conditions, leading to strong demand for land in prime locations with good accessibility.
However, regulatory and institutional challenges; such as lack of framework plans, public sector capacity, and market inefficiencies represent an obstacle to the use of value capture.

- Registration & Availability of Developable Land
- Regulations on Density & Land Use
- Public Sector Planning & Real Estate Capacity

Many governments and transit agencies have inadequate regulatory frameworks and lack of institutional capacity.
Potential for high value impact from investment in developing countries is at risk if the type of infrastructure and execution is incompatible with accretive land uses.

High impact potential at risk due to challenges in project preparation and management.

- Infrastructure Asset Management
- Risk Management Information System
- Geospatial and Cadaster Data Systems
Other factors such as social stratification and lack of public appetite for compact development represent a clear challenge to use of value capture in certain cities.

Normally difficult conditions such as strong social stratification and lack of market appetite for dense development.
Value capture is a powerful planning and financial tool to fund transportation investment, but important challenges need to be considered.

<table>
<thead>
<tr>
<th>MACRO CONDITIONS</th>
<th>REGULATORY AND INSTITUTIONAL</th>
<th>TECHNOLOGY AND SYSTEMS</th>
<th>OTHER FACTORS</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Demographic &amp; Economic Growth</td>
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<tr>
<td>• Urbanization Patterns</td>
<td></td>
<td></td>
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<tr>
<td>• Public Acceptance</td>
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<td></td>
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<tr>
<td>• Displacement</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Informal &amp; Illegal Settlements</td>
<td></td>
<td></td>
<td></td>
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Normally favorable macro conditions, leading to strong demand for land in prime locations with good accessibility.

Many governments and transit agencies have inadequate regulatory frameworks and lack of institutional capacity.

High impact potential at risk due to challenges in project preparation and management.

Normally difficult conditions such as strong social stratification and lack of market appetite for dense development.
Another key challenge when financing infrastructure with revenues from real estate is the very different risk-return profile of the two assets classes.

Core infrastructure return drivers differ from those of other asset classes

EXHIBIT 1: ASSET CLASS CORRELATIONS

<table>
<thead>
<tr>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Global equities</td>
<td>1.0</td>
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<td></td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>Global bonds</td>
<td>-0.2</td>
<td>1.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>US core private real estate</td>
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<td>-0.2</td>
<td>1.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private equity</td>
<td>0.9</td>
<td>-0.3</td>
<td>0.4</td>
<td>1.0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hedge funds</td>
<td>0.9</td>
<td>-0.3</td>
<td>0.1</td>
<td>0.9</td>
<td>1.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Global listed infrastructure</td>
<td>0.9</td>
<td>0.0</td>
<td>0.2</td>
<td>0.9</td>
<td>0.8</td>
<td>1.0</td>
<td></td>
</tr>
<tr>
<td>Global core private infrastructure</td>
<td>-0.1</td>
<td>-0.2</td>
<td>0.5</td>
<td>0.1</td>
<td>0.0</td>
<td>0.0</td>
<td>1.0</td>
</tr>
</tbody>
</table>

Source: Bloomberg, MSCI World Index for global equities, Barclays Global Aggregate Bond Index for global fixed income, NFI-ODCE for U.S. core private real estate; Burgiss for private equity, HFRI for hedge funds, S&P Global Infrastructure Index for global listed infrastructure, and MSCI Global Quarterly Infrastructure Asset Index for global core private infrastructure. Data are quarterly from Q2-2008 through Q4-2015 (the full available range for the MSCI Infrastructure Index), and are denominated in local currency. Data as of December 2016.

Source: J.P. Morgan Asset Management
The following two **case studies** illustrate how land value capture, real estate and ancillary revenues can be used effectively in transportation PPPs.

Parque Berrío Station, Medellín

Honolulu Rail Transit Project (HRTP), Hawaii
Real Estate and Land Value Capture in Transport PPPs

Case Studies:

- Parque Berrío Station, Medellín

Lessons Learned and Conclusions
MEDELLÍN

Colombia’s second largest city sits in the Aburrá Valley and is home to 2.5 million people.
AN EXPANDING CITY

Founded in 1616, the City grew at a steady pace for its first 300 years, before exploding in the late 20th century.
Medellín is in the midst of an urban transformation two decades in the making, driven by a series of public investments in cultural facilities, open space, and transport.
METRO DE MEDELLÍN

The city’s elevated metro system, inaugurated in 1995, is the city’s lifeblood and a central player in the city’s renaissance.
Metro’s mantra “Cultura Metro,” has made it one of the most respected institutions in the city and elicited praise from observers all around the world.
THE OPPORTUNITY

A renewal of an interagency agreement between Metro and the City enabled Metro to request an expanded intervention area around one of its key stations, Parque Berrío.
Parque Berrío is located at the center of a larger-scale planning area in Medellín’s historic center. HR&A sought to identify a funding and governance model for the Parque Berrío project that could be replicated at other Metro stations, including San Antonio and Prado in the same district.
PROJECT GOALS
HR&A and the client met with stakeholders from across all sectors and areas of the city to arrive at a set of shared goals for Parque Berrío.

