UBS Investment Bank

State of New Jersey

Asset Evaluation Program
Phase 1 Report

November 15, 2006

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SECTION 1

Executive Summary

Executive Summary

As detailed below, UBS, working closely with the State (together, the "Project Team"), has undertaken a range of activities to produce this initial Phase 1 report (the "Report"). At the conclusion of Phase 1 of the Asset Evaluation Program (the "Program"), the Project Team identifies several assets having sound commercial viability (referred to as Tier 1 Assets), and a meaningful potential value from pursuing public-private partnerships ("PPP"). These Assets are the likely candidates for near-term PPPs. These Tier 1 Assets include:

- Atlantic City Expressway
- Development Rights at New Jersey Transit Stations
- Garden State Parkway
- New Jersey Lottery
- New Jersey Turnpike

In addition, the Project Team identifies several Tier 2 Assets, which are characterized by a likelihood of successful PPPs but for which only limited information is currently available. These Tier 2 Assets include:

- Atlantic City International Airport
- Fiber Optic Network
- High Occupancy Toll Lanes
- Naming Rights
- Newly-Tolled Facilities
- PNC Bank Arts Center

UBS recommends that all of the Assets in Tier 1 and Tier 2 be considered in Phase 2.

As part of the Phase 1 work, the Project Team:

- Identifies many important policy decisions to be made by the State regarding these Assets before analysis can be completed
- Recognizes that a period of study and information gathering is necessary to move any of these Assets forward
- Does not recommend one type of PPP methodology that should be pursued if the State were to proceed
- Conducts thorough analyses regarding the alternative uses of proceeds to optimize their impact, but does not make recommendations about how proceeds should be allocated

Phase 1 Work and Work Product

The Project Team has undertaken a range of activities to produce this Report, including:

- **Review of State Assets.** A high-level evaluation of State Assets across different sectors with a view to identifying a core group of Asset Classes and Assets that merit the most serious and immediate attention for pursuing a PPP

Executive Summary

- **Review of Issues, Risks, and Policy Impacts.** A preliminary assessment of the structural issues, financial benefits and risks, and social and policy impacts of various PPP structures
- **Review of Types of PPPs.** A preliminary evaluation of a number of structures the State may use to extract excess value from Assets. These structures include:
  - Public Authority Model
  - Operating Lease Arrangement/Service or Management Contract
  - Long-Term Concession/Lease ("Lease")
  - Availability/Shadow Payment
  - Trade Sale
  - Initial Public Offering (IPO)
  - Not-for-Dividend Company
- **Estimated Asset Value Drivers.** A preliminary sensitivity analysis to determine key value drivers for the individual Assets
- **Transaction Proceeds Application Strategy.** Development of a model to identify and assess optimal strategies to accomplish the State's debt service reduction and debt defeasance objectives

Review of State Assets

The starting point for the Phase 1 work is an inventory of the major State Asset Classes and a preliminary screening to identify those Asset Classes that merit the State's near-term focus. The Project Team evaluates the broad Asset Classes against several criteria that UBS has established as critical for successful PPP projects based on UBS's global experience. The Asset Classes evaluated include:

- Airports
- Convention Centers, Stadiums and Other [1]
- Equipment
- Existing Prisons
- Hospitals
- Lottery
- Naming Rights
- Newly-Tolled Facilities
- Real Estate Development/Train Stations
- Recreation Facilities (Parks)
- Rights-of-Way
- Solid Waste Facilities
- Student Loans
- Toll Roads
- Transit
- Water/Wastewater Facilities
- Waterways and Ports

After particular Asset Classes are determined to have potential, the specific Assets within the classes are examined to determine if any specific facts make them better or worse suited for a PPP. After a period of due diligence, a PPP impediments analysis is conducted and several individual Assets are reviewed to determine their viability. These Assets include:

Note:

1 Other includes racetracks, concert halls and meeting spaces

- Atlantic City Expressway
- Atlantic City International Airport
- Development Rights at New Jersey Transit Stations
- Fiber Optic Network
- Garden State Parkway
- Higher Education Student Assistance Authority ("HESAA")
- HOT Lanes [1]
- Naming Rights
- New Jersey Lottery
- New Jersey Turnpike
- Newly-Tolled Facilities
- New Jersey Sports and Exposition Authority ("NJSEA")
- PNC Bank Arts Center

These Assets are analyzed and placed into categories based on their viability for a PPP.

Estimated Asset Value Drivers

The Project Team conducts a preliminary assessment of the value drivers for several assets in Tier 1 and Tier 2 for which sufficient data are available using a series of different analytical techniques. This analysis includes the review of numerous inputs and assumptions. Also, as part of this process, the Project Team reviews global precedent transactions, project size, market capacity, project commercial viability, commercial/structuring issues and constraints, financial risks, timing issues, and other factors.

The Project Team tests many of the value drivers associated with the assets under consideration, preparing numerous iterations of analyses, adjusting variables to determine the general drivers of value for the assets. What is clear from this process is that many of the core value drivers for these assets are within the State's control.

The Project Team focuses mainly on those drivers under the State's control, such as price increases and their timing, labor expenses, maintenance requirements, asset usage, competing and complementary facilities, and capital expenditure ("CapEx") timing and size. The Project Team also considers global drivers outside of the State's control (e.g., inflation, economic growth, etc.).

An important part of Phase 2 will be to further evaluate and set parameters for each of these drivers to gauge market reactions. The total value of the State's Program will be heavily influenced by decisions on pricing and regulation that the State will be required to make before it enters into a PPP for any assets.

Current Market Conditions

Strong current interest in infrastructure by both equity investors and debt providers is driving high volumes of merger and acquisition activity in the sector. Recent infrastructure transactions have seen overall leverage at historically high levels, and very aggressive financing terms. For long-term toll road Leases, there are examples of debt-to-EBITDA multiples well in excess of traditional market levels. The implications for the State of New Jersey of the robust market for infrastructure assets are positive:

- Increasingly large deals are being executed successfully
- Investors and lenders are willing to provide structures that will increase the value paid for the assets, while allowing an acceptable return for investors

Note:
1 High occupancy/toll ("HOT" Lanes)—a user may pay a toll to use the lane if they are not in a high occupancy (greater than two people) vehicle

- Equity returns are competitive, and some investors have shown willingness to compress their bid-level equity returns with the hope of recouping some of this over time through refinancing and restructuring fees
- Strong competition among banks and between the bank markets and the bond markets translates into lower cost financing and higher valuation

All of these factors, combined with a relative scarcity of attractive assets currently being considered for PPPs, suggest that there is a strong market appetite for many of the assets in the Report and that potential exists for relatively robust valuations in properly structured PPPs.

Conclusions

The Project Team recommends that the State choose, at the conclusion of Phase 2, one or more **Pathfinder Projects**. A Pathfinder Project is one of meaningful size that can be prepared for and brought to market relatively quickly. This will allow the State to establish its presence in the market, create visibility and broaden investor interest in future projects. The most likely candidates for one or more Pathfinder Projects will be those ranked in Tier 1 as a result of the Phase 1 analysis.

Prior to pursuing a PPP for any of these Assets, there is significant additional work to do. A portion of the work will be the responsibility of the State in terms of decision-making on major policy issues. In this Report, the Project Team identifies the top value drivers for the State to consider. Prior to a successful transaction involving any Asset, the State must provide and analyze additional information, prepare legislation, and make key policy decisions. The ground work has been done to analyze the financial implications of such policy decisions and the potential use of transaction proceeds. UBS recommends that the State proceed expeditiously into Phase 2 of the Program.

SECTION 2

Introduction

Introduction

The State of New Jersey (the "State") and/or its independent authorities (including, but not limited to, the New Jersey Turnpike Authority; New Jersey Transit; South Jersey Transportation Authority; New Jersey Sports and Exposition Authority; New Jersey Higher Education Student Assistance Authority; collectively referred to herein as the "Authorities") own assets that have been identified as potentially having significant realizable value to the State. These include assets owned or operated by the State and the Authorities including, but not limited to, toll roads; transit facilities; rights-of-way; buildings; air rights or other development rights; naming rights; infrastructure such as airports, bridges, water facilities, ports, parks and recreational facilities; and non-depreciable (or non-capital) assets such as the lottery and student loan portfolio (each, an "Asset" or collectively, the "Assets").

The State has established the Program with a view towards the development and implementation of strategies to optimize value from the Assets. The State is interested in determining the value of these Assets and exploring the feasibility of realizing excess value through PPPs or other types of transactions. The State's goal is to have a transformative effect on its financial position through a significant reduction in existing or future debt, an improvement in capital investments and an improved/increased efficiency and quality in delivering service from the operator of the Assets. A collateral benefit of the Program is to shift risks currently borne by the State into the private sector.

The State anticipates that the Program will be implemented in three phases:

- Phase 1 will consist of an asset/liability study and substantive analysis of a broad range of Assets and will identify various options for extracting the excess value from the Assets
- Phase 2 will consist of an in-depth analysis and structuring of some or all of the options identified in Phase 1. The State reserves the right, in its sole discretion, not to proceed with Phase 2. Upon completion of Phase 2 the State will, in its sole discretion, determine whether to proceed with one or more transactions that deliver optimal benefit and value to the State
- Phase 3 will consist of the State's execution of the chosen transaction(s)

UBS Investment Bank ("UBS") has been retained to work with the State to develop an analysis for Phase 1. This Report presents the Project Team's analysis for Phase 1 of the Program.

State of New Jersey Goals

The State's objectives in undertaking the Program are to:

1. Identify and evaluate transactions which could generate significant funds to reduce the amount of State debt
2. Provide funds to invest in capital facilities and projects while minimizing reliance on new debt issuance
3. Identify other opportunities to reduce the State's ongoing infrastructure investment requirements
4. As appropriate and beneficial, involve the private sector in the investment in upgrades, maintenance, and new construction associated with the Assets considered
5. Enhance the efficiency and quality of service delivered by the operator of the Assets
6. Execute any transactions deemed to meet these criteria and selected for action

Introduction

New Jersey currently has the third highest level of debt per capita in the nation as well as the highest levels of property taxes in the nation[1]. The Program is one initiative introduced by Governor Corzine that could potentially generate substantial funds to be used to reduce the amount of State debt and invest in new infrastructure and facilities, thereby enabling the State to direct more funds to other State purposes.

More specifically, through the Program, the State seeks to identify, develop, and implement strategies to optimize the value from various State Assets, including Assets owned by independent State authorities. Of particular interest will be identifying those Assets that can generate value well in excess of the amount of their associated debt or investment needs. The first step, as detailed below, is to identify those Assets having potentially significant realizable value to the State. The State wishes to evaluate the feasibility of monetizing these Assets' value through PPPs or other transactions.

Phase 1 Work Scope

The Program's Phase 1 work scope was established by the State through the "Request for Qualifications ("RFQ") for Asset Monetization Financial Advisor" (dated August 15, 2006) and through subsequent discussions that UBS has held with State officials. The Phase 1 work scope includes:

- Advising the State regarding the development of strategies and transaction structures for maximizing the value to the State of selected Assets
- Preparing an asset/liability study of the selected State Assets
- Developing alternative transaction structures for maximizing the value to the State of the selected Assets along a spectrum of options, ranging from maintaining the status quo by taking no action, to full divestiture of the Asset
- Beginning intensive due diligence of potential Assets
- Assisting in the review of structural issues, legal issues, financial risks and benefits, and potential public policy impacts of the proposed options
- Proposing appropriate methods to accomplish the State's objectives
- Identifying major value drivers
- Identifying areas of missing information needed to augment assumptions and models necessary for proper valuation
- Assessing market appetite for the Assets under consideration
- Analyzing and recommending the most efficient use of transaction proceeds with respect to reducing the State's outstanding indebtedness and/or funding future State capital needs
- Advising the State on the preparation of a Request for Proposal process to appoint additional specialized and qualified consultants to assist on Phase 2

Note:

1 Source: Tax Foundation: "2005 Evaluation Report"

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Phase 1 Work and Work Product

The Project Team gathered data and prepared analyses related to each of the Phase 1 work scope areas.

- **Review of State Assets.** A comprehensive review of State Assets forms the foundation of the Phase 1 work. In all, the Project Team undertakes preliminary, high-level evaluations of numerous State Assets across different Asset sectors and groups the Assets by sector ("Asset Class"). In this Report, the Project Team analyzes and assesses the available information for each Asset Class and selected Assets, and preliminarily identifies those Asset Classes and Assets that (i) are most commercially viable and could be the highest value candidates and (ii) would allow for operating, financing, and maintenance efficiencies to significantly increase their value. This initial screening, together with the more specific analyses and evaluations discussed below, is designed to identify a core group of Asset Classes and Assets that merit the most serious and immediate attention. Upon the State's review and direction, these candidates would be the focus of the analytical and transactional work to be undertaken in Phase 2
- **Review of Issues, Risks, and Policy Impacts.** The Project Team undertakes a preliminary assessment of the structural issues, financial benefits and potential risks, and social and policy impacts of various transaction structures as they relate to each Asset. This Report also highlights those sectors and projects having the greatest potential risks and policy impacts, so that the State may weigh these considerations against potential value creation and risk mitigation strategies. The analysis considers short-term and long-term risks and issues, as risks and issues can be expected to evolve over time. The objective is to help ensure that the State's desired outcomes are achieved and the potential for unforeseen or unwanted developments is minimized
- **PPP Alternatives.** UBS identifies and preliminarily evaluates a number of structures the State may use to capture excess value of Assets. These structures include:
  - Public Authority Model
  - Operating Lease Arrangement/Service or Management Contract
  - Long-Term Concession/Lease ("Lease")
  - Availability/Shadow Payment
  - Trade Sale
  - Initial Public Offering (IPO)
  - Not-for-Dividend Company

  UBS completes a preliminary assessment of the value potential to the State of each of these structures. As part of this process, the Project Team reviews global precedent transactions, project size, market capacity, project commercial viability, commercial/structuring issues and constraints, financial risks, timing issues, and other factors.

- **Transaction Proceeds Application Strategy.** UBS has developed a linear optimization model to identify and assess strategies optimally to accomplish the State's debt service reduction and debt defeasance objectives. The Project Team also performs a comparative analysis to evaluate the relative benefits of such defeasance compared to the avoidance of debt incurred for capital projects. UBS has also begun developing a framework and data to assist the State in analyzing potential federal tax law implications of various defeasance and redemption strategies. The Optimization Model contains information on every outstanding State tax-supported debt issue, including information on over 1,800 individual maturities on 140 issues. The model will allow the State to achieve its debt defeasance and debt service reduction goals most efficiently. During Phase 2, UBS proposes to work with the State to refine debt service reduction objectives and design a comprehensive debt reduction strategy

Through the analyses and evaluations outlined above, the Project Team divides the pool of Assets into Tier groups based on recommended further action. These Tiers are:

- Tier 1—Assets having sound commercial viability; those likely to be the preferred candidates for near-term PPPs
- Tier 2—Assets that appear promising but for which additional information is required before a more definitive assessment may be made
- Tier 3—Assets that are considered lower value candidates but that may benefit from private participation to reduce ongoing required State financial support
- Tier 4—Assets that are not deemed suitable at this time but are candidates for later development or action

Dividing Assets into these Tiers will allow for proper allocation of resources during Phase 2, should the State proceed to Phase 2, and efficient further analysis of potential opportunities.

Next Step—Phase 2

If the State elects to proceed to Phase 2, UBS expects the Phase 2 work to consist of more comprehensive study and analysis of, at a minimum, Tier 1 and Tier 2 Assets developed in Phase 1. The Phase 2 work scope would be expected to include:

- Helping to identify and procure appropriate experts and consultants in key disciplines (revenue and traffic forecasting, for example) as well as technical accounting and legal areas; coordinating the consultants' work and the flow of information
- Establishing "expertized" data and assumptions, together with the above experts and consultants, for the Asset valuation model and addressing the market demands for information in order to develop a complete bid package
- Finalizing a plan to proceed with the value-enhancing transactions for selected Assets
- Assisting in identifying and developing legislative amendments, as required, as well as preparing presentation materials for relevant parties and stakeholders including potential investor groups and various regulatory bodies
- Performing discreet market soundings to assess and clarify market appetite for specific Assets

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- Recommending an appropriate solicitation approach for the implementation of the selected Assets' transactions

Preliminary estimates of value drivers for various Asset Classes were begun as part of the Phase 1 work based on available data. A significant level of additional detailed data is required to determine accurate values for individual Assets. Phase 2 work will, therefore, involve assisting the State in identifying, collecting and utilizing the data needed to develop more precise asset value estimates.

SECTION 3

Assets Considered for Public-Private Partnerships

Assets Considered for PPPs

Inventory of Asset Classes

The starting point for the Phase 1 work is an inventory of the major State Asset Classes and a preliminary screening to identify those Asset Classes meriting the State's near-term focus. The Asset Classes evaluated include:

- Airports
- Convention Centers, Stadiums and Other [1]
- Equipment
- Existing Prisons
- Hospitals
- Lottery
- Naming Rights
- Newly-Tolled Facilities
- Real Estate Development/Train Stations
- Recreation Facilities (Parks)
- Rights-of-Way
- Solid Waste Facilities
- Student Loans
- Toll Roads
- Transit
- Water/Wastewater Facilities
- Waterways and Ports

Evaluation Criteria. Following discussions with the working group, UBS has developed a set of evaluation criteria to assess the transaction potential of each Asset Class. These criteria are intended to identify Asset Classes (i) having attributes that are attractive to private sector owners and investors and/or (ii) having the potential, based on UBS's experience in the U.S. and global markets, for successful PPPs. Through the application of these criteria to each Asset Class, a consistent and systematic assessment of each Asset Class is developed.

Key Criteria. The Asset Classes shown above are evaluated generally along a set of ten key criteria. The evaluation criteria are as follows:

1. **Stand-Alone Operation.** Clear physical and service boundaries facilitate the private sector's ability to define operational responsibilities, risks and risk mitigation methods, service delivery output expectations and valuation
2. **Output/Service Delivery Driven.** The private sector seeks to participate in assets that provide opportunities to improve output/service performance and thus increase net revenue production
3. **Substantial Operating Component.** The private sector seeks to participate in assets that have significant operating responsibilities as these provide the opportunity to improve operating performance and lower operating costs, which in turn increases net operating margins and enterprise value. Assets with the highest opportunity to benefit from operational efficiencies are most valued. Also critical is the level of prospective capital investment required to meet operational standards. The private sector will find attractive those opportunities that provide an adequate return of and on capital invested

Note:

1 Other includes racetracks, concert halls and meeting spaces

4. **Alternative Use of Asset.** Asset Classes that can be used to create additional business and revenue opportunities are valuable. The private sector seeks opportunities to fully tap the assets they control, including opportunities to optimize customer flow, billing systems, marketing, and real estate. Asset Classes with surplus rights-of-way, under-commercialized locations, and similar features tend to be attractive for private sector involvement
5. **Innovation in Delivery.** The private sector seeks opportunities to create value through innovation. Those Asset Classes using less developed technology and systems present opportunities for the private sector to improve efficiency, create new business opportunities, and leverage existing facilities and equipment
6. **Long-Term Availability.** Asset Classes containing assets with long useful lives are generally most attractive for private sector participation because they provide the greatest opportunity to benefit from improved financial/operating performance. Longer time frames also provide greater opportunity to weather business cycles, recover from unexpected negative events and maximize financing packages
7. **Minimum Transfer of Social Control.** Generally speaking, private investors look for businesses that do not have significant social impact as these businesses are more likely to be subject to social and political actions and events. Services with significant social impacts, such as prison management, therefore may draw a more limited investor base
8. **Manageable Security/Safety Issues.** Asset Classes having major security or safety issues may impose significant additional operating costs, impose additional operational restrictions or require a significant, ongoing level of State or federal involvement and oversight. For these reasons, it would be, in general, more difficult to extract excess value from these Assets. However, if after taking these costs into account, return on capital remains strong, private sector participants will still be interested
9. **Risks Commercial in Nature.** The private sector is most interested in, and capable of assuming, commercial risks such as market trends, pricing changes, currency fluctuations and similar risks. Those Asset Classes whose risks are primarily commercial rather than non-commercial (e.g., legal, environmental, safety, political) will be most attractive for private sector participation. The most suitable Asset Classes will have no significant environmental or land ownership risks that are allocated to the private sector
10. **Manageable Size.** Generally speaking, the most desirable Asset Classes are those with Assets large enough to warrant the considerable effort required to effect a transaction but not so large that they pose untenable commercial, financing, or other risks. Different investor classes will have different transaction size preferences

Assets Considered for PPPs—Asset Classes. An evaluation matrix, below, presents UBS's initial assessment of each Asset Class based on the evaluation criteria. A score for each criterion was assigned to each Asset Class. Taken together, these scores illuminate those Asset Classes that will contain the most favorable candidates.