1. Ensure the safety of passengers, businesses and residents through control measures.

2. Transform Parque Berrío into the flagship project of the Metro network, while preserving the area’s uniquely vibrant and authentic flair.

3. Leverage the area’s status as a center of economic and social activity to catalyze the revitalization of the historic center. Crucially, expand “Cultura Metro” throughout the area.

4. Develop a sustainable business plan for the operations and maintenance of the station and public spaces.

5. Set a national precedent for the use of value capture instruments and public-private partnerships to finance public infrastructure.
THE CHALLENGE
Capital costs for the proposed station and open space redevelopment project far exceed Metro’s available funds, and the revenue-generating potential of the project, obliging Metro to seek an alternative funding plan.

$13.3 MILLION
Estimated project Capital costs

$21,900
Current Annual Net Operating Income

Source: Metro de Medellín

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REVENUE SOURCES

To close the remaining gap, and to provide a guaranteed payment to a third-party private partner who could fund the upfront capital costs, we recommended the use of the widest possible array of revenue sources.

PROJECT LEVEL

• Revenue Generation
  • Retail rents
  • Advertising
  • Events

• Cost Reductions
  • Capital cost adjustments
  • Revision and optimization of kiosk plans
  • Assigning cost-producing elements to other categories

DISTRICT LEVEL

• Business Improvement District (BID)
• Special Assessment District (SAD)
• Tax Increment Financing (TIF)
• Density Bonus

PUBLIC FUNDS

• Metro funding
• City funding
• State funding
PROJECT LEVEL REVENUES
We started by evaluating the future opportunities of generating real estate and ancillary revenues in the new station and refurbished open space.

PROJECT LEVEL

- Revenue Generation
  - Retail rents
  - Advertising
  - Events

- Cost Reductions
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  - Assigning cost-producing elements to other categories

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PUBLIC FUNDS

- Metro funding
- City funding
- State funding
PROJECT-LEVEL REVENUES

Within the intervention area, the three proposed sources of revenues are retail rents, advertising, and events.

**Retail Rents**
*Mercado de Tranvía, Medellín*

$300,000

**Advertising**
*El Dorado Airport, Bogotá*

$420,000

**Events**
*Parque de los Deseos, Medellín*

$200,000

Total:
$920,000
PROJECT-LEVEL GAP

Project-level revenues are not sufficient to cover operating costs of $2.2 million within the intervention area.

Annual Operations and Maintenance

<table>
<thead>
<tr>
<th>Costs</th>
<th>Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1.9 MILLION</td>
<td>$920,000</td>
</tr>
<tr>
<td>$350,000</td>
<td></td>
</tr>
</tbody>
</table>

Station Costs
Public Space Costs

Project-Level Revenues

HR&A Advisors, Inc.
After evaluating the opportunities of generating revenue at project-level, we explored the use of governance and value capture mechanisms in the area around the station.

**PROJECT LEVEL**
- Revenue Generation
  - Retail rents
  - Advertising
  - Events
- Cost Reductions
  - Capital cost adjustments
  - Revision and optimization of kiosk plans
  - Assigning cost-producing elements to other categories

**DISTRICT LEVEL**
- Business Improvement District (BID)
- Special Assessment District (SAD)
- Tax Increment Financing (TIF)
- Density Bonus

**PUBLIC FUNDS**
- Metro funding
- City funding
- State funding
## District-Level Mechanisms

The zoning code (Plan de Ordenamiento Territorial) allows a set of district-level funding mechanisms to be applied in Medellín.

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<tr>
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<tr>
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</tr>
<tr>
<td>Betterment Levies</td>
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<tr>
<td><strong>Cesiones Urbanísticas (Art. 514-521 POT)</strong></td>
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<tr>
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| Incremento Impuesto Predial por Valorización |
| Special Assessment District (SAD)  |
| **Área de Revitalización Económica**  |
| Business Improvement District (BID)  |
| **Venta Derechos Construcción y Desarrollo (Art. 505-513 POT)**  |
| Density Bonus / Rezoning  |
| **Compensación por Construcción**  |
| Negotiated Exaction  |
| **Cobro de Plusvalía**  |
| Surplus Value Capture  |
### Recurring Revenues

- **FIRI (Art. 536 POT)**
  - Tax Increment Financing (TIF)