Assets Considered for PPPs

Key Criteria	Asset Classes																
	Lottery	Naming Rights	Rights-of-Way	Toll Roads	Real Estate Development/ Train Stations	Convention Centers, Stadiums and Other [1]	Newly-Tolled Facilities	Waterways and Ports	Hospitals	Student Loans	Transit	Airports	Water/ Wastewater Facilities	Existing Prisons	Solid Waste Facilities	Recreation Facilities (Parks)	Equipment
Stand Alone Operation	+ + +	+ + +	+ + +	+ + +	+ +	+ +	+ + +	+ + +	+ +	+ + +	+ + +	+	+	+ +	-	+ +	-
Output/Service Delivery Driven	+ + +	NA	NA	+ + +	NA	+ +	+ + +	+ +	+ + +	+ +	+ + +	+ +	+ +	+ +	+	+	-
Substantial Operating Component	+ + +	NA	NA	+ + +	NA	+ + +	+ + +	+ + +	+ + +	+ +	+ + +	+ + +	+ + +	+ +	+ + +	+	NA
Alternative Use of Asset	- -	-	+ +	+	+ +	+ + +	+	+ +	-	- - -	-	+ +	- - -	- -	- - -	+	- - -
Innovation in Delivery	+ +	+ +	+ +	+	+ +	+	+	+ +	+	+	+	+ +	+	+	+	-	- -
Long-Term Availability	+ + +	+	+ +	+ + +	+ +	+ + +	+ + +	+ +	+ +	+	+ +	+ + +	+ + +	+ +	+ + +	+ +	-
Minimum Transfer of Social Control	+ +	+ + +	+ +	+	+ +	+ + +	- - -	+	-	+	-	-	- -	- - -	+	- - -	+ +
Manageable Security/ Safety Issues	+ + +	+ + +	+	+	+	-	+	- - -	+	+ +	- - -	+	- - -	- -	+ +	+	+ +
Risks Commercial in Nature	+ + +	+ + +	+ + +	+ +	+ + +	+ +	+ +	+ +	+	+ +	- - -	+	+	-	-	+	+
Manageable Size	+ +	+ + +	+ +	+ +	+ +	+ +	+ +	+ +	+ +	+ +	+	+ +	+ +	+ +	-	- -	-
Overall Potential	+ + +	+ + +	+ +	+ +	+ +	+ +	+ +	+ +	+ +	+ +	+	+	+	+	+ / -	-	-

+++ Very Favorable ++ Favorable + Somewhat Favorable – Somewhat Unfavorable – – Unfavorable – – – Very Unfavorable NA: Not Applicable

Note:

1 Other includes racetracks, concert halls and meeting spaces

Assets Considered for PPPs

Initial Grouping of Assets

UBS has adopted a system to group Assets for the State's consideration. As the Asset evaluation matrix described above shows, Assets fall into different levels of readiness, marketability, difficulty, etc. For ease of review, UBS establishes the following four categories to reflect the overall potential for the Assets.

Overall Potential

- **Extremely Viable.** These Assets would be valuable private sector enterprises, currently operating with positive cash flows. They would exhibit some pricing and cost flexibility. This Class includes service-based Assets with room for innovation or technology changes would be included. While some issues might exist regarding current legislative status or management of safety and pricing, these are generally of the type typical for the industry concerned
- **Very Viable.** These Assets exhibit many of the characteristics of the Extremely Viable group. They, however, have more interfaces with multiple parties (e.g., federal regulators, vendors, etc.) or introduce high risks of construction, reinvestment, or pricing for their Asset Class. Additionally, this Class includes projects that offer challenges to the financial markets due to size or unusual risk features
- **Moderately Viable.** These Assets demonstrate marginal business characteristics (e.g., volatile revenues or low operating margins). They are complicated by multiple interfaces, existing liens, or agreements. This Class includes multiparty developments
- **Marginally Viable.** These Assets demonstrate weak viability as a successful private sector project. Whether resulting from a financial, legal or business issue, they in general fail to meet the requirements for a viable private sector participation

Assets Considered for PPPs

The conclusions drawn from this analysis of Asset Classes include:

- **Lottery—*Determined to be extremely viable.*** Lottery is a low-capital investment, highly commercial enterprise that lends itself to further consideration. The need to regulate the business and determine the scope of the games for the future will be critical business issues
- **Naming Rights—*Determined to be extremely viable.*** There is an active market nationally and internationally in naming rights. Given the dense population corridor, the value of highly visible venues should be further investigated
- **Rights-of-Way—*Determined to be very viable.*** The development of companion or supplemental commercial opportunities along project corridors is commonly very profitable. Service Stations along roads are a good example. The segregation of these opportunities from the core purpose of the corridor might prove valuable
- **Toll Roads—*Determined to be very viable.*** Internationally and domestically a successful sector, this asset class incorporates many critical service elements and is generally favored in the markets. The commercial nature of the risks, once pricing guidelines are established, is a positive. The best candidates will allow for further business developments. Construction risk associated with mandatory expansion plans or asset enhancement or capacity driven works is a negative common to all such investments
- **Real Estate Development/Train Stations—*Determined to be very viable.*** The commercial development of adjacent rights-of-way or train stations is a viable consideration. Stations around the world have taken the opportunity to provide multiple commercial services to the passengers as they pass through. Well-designed projects can be commercially viable
- **Convention Centers, Stadiums and Other—*Determined to be very viable.*** The commercial nature of the activity at these venues and the ability to develop companion businesses within the venue makes these assets attractive candidates when they serve in strong markets. Security at large public events can be an issue but the category merits further review
- **Newly-Tolled Facilities—*Determined to be very viable.*** New, easy-to-implement technology and evolving Federal regulations have created the opportunity to consider tolling previously un-tolled facilities. These projects have limited construction risk and can provide some risk mitigation to investors in that they have established travel patterns to evaluate. The dense population and well established travel corridors in NJ provide significant opportunities for private sector participation. Heightened construction risk from those assets needing extensive capital investment can be a deterrent to investment and may result in required State participation
- **Waterways and Ports—*Determined to be very viable.*** There are many examples of successful commercial port and water-related projects in the U.S. and abroad. The security issues can, however, substantially weaken the project appeal. Nonetheless, the critical commercial impact and limited locations for ports present a business opportunity for the private sector

Assets Considered for PPPs

- **Hospitals—*Determined to be very viable.*** The health care market is a combination of public and private service providers. The financial health of individual facilities may vary widely. Further, the selection of individual assets can be difficult when social issues of availability of service in low density or high unemployment areas arise
- **Student Loans—*Determined to be very viable.*** There are several successfully operated commercial student loan portfolios. The financial market nature of these investments makes them worthy of more detailed analysis. Individual portfolio characteristics will ultimately determine the viability
- **Transit—*Determined to be moderately viable.*** Extracting excess value from transit systems is difficult because of the capital intensive nature of these assets and general lack of operating profitability. This mode of transportation, however, has high barriers to entry and heavy technological and capital investments which therefore merit further consideration. The significant security/safety issues make it more difficult to minimize State involvement in the future
- **Airports—*Determined to be moderately viable.*** Airports have been successfully developed and operated on a private basis internationally. They do, however, have issues of security, social development and economic impact that can weaken their business viability. Existing agreements and practices often are not commercially viable
- **Water/Wastewater Facilities—*Determined to be moderately viable.*** These facilities, while single purpose in nature, can be commercially viable investments as is indicated by the number of private water companies operating in the U.S. and internationally. The security and social issues of service delivery make the projects less attractive
- **Existing Prisons—*Determined to be moderately viable.*** The commercialization of services with social impact limits investor interest. Operations of existing facilities can be contracted out to the private sector successfully as is evidenced in the U.S. market. PPPs relating to the "bricks and mortar" elements of new facilities is more common and offers wider opportunities for savings from commercial efficiencies
- **Solid Waste Facilities—*Determined to be marginally viable.*** Like water facilities, these plants can be commercially viable but pricing and lack of alternatives for the property can constrain value. An overbuilt market can significantly alter the commercial viability of an individual asset
- **Recreation Facilities (Parks)—*Determined to be marginally viable.*** These facilities often do not offer the commercial opportunities investors seek. The social issue of preventing commercialization of open space can make these projects difficult and likely to be only subsidy restricting
- **Equipment—*Determined to be marginally viable.*** The difficulty defining the scope of packages, the limited commercial nature of some assets and the restricted portability of much equipment make this a commercially difficult market for major systems

Screening of Individual Assets

The Asset Classes determined to be viable were then screened for individual assets that should be studied further. UBS and the State considered numerous Assets within the Asset Classes. These individual Assets were considered along a series of key criteria to determine their potential viability. The Project Team conducted additional due diligence on these Assets for an impediments analysis aimed at determining if any particular fact would prevent the Asset from being part of a PPP transaction.

The goal of this portion of the analysis is to begin to rank the potential Assets and/or projects for further analysis. Phase 1 will accomplish this ranking. At the conclusion of Phase 2, one or more Pathfinder Projects could be selected by the State from the Assets with the highest ranking in Phase 1. A Pathfinder Project is one of meaningful size that can be prepared for and brought to market relatively quickly, with significant market visibility and broad investor interest. This type of project will allow the State to establish its market presence with a successful first transaction, conveying important information about the State's ability to run a process, the State's appetite for risk, willingness/ability to complete a transaction, and its need for control over infrastructure.

In screening the individual Assets for one or more potential Pathfinder Projects, the Project Team considers several relevant factors:

- The **scope** of the project, that is the ability to define the limits of the project, is critical to financial viability. Projects that have indefinite limits are harder to value. Indefinite limits may refer to unclear limits on companion business development rights or unclear limits on competitive projects
- The absolute **size** of the project impacts its marketability. A Pathfinder Project should be large enough to attract strong international interest but not so large as to force excessively large bidding groups to form, limiting the final number of competitors. Multi-billion dollar projects can be very efficiently managed in today's marketplace
- The **time** required to implement a transaction should be long enough to organize effective bidding competition but short enough to maintain a high bidder interest level and establish a successful early project for the State. Time considerations suggest that there may be benefit in first offering a less complex business, with available due diligence information, that could extract value and be financed relatively quickly
- Assets that do not require too many **skill-sets** are also favored as initial projects. In order to manage complex, multi-purpose assets, large, often unwieldy bidding groups will form. Large multi-functional assets may be more valuable if properly segmented into separate offerings
- The ideal early asset transaction would be readily **financeable**. This suggests the State consider avoiding projects with unproven technology, significant business risks, complex implementation techniques, etc. These issues would deter potential lenders and investors that would otherwise be drawn to the State's Program
- Projects with a limited number of required governmental and other **interfaces** are favored. Assets with complex, multi-party arrangements (a transit station development, for example) may take longer to implement and entail a more difficult selection process

Assets Considered for PPPs

- The **legal platform** required to effect a PPP transaction is also important. Legislation providing clear authorization would be required for virtually all assets in order to enable the State properly to regulate, supervise and contract for services. Transactions relating to assets that have additional legal issues (such as airports that require FAA approval, roads that may require Federal Highway approval and transit systems that may have received Federal Transit Administration funding) will be more complex and thus rank lower
- Preferred near-term assets will have detailed, current **technical information** and operating data. It will be possible to implement PPP transactions more rapidly for projects that have in-depth data available. The market will require both historical and projected information as to the Asset's performance, state of its physical plant, market information, etc. Assets that have currently available, independently "expertized" data will be valued more effectively. Any lack of information represents a risk to investors and therefore can be detrimental to an Asset's valuation
- **Land ownership** is considered for the physical assets. Clear delineation of ownership of the asset by the State will be important to determine what rights or assets are available for transfer
- The Assets are also evaluated to determine if the business is **economically sound**. One of the vital elements of a PPP is that the underlying business be economically viable. To the extent it is not, the State must determine what, if any, additional incentives it may offer to create an economically sound platform

Assets Considered for PPP—Individual Discrete Assets. The Project Team has created a matrix to analyze a number of specific Assets for viability along the criteria set forth above. Each Asset is assigned an overall ranking for determining whether it is favorably positioned to move forward for in-depth analysis in Phase 2. It is important to note that several of the outcomes on ranking could be influenced by State action. For example, the legal/legislative basis for a PPP transaction will be subject to action by the State. Technical information that currently is weak or unavailable could be developed to make an Asset more readily analyzable. The economics of a business could be affected by decisions to open up or restrict competitive business elements. These preliminary rankings were generally based on the current state of information. The one exception is that for the legal basis on which a transaction moves forward, the analysis assumes that the State will have prepared an effective legislative framework for the project to move forward.