- **Beneficios Tributarios (Art. 535 POT)**
  - Tax Incentives

- **Contribución de Valorización (Art. 522 POT)**
  - Betterment Levies

- **Cesiones Urbanísticas (Art. 514-521 POT)**
  - Impact Fees

### One-Time Revenues

- **Venta Derechos Construcción y Desarrollo (Art. 505-513 POT)**
  - Density Bonus / Rezoning

- **Compensación por Construcción**
  - Negotiated Exaction

- **Trans. de Derechos Construcción y Desarrollo (Art. 500-504 POT)**
  - Transfer Development Rights (TDR)

- **Cobro de Plusvalía**
  - Surplus Value Capture

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**DISTRICT-LEVEL MECHANISMS**

After evaluating the project characteristics and needs and the external conditions, HR&A decided to use four of the mechanisms available in the zoning code.
LIMITATIONS FOR FINANCING

Despite the wide range of mechanisms available in the municipal and national legislation, there are actual challenges for using their revenue to finance urban infrastructure.

- Lack of sophisticated and developed municipal capital markets;
- Difficulties to earmark project revenues and pledge them for debt issuance or acquisition at the municipal level;
- Size of debt issuance being too small to cover financing costs and make it attractive to private capital markets;
- Need for municipal, national, and multilateral guarantees.
**DISTRICT-LEVEL REVENUES**

The creation of a business improvement district (BID) would enable Metro to overcome its operating gap.

**INTERVENTION AREA** (Project Level)

14 Acres

**BUSINESS IMPROVEMENT DISTRICT** (District Level)

30 Acres

3.4 million built SF
DISTRICT-LEVEL REVENUES

Annual contributions of the property owners in the BID of less than 3% the average rents in the area would enable Metro to overcome its operating gap.
CAPITAL FUNDING GAP

The project's net operating income of $570,000, taking into account BID revenues, are insufficient to make the $13.3 million in anticipated capital costs appealing to private sector investors.

$13.3 MILLION
Estimated project Capital costs

$570,000
Expected Net Operating Income

Source: Metro de Medellín

HR&A Advisors, Inc.
GUARANTEED PAYMENT

A private investor will be sought to front capital costs of $13.3 million. To cover these, Metro must guarantee a payment of approximately $1.1M annually (adjusted for inflation for 30 years).

Net Cashflow

Availability Payment

Net Operating Income

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AREA OF INFLUENCE
Metro should designate an additional area that will benefit from the infrastructure investment, which we called the Area of Influence, in which to apply additional district-level financing mechanisms.

INTERVENTION AREA (Project Level)
14 Acres

BUSINESS IMPROVEMENT DISTRICT (District Level)
30 Acres
3.4 million built SF

AREA OF INFLUENCE (District Level)
74 Acres
14.2 million built SF

Quarter-mile Radius
APPLIED MECHANISMS

Tax increment financing (TIF) and density bonuses will be leveraged to raise funds from new construction, while the designation of the area as a Special Assessment District (SAD) will enable revenue generation from existing properties.
CLOSING THE GAP

TIF, SAD, and Density Bonus revenues will enable Metro to meet its annual availability payment obligation every year for the next 30 years, making a public-private partnership with one or more entities possible.

Guaranteed Payment

COP 0.000
COP 5.000
COP 10.000
COP 15.000
COP 20.000
COP 25.000
COP 30.000
COP 35.000
COP 40.000

Guaranteed Payment
Density Bonus Revenues
Special Assessment District Revenues
TIF Revenues
Project-Level Net Operating Income

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PARTNERSHIP MODEL
Given the need for private upfront capital and Metro’s desire to share operating responsibilities for the station and surrounding public space with a third party, a concession is the preferred model for Parque Berrío.
Lessons learned and conclusions:

1. Mix and match: combine different mechanisms that generate revenues of various magnitudes, at different times, from both existing and new development;

2. Risk allocation: separate operating and capital investment risks by using different mechanisms to support the repayment or subsidization of those costs;

3. Private partner: seek a private partner with financing and operating capacity to avoid the need for an initial public outlay.
Real Estate and Land Value Capture in Transport PPPs

Case Studies:
- Parque Berrío Station, Medellin
- Honolulu Rail Transit Project, Hawaii

Lessons Learned and Conclusions
Lessons learned and conclusions:

1. **Sizeable Opportunity:** Land value capture and real estate and ancillary revenues should be explored as a significant funding opportunity for capital and/or operating costs in transportation projects;

2. **Not Everyone Fits the Mold:** The adequacy of mechanisms to monetize the value that the transportation project generates needs to be carefully studied, as not all the mechanisms are suitable to all projects and market contexts.

3. **The Devil is in the Details:** The timing and risk-return profile of real estate-driven revenues is very different from those of core infrastructure investments, which means that the debt instruments and PPPs need to be structured to absorb the risk differential.