The results of the analysis are presented below.

Assets Considered for PPPs

	Individual/Discrete Assets												
Key Criteria	**New Jersey Lottery**	**Atlantic City Expressway**	**New Jersey Turnpike**	**Garden State Parkway**	**HOT Lanes**	**Newly-Tolled Facilities**	**Development Rights at NJ Transit Stations**	**Naming Rights**	**PNC Bank Arts Center**	**Atlantic City International Airport (ACIA)**	**Fiber Optic Network**	**NJSEA[1]**	**HESAA**
Scope (i.e., Discrete Project)	+ + +	+ + +	+ + +	+ + +	+ + +	+ +	+ + +	+ + +	+ + +	+ + +	+	+ +	+ +
Size	+ + +	+ + +	+ +	+ +	+ (?)	+ +	+ +	+ + +	+ +	+ +	+ +	+ +	+ +
Time	+ +	+ +	+ +	+ +	+ +	+ +	+	+ +	+ +	+	+	-	+
Skill-Sets	+ + +	+ + +	+ + +	+ + +	+ + +	+ + +	+ +	+ +	+ +	+ + +	+ +	+ +	+ +
Financeable	+ + +	+ +	+ +	+ +	+ +	+ + +	+ +	+ +	+ +	+ + +	+ +	-	- - -
Interfaces	+	+ + +	+ + +	+ + +	+ + +	-	- -	+ +	+	- -	+	-	+
Legal Platform [2]	+ +	+ + +	+ + +	+ + +	+ + +	+ +	+ + +	+ + +	+ + +	+	+ + +	+ + +	+ + +
Technical Information	+ + +	+ +	+ +	+ +	+	+	+ +	+ +	+ + +	+	+	+ + +	+ +
Land Ownership	**NA**	+ +	+ +	+ +	+ (?)	+ + +	+ (?)	+	+ +	-	**NA**	+	**NA**
Economically Sound	+ + +	+ + +	+ + +	+	+ +	+ + +	+	+ +	+ +	+ +	+	-	- - -
Overall Potential	+ + +	+ + +	+ +	+ +	+ +	+ +	+ +	+ +	+ +	+ +	+	+	-

+++ Very Favorable ++ Favorable + Somewhat Favorable – Somewhat Unfavorable – – Unfavorable – – – Very Unfavorable NA: Not Applicable

Notes:
1 Reflects a group of 7 venues
2 Assuming enactment of appropriate legislation
(?) Additional due diligence required

Assets Considered for PPPs

The results of the matrix above place the discrete Assets into the following categories:

Overall Potential

- **Extremely Viable.** These include the Lottery and the Atlantic City Expressway
- **Very Viable.** These projects include the New Jersey Turnpike, the Garden State Parkway, HOT Lanes, Newly-Tolled Facilities, Development Rights at New Jersey Transit Stations, Naming Rights, the PNC Bank Arts Center and ACIA
- **Moderately Viable.** The New Jersey Sports and Exposition Authority Assets would fall into this category. Technological equipment such as the Fiber Optic Network may also fall into this category
- **Marginally Viable.** HESAA, due to issues of financeability, falls here

SECTION 4

Public-Private Partnership Structures

PPP Structures

Introduction

In the international markets, there are several models that have been successfully implemented to generate excess value from government assets. The various models differ in several ways. They alter the extent of the relationship among parties, varying along a spectrum from minor involvement in maintenance or operations to transfer of full and permanent ownership to the private sector. On the following pages, UBS presents several generic descriptions of models in order to characterize the major distinctions in terms of roles, responsibilities and risks. There are many potential variations on these basic models. It is important to note that all of the Assets considered are currently in a Public Authority model, or directly owned by the State.

UBS's analysis introduces a variety of structures for consideration by the State. The following section summarizes the salient features of several of the market methodologies including:

- Public Authority Model
- Operating Lease Arrangement/Service or Management Contract
- Long-Term Concession/Lease
- Availability/Shadow Payment
- Trade Sale
- Initial Public Offering (IPO)
- Not-for-Dividend Company

One of the key elements considered for each method is the risk allocation. In this, UBS considers six key risks and the allocation of such under each model. These include:

Type of Risk

Construction/CapEx	♦ Risk of the cost, successful completion and delivery of construction and timing of expenditures, as well as the financing cost of such future investments
Usage	♦ Risk of the number of transactions, traffic risk, sales or volume risk
Commercial	♦ Commercial risks of competition, alternative businesses, or economic cycles
Operation and Maintenance	♦ Risk around operations and maintenance expenses due to changes in prices, timing of needs or unforeseen events
Financial	♦ Risks of currency, interest rates, market conditions
Management	♦ Risks of managerial decisions and executive staffing decisions ♦ Risks of strategic plan and its implementation by management

PPP Structures

Summarized below is the expected risk allocation for each of the structures:

Type of Risk	Public Authority Model	Operating Lease Arrangement or Service/ Management Contract	Lease	Availability/ Shadow Payment	Trade Sale	IPO	Not-for-Dividend Company
Construction/ CapEx	State/Authority	State/Authority	Private Sector	Private Sector	Private Sector	Private Sector	Private Sector
Usage/Traffic	State/Authority	State/Authority and Private Sector	Private Sector	State/Authority (availability) Private Sector (shadow)	Private Sector	Private Sector	Private Sector
Commercial	State/Authority	State/Authority and Private Sector	Private Sector	State/Authority (availability) Private Sector (shadow)	Private Sector	Private Sector	Private Sector
Operation	State/Authority	Private Sector	Private Sector	Private Sector	Private Sector	Private Sector	Private Sector
Maintenance	State/Authority	State/Authority	Private Sector	Private Sector	Private Sector	Private Sector	Private Sector
Financial	State/Authority	State/Authority	Private Sector	Private Sector	Private Sector	Private Sector	Private Sector
Management	State/Authority	State/Authority and Private Sector	Private Sector	Private Sector	Private Sector	Private Sector	Private Sector

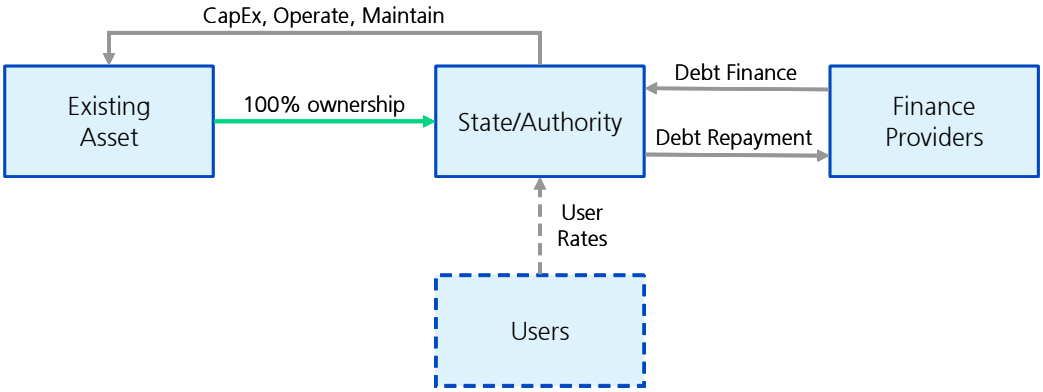
Asset–Specific Innovations

After considering which of these models is most appropriate for each selected Asset, the State can develop unique variations on these models in order to accomplish its goals. Several approaches the State may consider for specific Assets include: competition for difficult construction programs on design, safety, timing, traffic management, etc.; implementation of partial or modified structures with features that uniquely address the State's interests in revenue sharing or regulatory control, etc. As the specific requirements of each Asset are determined in Phase 2, each structure adopted will be customized efficiently to address the market's and State's requirements.

Public Authority Model (Status Quo)

- The Public Authority model, or publicly owned infrastructure, is the prevailing model used in the U.S. for the development, financing, management, operation and maintenance of federal, state and interstate road networks and other revenue generating infrastructure assets
- Under this system, an Authority is created by the State and given authority to develop, finance, manage, and operate the project. The public Authority collects tolls or other fees to cover debt service, operating expenses, and major maintenance and rehabilitation costs
- The assets are generally managed by the Authority's staff, including a board of directors appointed by the State (or regional or local municipal entity)

Description



- Full ownership of the asset and responsibility for operating, maintaining, investing and financing the asset remains with the State/Authority
- The State/Authority has full power and autonomy to set rates and charges
- In certain cases, the State or local municipal entity may provide a subsidy or other external funding to the Authority in excess of revenues generated by the asset (transit systems would be a prime example)
- Projects are generally financed with 100% debt, with nominal "equity" from the State or State agency typically relating to the purchase of land, upfront design and development expenses, and environmental studies
- There are no true equity investors in the Authority and no dividend or profit distributions; surplus funds are retained by the Authority for additional projects or (perhaps) shared with the State or local municipal entity

Risk Transfer

Type of Risk	Party Assuming the Risk
Construction/CapEx	State/Authority
Usage/Traffic	State/Authority
Commercial	State/Authority
Operation	State/Authority
Maintenance	State/Authority
Financial	State/Authority
Management	State/Authority

Public Authority Model (Status Quo) (continued)

Implementation Time

- None; structures already exist

Benefits

- No preparation for a transaction is required
- Because of the ability to issue tax-exempt debt, the cost of debt financing is generally lower than that it would be for a private sector owner
- Generally acceptable to bondholders, the public, State government, and other stakeholders
- State/Authority maintains full operational control
- State/Authority maintains control of service level and service delivery
- State/Authority maintains control of user fees and other pricing

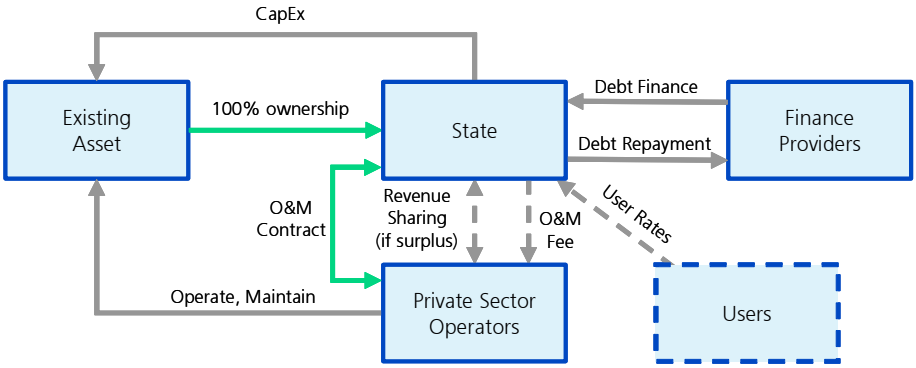
Issues

- Generally discourages aggressive capital structures or leverage, which may limit proceeds for the State
- State/Authority retains revenue risk and political pricing risk
- State/Authority retains significant construction/CapEx, traffic, maintenance, commercial, and management risks
- State/Authority remains responsible for financing and related tasks (legal, credit rating, bond insurance, etc.)
- No efficiencies from private sector involvement
- Asset revenues are not maximized as user fee levels are typically limited by public policy issues

Operating Lease Arrangement or Service/Management Contract

- Variation of the previous model with the exception that the Authority outsources specific asset management and operational services, with the objective to achieve higher operational efficiencies by contracting out to the private sector a discrete and defined scope of services over the medium term
- The State retains responsibility for revenue collection
- The private sector assumes an operating and/or management role and in exchange it receives an operating or management fee. Incentives for efficient operations may be included in the contract and result in surplus revenue sharing
- In the U.S., this model is used extensively for individual components of services requested in complex infrastructure assets that require coordination and delivery of different type of services, such as ports and to lesser extent airports

Description



- Full ownership of the asset remains with the State while the responsibility for operating and maintaining all or portions of the asset is transferred to the private sector
- The State remains responsible for the financing of the asset
- The State maintains control on the level of rates/charges and on the service and safety standards
- The State pays a management fee to the private sector
- The State and the private operator share revenue from customers (if surplus)
  - typically, the operator pays the State an amount that can vary according to performance and rates and retains the remaining revenue
- The private operator's profits depend on the performance of the asset, which typically gives the operator incentive to improve operating efficiency and increase revenues
- The length of these contracts is usually between 1 and 5 years, but may be as long as 15 years under tax law

Operating Lease Arrangement or Service/Management Contract (continued)

Risk Transfer

Type of Risk	Party Assuming the Risk
Construction/CapEx	State
Usage/Traffic	State and private sector
Commercial	State and private sector
Operation	Private sector
Maintenance	State
Financial	State
Management	State and private sector

Implementation Time

- 3–6 months

Attractions

- The State transfers part or all of the maintenance and operational risk to the private sector
- Effective at introducing private sector efficiency and technical capability relatively quickly
- Can incorporate ongoing efficiency incentives contractually via risk/reward mechanism
- Can be an effective first step to greater private sector involvement
- Acceptability to stakeholders
- Pricing control remains with the State
- The State retains the ability to use tax exempt financing

Issues

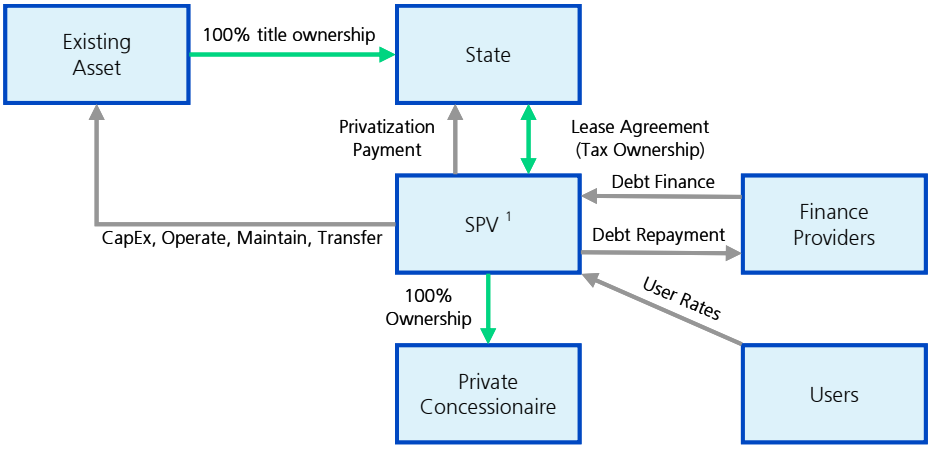
- Does not provide external capital/ generates no upfront proceeds for the State
- The State retains construction/CapEx risk and, to a lesser extent, commercial risk
- The State remains responsible for the financing
- Difficulty in setting outputs/ targets
- Efficiency in operations create modest annual savings

Long-Term Concession/Lease

Introduction

- The long-term concession (sometime referred to as the "Concession and Lease" or just the "Lease") is the lynchpin and the fundamental platform for implementing a public-private partnership arrangement in the infrastructure sector
- Under a Lease arrangement, the State assigns (or grants) the right to set, collect and manage user fees in exchange for (i) monetary payments by the private sector (lump-sum or annually as a fee to the State) and (ii) acceptance by private sector of a pre-agreed set of obligations and responsibilities over the term of the Lease
- The term of the Lease can range from long-term (30 to 40 years) to very long-term (50 to 99 years)
- In the U.S. examples of the implementation of this methodology include: Chicago Skyway, Indiana Toll Road, Pocahontas Parkway (Richmond VA), SR 125 (San Diego, CA), TTC – 35 (Texas), Dulles Greenway, Route 495 HOT Lanes in Virginia
- International examples are numerous worldwide including the ETR 407 in Canada, Australian airports

Description



Note:
1 SPV: Special Purpose Vehicle

- Title to assets remains with the State while tax ownership and depreciation benefits transfer to the private sector
- Responsibility for operating, maintaining, investing and financing the asset during the life of the Lease is transferred to the private sector
- The original asset along with any additional assets created during the life of the Lease revert to public sector ownership at the end of the Lease at a pre-agreed valuation
- The length of these contracts outside the U.S. is usually around 30 years, although U.S. tax law would suggest longer term in order to allow tax ownership to transfer (80% of useful life)
- The responsibility for setting rates/charges is controlled by the State via the contract
- The private operator's profits depend on the performance of the asset, which typically gives the operator incentive to improve operating efficiency and increase net revenues
- State may retain a right to revenue sharing from inception of the Lease or in excess of defined thresholds

Long-Term Concession/Lease (continued)

Risk Transfer

Type of Risk	Party Assuming the Risk
Construction/CapEx	Private sector
Usage/Traffic	Private sector
Commercial	Private sector
Operation	Private sector
Maintenance	Private sector
Financial	Private sector
Management	Private sector

Implementation Time

- 9–12 months

Attractions

- Significant proceeds to the State upfront
- The private sector raises and repays debt with no recourse to the State, allowing for aggressive capitalization
- The State transfers revenue, construction/CapEx, operational and maintenance risk to the private sector
- Integrated CapEx and OpEx planning by lessee may allow for further efficiencies
- May be more acceptable to some stakeholders than a pure divestment
  - assets remain in the State ownership, revert to State control at the end of the contract
- Failure to perform by lessee can be addressed with State re-asserting control

Issues

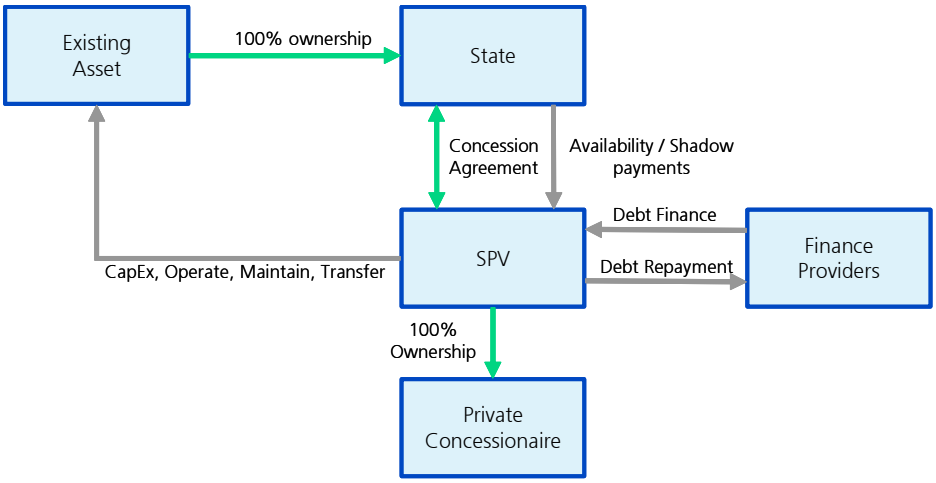
- Complex arrangements
- High procurement costs and time-consuming process
- Requires continuous monitoring of service and quality standards (can be contracted to third parties)
- Suitable mainly for stand-alone, revenue-generating assets
- Non-revenue generating projects (economic development) may require continued State involvement
- Limited upside potential to the State unless sharing arrangements negotiated

Availability/Shadow Payment

Introduction

- This structure is suitable for assets with a weak revenue base or assets where the State for policy reasons does not want to move to market pricing
- In the U.S., this model is being explored in Texas
- International examples include: UK, Portugal, Eastern Europe, Asia and Israel road programs

Description



- Availability/shadow payment is a variation on a Lease methodology; it is not a methodology for extracting excess value in itself and may not generate upfront proceeds to the State. It is rather a type of operating contract between the State and the private sector
- The security provided to the lessee is an obligation of the State from its resources
  - availability: the State agrees to pay the private operator a set amount if certain pre-agreed operating (e.g., service quality, safety) criteria are met. Measurement and penalty systems are introduced to quantify any variation from the agreed standards and adjust the State payment accordingly. State retains traffic risk. Source of State's payment may be taxes or some user fees, but not exclusively user fees
  - shadow: the State agrees to pay the private sector a set amount based on volume of traffic. Therefore, traffic risk is shifted to the private sector. Source of State's payment may be taxes or some user fees, but not exclusively user fees

Availability/Shadow Payment (continued)

Risk Transfer

Type of Risk	Party Assuming the Risk
Construction/CapEx	Private sector
Usage/Traffic	State (availability)/ Private sector (shadow)
Commercial	State (availability)/ Private sector (shadow)
Operation	Private sector
Maintenance	Private sector
Financial	Private sector
Management	Private sector

Implementation Time

- 9–18 months

Attractions

- Permits procurement or maintenance of significant assets by the State, using a deferred payment stream
- The private sector assumes life-cycle costing risks
- The private sector raises and repays debt
  - guaranteed payments from the State allow the private sector to secure better financing terms than with real user fees
- The State transfers construction/CapEx operations and maintenance risk to the private sector
- Acceptable to users who do not pay directly for the service but through taxes

Issues

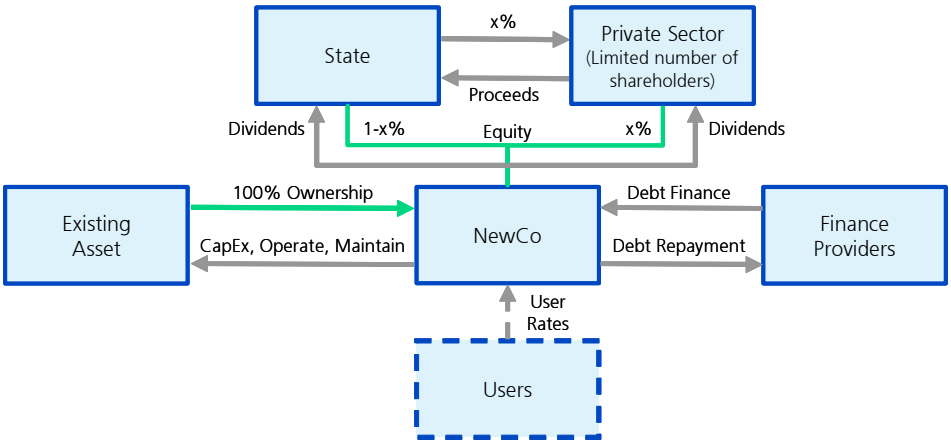
- Ongoing payments from the State to the private sector
- Requires continuous monitoring of service and quality standards (can be contracted to third parties)
- Limited risk transfer if the State continues to retain the responsibility for and risks of collecting real user fees

Trade Sale

Introduction

- Similar to a long-term Lease, but without reversion of ownership
- A contract establishes the private sector entity's obligations, responsibilities and financial awards
- Ownership is limited to the State and a limited number of private sector shareholders

Description



- A newly created company ("NewCo") has 100% ownership of the asset
  - transfer of title of assets into a newly created company, or
  - transfer of concession ownership into a newly created company
- The State sells equity ownership (total/partial) in NewCo to the private sector, such as a financial or strategic investor or infrastructure fund. No publicly traded shares
  - as opposed to a Lease, ownership is actually sold for an indefinite period of time and does not automatically revert to the State
- State may regulate user fees for public policy purposes
- NewCo is responsible for the construction/CapEx, maintenance, operation and financing of the asset

Risk Transfer

Type of Risk	Party Assuming the Risk
Construction/CapEx	Private sector
Usage/Traffic	Private sector
Commercial	Private sector
Operation	Private sector
Maintenance	Private sector
Financial	Private sector
Management	Private sector

Trade Sale (continued)

Implementation Time

- 9-12 months

Attractions

- May carry a premium price over long-term Lease
- Significant proceeds to the State upfront
- NewCo raises and repays debt; no recourse to the State, allowing for aggressive capitalization
- The State transfers revenue, construction/CapEx, operational and maintenance risk to the private sector
- Integrated CapEx and OpEx planning may allow for further efficiencies
- The State can retain control by only selling a portion of the asset
- The State can retain board representation

Issues

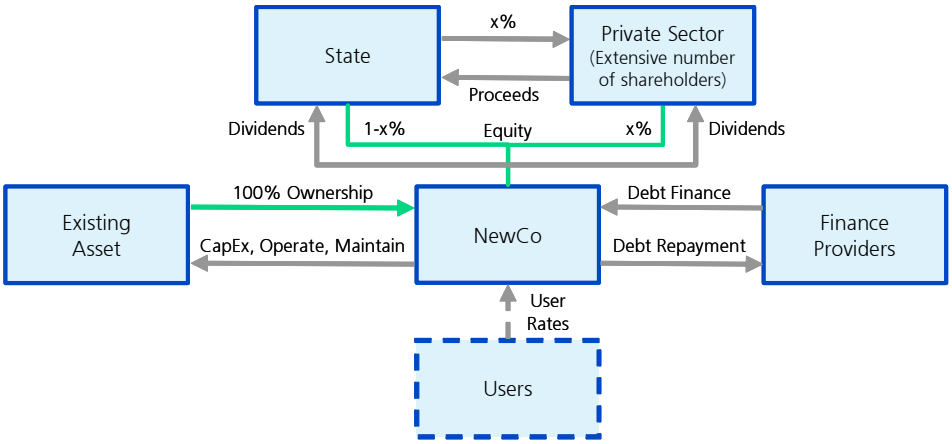
- Regulatory framework required to ensure private sector maintains asset and service quality
- Corporatization process (creation of NewCo) prior to the transaction
- State retains risks commensurate with its ownership stake
- Asset does not revert to the State

IPO

Introduction

- Partial equity offering in a newly formed company ("NewCo") that becomes a publicly traded entity through the initial public offering (IPO)
- Private sector ownership is diffused across a broader investor base
- This methodology is the "French model" for privatizing roads
- International examples include: ASF (France), SANEF (France), Autostrade (Italy), MTRC (Hong Kong), SMRT (Singapore), Japan Rail (Japan)

Description



- A newly created company ("NewCo") has 100% ownership
  - transfer of title of assets into a newly created company, or
  - transfer of Lease ownership into a newly created company
- The State sells partial ownership in NewCo to the private sector, through a listing in a stock exchange where the shares are traded
  - as opposed to a Lease, ownership is actually sold and does not automatically return to the State after a set period of time
- NewCo is responsible for the construction/CapEx, maintenance, operation and financing of the asset

IPO (continued)

Risk Transfer

Type of Risk	Party Assuming the Risk
Construction/CapEx	Private sector
Usage/Traffic	Private sector
Commercial	Private sector
Operation	Private sector
Maintenance	Private sector
Financial	Private sector
Management	Private sector

Implementation Time

- 12–18 months

Attractions

- Significant proceeds to the State
- NewCo raises and repays debt
- The construction/CapEx, operational and maintenance risk is transferred to NewCo
- The State can exercise influence in the asset through control and governance mechanisms (e.g., board representation, regulation, company by-laws, or veto rights)
- State can retain control through holding a majority stake
- Shares are publicly traded with no single investor in control, unless holding a majority stake
- State would be able to generate additional proceeds in the future by reducing the ownership stake at a higher valuation based on improved operations

Issues

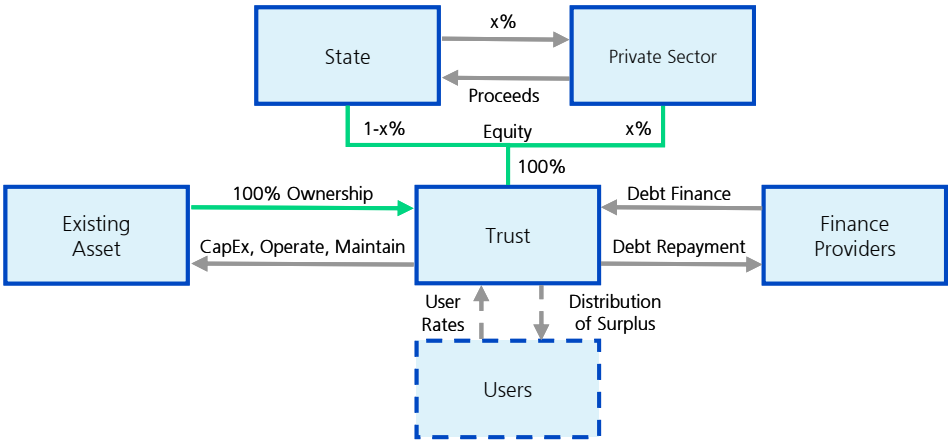
- IPOs normally carry a discount over trade sale prices
- Regulatory framework required to ensure private sector maintains asset serviceability
- Corporatization process (creation of NewCo) prior to the transaction
- Additional regulatory requirements for a listed company (e.g., reporting, governance, Sarbanes-Oxley,etc.)
- State retains risks commensurate with its ownership stake
- Asset does not revert to the State

Not-for-Dividend Company ("Trust")

Introduction

- Model pursued by large, complex infrastructure assets where the policy objective is not to have private sector profit taking and is particularly suitable where subsidies exist or are required
- Surpluses (dividends) are reinvested in the company or used to reduce charges
- International examples include: NATS (UK), and NetworkRail (UK)

Description



- Full ownership and operation of the asset is transferred from the State to an entity that does not distribute dividends (Trust)
- Economic regulation by the State
- Financial surpluses generated from the asset are retained for the benefit of customers/users instead of being distributed to shareholders as dividends
- The surplus can be transferred to the customer/user through a reduction in rates/charges or retained by the company for future investment
- Potential structures for this entity include a company limited by guarantee, a cooperative, or a trust
- Consideration payable to the State for the sale would be provided by the raising of debt capital by the not-for-dividend entity
  - however, in order to ensure that the entity has sufficient reserves against losses, no consideration for the equity value of the company is likely to be achievable
- In order to incentivise effective performance and efficiency, a management incentive package is typically designed to align management incentives with performance and efficiency outputs
- 100% debt funded entity with no dividend distributions

Not-for-Dividend Company (continued)

Risk Transfer

Type of Risk	Party Assuming the Risk
Construction/CapEx	Private sector
Usage/Traffic	Private sector
Commercial	Private sector
Operation	Private sector
Maintenance	Private sector
Financial	Private sector
Management	Private sector

Implementation Time

- 9–18 months

Attractions

- Designed to facilitate raising of long-term, low cost private finance
- Allows for 100% leverage
- Significant proceeds to the State
- Acceptability to stakeholders due to no dividends pay-out to the private sector

Issues

- Requires more supportive regulatory framework than in the previous methodologies
- Incentivization of management unproven
- Asset does not revert to the State

SECTION 5

State of Current Information

State of Current Information

As summarized in Section 3, many of the Assets reviewed exhibit characteristics favorable to potential public-private partnerships. As in any analysis, the validity of the output depends on the validity of the input. During Phase 1, for each Asset Class, UBS has conducted preliminary due diligence, interviewing senior officials knowledgeable about the Asset Class, and reviewing reports in order to identify the level of information available for an analysis. For certain Assets, the available information was sufficient to enable UBS to begin the analytical evaluation. However, for other Assets, information was very limited so the Project Team has been unable to commence detailed analysis.

In general, in order to perform a preliminary numerical analysis, UBS requires, among other things, detailed historical and projected technical, economical and financial information, published research or consulting reports that aid in understanding the future prospects of an asset, and the key drivers of operating performance. Such information is simply unavailable for certain assets and categories for various reasons, including but not limited to (i) the lack of requirements to file individual audited public financial statements, (ii) the lack of need for an internal, long-term budget to perform the daily operations of a particular asset, or (iii) the absence of any external sources of projections and consulting studies. Generally, those assets that are associated with debt-issuing entities (e.g., New Jersey Turnpike Authority, South Jersey Transportation Authority, etc.) have more detailed, independent material available as it has been a requirement of their prior bond offerings and trust documents. For Assets that are not independently held or accounted for (e.g., individual lanes of highway or technology associated with assets), it is generally more difficult to obtain sufficiently detailed information.

The data deficiencies for Assets considered to be favorable for evaluation were noted to the State. A major element of the Phase 2 work scope would be assembling such material to enable analysis to proceed.

SECTION 6

Methodologies to Estimate Asset Value Drivers

Methodologies to Estimate Asset Value Drivers

Introduction

As discussed herein, several alternative structures can be considered for each of the Assets under review. One of the factors used to evaluate the structure of PPP for a particular asset is an estimation of the range of values and drivers of value for the Asset, and how such range and drivers of value would be affected by the structure. For PPPs via (i) a Lease, (ii) a trade sale, or (iii) an IPO, estimates of the range and drivers of asset values can be calculated using the analytical approaches discussed in detail below. Among these three methods, depending on the terms, a trade sale would typically be expected to garner the highest range of estimated values, followed by a Lease agreement, and an IPO, respectively. The relatively higher values typically associated with a trade sale reflect the incremental value associated with the permanent transfer of ownership of the asset, whereas the relatively lower values associated with an IPO reflect the need to provide investors with an IPO discount which reflects the unproven state of the asset as a publicly owned operation.

With regard to generating value via the other three structures (i.e., (i) operating lease arrangement or service/management contract, (ii) availability/shadow payment and (iii) not-for-dividend company), the economic arrangements between the State and a third party would be sufficiently complex and case-specific, that further definition of specific terms and conditions needs to be accomplished before estimated ranges of value and drivers of value for an asset can reasonably be determined. In addition, an analysis of the Public Authority Model (Status Quo) must be individualized to reflect each Asset's relevant bond documentation.

A complete analysis consists not only of estimating a range of values for the assets, but must include assessing the factors that affect such estimates of value (i.e., the drivers of value). Accordingly, for each of the methodologies discussed below, sensitivity analyses are conducted. Several scenarios are typically evaluated in order to isolate the effects on value of changing individual assumptions on a *ceteris paribus* basis.

Methodologies Used to Estimate the Drivers and Range of Asset Values. The methodologies that can be used by investors to estimate the drivers and range of values for the Assets under consideration include (i) the discounted cash flow ("DCF") analysis, (ii) the internal-rate-of-return ("IRR") analysis, and (iii) the multiples ("Multiples") analysis. Each of these methodologies and their validity in estimating the drivers and range of value of the assets being considered is described below.

DCF Analysis

The DCF analysis is a commonly used analysis by investors to estimate the drivers and range of value of the Assets under consideration given the nature of the cash flows generated by these Assets. For the most part, the cash flows (i) are predictable, (ii) may vary greatly from year to year (e.g., because of large capital expenditures in a given year), and (iii) may be finite (e.g., the length of the Lease period).

- Methodology:
  - periodic cash flows that the asset generates on an un-levered basis ("Free Cash Flows") (i.e., cash flows before the expenses and tax effects of any interest on debt or dividend payments to equity investors) are projected for a period of time (e.g., the concession period)
  - the Free Cash Flows are then discounted to the present at a discount rate that takes into account (i) the time value of money, (ii) the risk associated with the asset's Free Cash Flows, and (iii) the capital structure of the asset (i.e., the mix of debt and equity used to finance the asset)
  - the output of the DCF analysis is an estimated value for the asset for a given set of Free Cash Flows. To account for the different perspectives that investors may have on the underlying assumptions about the Free Cash Flows and the discount rate, assumptions are varied to establish a range of estimated values of the asset

IRR Analysis

Similar to the DCF analysis, the IRR analysis is a commonly used analysis by investors to estimate the range and drivers of value of the Assets under consideration given the nature of the cash flows generated by these Assets. In addition, when assets are financed using highly-leveraged capital structures, as would be the case for many of the Assets being considered, the IRR analysis is used.

- Methodology:
  - periodic dividends that the investor will receive from the asset and investments made in the asset by the investor are projected for a period of time
  - the output of the IRR analysis is an estimated rate of return, expressed as an annualized percentage rate, which is calculated based on the entire series of cash flows to and from the investor in connection with the asset. Such estimated rate of return is then compared to the investor's targeted rate of return and, to the extent that the estimated rate of return exceeds or falls short of the investor's targeted rate of return, the estimated value is increased or decreased accordingly
  - to account for the different perspectives that investors will have on the underlying assumptions about the dividends and investments in the asset and their targeted rate of return, the level of return is varied to establish a range of estimated values of the asset

Multiples Analysis

Multiples analysis is less commonly used by investors to estimate the range and drivers of value of infrastructure assets. The foremost challenge to the validity of multiples analysis lies in the difficulty in identifying the appropriate multiple to apply to estimate the asset's value. The unique characteristics (e.g., growth profiles, projected capital expenditure requirements, concession structures and terms) of most of the assets being considered make it inherently difficult to determine the appropriate multiples to estimate the value of the asset. As a result, investors generally place limited weight on the multiples analysis as a means of estimating asset values and value drivers.

- Methodology:
  - an important financial metric for the asset (e.g., the last twelve months of earnings before interest, taxes, depreciation and amortization) is identified
  - a multiple, representing the ratio of an asset's estimated value to the financial metric, is determined. The multiple is often estimated by observing the multiples of comparable publicly-traded companies (i.e., assets in similar lines of business) to the asset being valued. Similarly, the appropriate multiples can be estimated by observing the multiples derived from the price paid for an asset comparable to the asset being valued
  - once the appropriate multiple is determined, it is multiplied by the asset's financial metric to determine an estimate of the asset's value. To account for the different perspectives that investors will have on what the appropriate multiple should be, multiples are varied to establish a range of estimated values of the asset

Work Performed

As indicated above, the DCF and the IRR methodologies are the most commonly used by investors to estimate the range and drivers of value of the Assets under consideration. As such, the Project Team has begun to construct comprehensive financial models for each Asset under consideration to approximate the type of analysis that would be performed by potential investors.

Modeling Inputs. These financial models are extremely complex and require a vast number of inputs for the various scenarios contemplated. UBS spent a significant amount of time with the State's representatives collecting and reviewing operational, technical and legal documents from the State and the Authorities in order to derive the inputs for the models. Some of these inputs are supported directly by documentation, while others are estimated by the State's representatives based on the documentation provided. In order to better delineate values, these estimated inputs should be generated by independent industry experts. UBS would expect that this would be a major focus of Phase 2.

Isolating Value Drivers. The models enable the efficient examination of multiple combinations of inputs and financing structures for a single asset. Perhaps more importantly for the State, they also enable the isolation of individual drivers of value.

UBS has tested some of the value-drivers associated with the Assets under consideration. UBS has focused mainly on those drivers under the State's control, such as price increases and timing, labor expenses, maintenance requirements, asset usage, competing and complementary facilities, and capital expenditure timing and size. UBS has also considered, to a lesser extent, global drivers outside of the State's control (e.g., inflation, economic growth, etc.).

Methodologies to Estimate Asset Value Drivers

Based on the limitations regarding availability of information on the Assets considered, UBS has run preliminary sensitivities for certain Assets only. The preliminary results of this analysis indicate:

- Changes in user fees and the timing of such changes are critical value drivers
- Expenses, in particular labor, have a significant impact on value
- While the Lease length is critical to a private entity's tax position, after a critical point further increases in length have limited value
- The required level and timing of maintenance or capital reinvestment in facilities are major drivers of value
- Market share is a significant value driver
- Changes in Lottery stakes and frequency of draws for existing products would have an impact on Lottery value
- Optimization of payout ratio and determining the right balance between prize payout and player participation would impact Lottery results
- Introduction of new games, such as Keno, can provide significant incremental value to Lottery
- Changes in the number of enplanements and operating margins may have a significant impact on airport value

What is clear from the analysis is that numerous core value drivers for these Assets are within the State's control. An important part of Phase 2 will be for the State to further evaluate and set parameters for each of these drivers to gauge market reactions. The total value of the State's Program will be heavily influenced by decisions on pricing and regulation that the State will be required to make before it executes a transaction on any Assets.

SECTION 7

Use of Proceeds

Use of Proceeds

UBS has developed a framework to evaluate the highest and best use of any upfront proceeds the State receives from a transaction. Consistent with the goals of the Program, UBS is prepared to evaluate defeasance alternatives for existing State tax-supported debt to provide for the maximum reduction in the State's debt service burden. Such debt reduction will provide the opportunity for increased flexibility in the operating budget due to the reduction in the amount of debt service which crowds out other state funding requirements. Transaction proceeds can also be used to fund capital programs, thus reducing the amount of new State debt required, including the School Facilities Construction Program (a large portion of which is still subject to legislative review and approval) and the Transportation Trust Fund capital program.

Optimization Analysis and Decision Framework

UBS's recommendations on the optimal use of proceeds will begin with a quantitative analysis. UBS has developed a model to provide a financially optimized solution for defeasing the State's tax-supported debt, given an amount of net proceeds (cash available) and a set of objectives and constraints determined by the State. This model, which includes proprietary linear-optimization financial technology, produces a financially optimized solution for defeasing State tax-supported debt given a wide range of qualitative and quantitative constraints.

Once an optimized type and amount of debt is selected for defeasance, an internal rate of return ("IRR") for the defeased debt is calculated. The IRR of the debt defeasance would be compared to the cost of new money borrowing that generates the same proceeds and debt service structure. This calculation identifies the "avoided cost" associated with using the net proceeds on a pay-as-you-go basis for capital projects of the State. If the IRR of the defeased debt is greater than the avoided cost of funding capital projects with cash, the debt defeasance option would be financially advantageous.

Beyond the basic framework and quantitative analysis, there are additional considerations relevant to the decision around use of net proceeds. Utilizing proceeds to invest in publicly supported projects may create more public, legislative and other stakeholder support for the PPP program. There may also be opportunities to generate significant savings for the State by avoiding payments to the U.S. Treasury that would otherwise be required. These payments may be avoided by applying net transaction proceeds to tax-exempt projects of the State.

SECTION 8

Market Conditions and Investor Review

Market Conditions/Investor Review

Demand in The Market

The demand for U.S. infrastructure assets is currently very strong due to a powerful combination of:

- Strong global liquidity and robust mergers and acquisitions ("M&A") activity fostered by:
  - favorable economic conditions
  - relatively low global interest rates
- Increasing interest in public infrastructure in general due to:
  - the attractive, low risk characteristics of infrastructure assets
  - growth of U.S., European, Australian, and Canadian pension funds seeking assets that generate stable and recurring cash flows over a long period of time consistent with the liabilities of the pension funds to their pensioners
  - the willingness of debt providers to provide acquirers with very favorable financing terms
  - investor interest in equity securities that pay dividends
- Increasing interest in U.S. public infrastructure in particular, as state and local governments show a willingness to explore PPP alternatives and investors seek opportunities in new asset classes
  - the desire of international investors to leverage their global infrastructure experience to enter the U.S. sector with creative approaches for optimizing value from infrastructure assets
  - the relative decline in opportunities around the world, particularly in Europe and Australia, where many of the most attractive infrastructure assets have already been privatized
  - the lower risk profile of the U.S. economy compared to that of developing countries
  - the potential for a clear and transparent regulatory framework and the ability to enforce it
  - advantageous U.S. tax treatment on dividends
  - weak dollar

All of these factors have resulted in meaningful capital flows targeting the sector, and have favorable implications for the Program.

A robust M&A market related to infrastructure investments not only is a strong indicator of the interest in this sector but has also allowed for the reorganization of capital investments and increased demand from traditional purchasers. The healthy volume and large size of recent global infrastructure M&A transactions underscores the strength of current investor interest in the sector and the willingness of capital providers to underwrite significant sector investments. As a result of strong investor demand, the last three years have seen an increasingly active M&A market for infrastructure. Selected major transactions are set forth in the table below:

Target	Acquirer	Sector	Date	Value (mm)
Autostrade	Abertis	Road	Pending	€46,000
Indiana Toll Road	Cintra/Macquarie	Road	2006	U.S.$3,850
Pocahantas Parkway	Transurban	Road	2006	U.S.$611
BAA plc	Ferrovial	Airport	2006	£15,900
Carpark	Q-Park	Car Park	2006	SEK 3,000
Kowloon Canton Railway Corporation	MTR Corporation	Rail	2006	HK$56,500
PD Ports	BBI	Ports	2006	U.S.$989
North Western	BBI	Ports	2006	U.S.$2,267
Chicago Skyway	Cintra/Macquarie	Road	2005	U.S.$1,920
Dulles Greenway	Macquarie	Road	2005	U.S.$617
ASF	Vinci	Road	2005	€19,000
Sanef	Abertis-led Consortium	Road	2005	€9,000
APRR	Eiffage-Macquarie Consortium	Road	2005	€16,300
NCP	3i	Car Park	2005	£555
Budapest Airport	BAA plc	Airport	2005	£1,255
Copenhagen Airport	Macquarie Airports	Airport	2005	U.S.$1,755
IEG	BBI	Ports	2005	U.S.$450
TBI	Abertis	Airport	2004	€800

Source: Press releases, investor presentations

Equity Capital

The current market for equity investment in infrastructure is strong, with a wide range of interested investors and strong competition for a relatively limited supply of attractive assets, which have forced equity returns to relatively lower levels than have been seen historically. This demand stems from several sources, as outlined below.

UBS expects that equity investor interest in the Assets will come principally from three broad categories of investors: strategic buyers (industry), financial sponsors and infrastructure funds. Depending on the asset, there may also be listed/public equity investor interest (i.e., directly through an IPO, or indirectly through investment in Assets purchased by a publicly-listed infrastructure fund). Key considerations for each of these investor categories are set forth below:

- **Strategic buyers (industry)**—Traditionally operators, developers or constructors in the infrastructure sector
  - appetite varies by asset class and deal structure; transportation infrastructure is seeing keen interest from toll road operators and construction/concession companies
  - typically look for long-term investments
  - often benefit from sector operational expertise, which can enhance the value of their bids
  - can become very aggressive bidders; increasingly competitive cost of capital
  - typically bid alone or as a majority party in a consortium
- **Financial sponsors**—Private equity funds with shorter term exit strategies
  - attracted by assets with high barriers to entry, strong cash generation and growth opportunities
  - typically look for short term investments (3-5 year) with a clear exit strategy
  - high equity return requirements (i.e., 20%+) may limit ability to bid competitively but have been present in certain opportunities
  - typically look to take part in a consortium
- **Infrastructure funds**—Private or listed equity funds with a targeted market sector and longer term strategy
  - attracted by assets with long-term contracted revenue base, stable earnings and cash flows; preference is for transport and utility infrastructure
  - typically look for long-term investments
  - lower equity return requirements (i.e., 10–15%) than for financial sponsors
  - ability to "recycle" equity capital by selling assets or equity stakes to new fund vehicles at higher future valuations based on improved operating performance
  - typically look to take part in a consortium
- **Listed/public equity investors**—Public market institutional and/or retail investors
  - attracted to infrastructure companies offering a combination of current income and capital appreciation
  - lower total return requirement than for financial sponsors
  - will require some discount to full value at the initial public offering ("IPO discount")
  - require the liquidity of a publicly-traded investment vehicle
  - potentially short hold period, which can result in share price volatility

Equity committed to infrastructure funds worldwide is estimated to be at least $85 billion[1]. Following the example of numerous successful European, Canadian and Australian infrastructure funds, many U.S. institutions in the last 18 months have launched their own infrastructure investment funds. Some examples include:

Institution	Fund Size ($mm)
GE & Credit Suisse First Boston	1,000
Goldman Sachs	3,000
Carlyle Infrastructure Group	1,000

Source: Factiva

In recent months, infrastructure investors have sought to increase their capacity to effect acquisitions by "recycling" equity capital. The overall effect of "recycling" equity capital, if viewed by investors as fair, is to increase the quantity and velocity of acquisition transactions and liquidity, which could have a favorable impact on any State transaction.

Debt Capital

The majority of the acquisition price for most infrastructure assets or concessions will be funded with debt. The current environment for debt capital to support investment in infrastructure assets is extremely favorable. As evidenced by successful recent long-term concession transactions for Chicago Skyway and the Indiana Toll Road, the bank and bond markets are willing to provide substantial debt capital on aggressive terms. It is clear that both domestic and foreign banks have shown a growing interest in importing many of the innovative financing structures developed in recent years for infrastructure transactions in Europe, Australia, and Canada.

An increasing number of debt providers are competing against each other to finance these projects, which is driving innovation and aggressive lending terms. This strong demand from the financial markets has led to increasingly sophisticated financing structures drawing from corporate, project and structured finance solutions. Recent financial product offerings have the potential to lower investors' overall cost of capital and, in turn, drive higher asset valuations. Some of the terms seen recently include:

- Higher overall leverage
- Longer tenors
- Lower debt service coverage ratio requirements
- Higher proportions of non-amortizing debt
- Enhancements like accreting interest rate swaps aimed at creating the economic effect of capital appreciation bonds (i.e., those with deferred payment of interest)

Note:

1 Source: Venture Economics, Private Equity Intelligence and UBS Private Funds Group

Both ratings agencies and debt providers are becoming increasingly comfortable with the analytical framework required to rate and underwrite loans/bonds for various infrastructure asset classes, including toll roads in particular. Their primary focus in assessing these transactions includes:

- The specific cash flow characteristics of the assets
- The strength of the overall business and its prospects
- The credibility of its projections
- The strength of the structural provisions aimed at protecting lenders and bondholders
- The track record of the management team and investors with similar transactions

Even with these more innovative and aggressive lending structures, the monoline bond insurers have maintained a presence in these transactions. Investors and lenders alike are gaining comfort through the willingness of monoline insurers to insure the repayment of principal and interest on debt associated with Infrastructure projects.

Together these factors are bringing down the cost of debt capital to support infrastructure investment.

An additional source of debt capital to support the Public Authority Model can be found in the municipal high yield market. During the past several years, high yield municipal bond funds have seen explosive growth. While the high yield segment currently represents only about 5% of the $2.1 trillion municipal market, high yield funds have seen inflows during the first three quarters of 2006 representing nearly 50% of the inflows in the entire municipal market ($6.6 billion vs. $13.4 billion). The gravitation to municipal high yield issues has been largely driven by the prevailing desire by investors to capture higher yields than those available from traditional municipal bonds. This overabundance of demand, coupled with a general lack of supply, provides a significant opportunity to potential high yield issuers. Investors have become increasingly flexible with regard to the term of the debt (up to 30 years and potentially beyond), the amortization requirements and the related bond covenants. Above all else, the imbalance between supply and demand has resulted in historically low spreads between high yield bonds and highly rated bonds, providing the opportunity to borrow at extremely attractive yields.

Implications of Current Market Capacity

The high level of equity allocated for investment in infrastructure and the favorable debt market terms available have combined to drive strong recent transaction results. Recent infrastructure transactions have seen overall leverage at near-double digit debt-to-EBITDA multiples or higher, depending on the asset class. For long-term toll road concessions, there are examples of debt-to-EBITDA multiples in excess of 30x at transaction inception (e.g., Chicago Skyway and Indiana Toll Road).

The implications of the current debt and equity market capacity for the State of New Jersey are positive:

- Increasingly large deals are being successfully executed
- Investors and lenders are willing to provide structures that will increase the value paid for the assets, while allowing an acceptable return for the investors

- Equity returns are competitive, and some investors have shown willingness to compress their bid-level equity returns with the hope of recouping some of this over time through refinancing and restructuring fees
- Strong competition among banks and between the bank markets and the bond markets translates into lower cost financing and higher valuation

All of these factors, combined with the scarcity of assets coming to the market (as discussed below), suggest that there is a strong market appetite for many of the Assets considered and potential for relatively robust valuations in properly structured PPP scenarios.

Competing Supply

The State has an unparalleled opportunity to capitalize on robust market conditions and on the attractiveness of its infrastructure assets to launch a highly successful program. Being the first state to implement a comprehensive Program across multiple asset classes will benefit the State as the competing supply of mature, revenue-generating assets is expected to be relatively limited in the near term. Key differentiating factors of the Program include:

- The strong cash flow and growth potential of certain Assets, underpinned by
  - a stable local economy, including second among all states in median household income
  - the highest population density
  - location near and among major East Coast population centers
- The broad range of asset classes that could feasibly generate excess value through PPP transactions

As a result, the State's Assets have the strong potential to attract the attention of investors and lenders globally, which enhances the prospects for realizing strong valuations.

While relatively few infrastructure assets have been privatized in the U.S., the impending increase in the number and size of the assets offered to the private sector must be considered. To date, twenty-six U.S. states have already passed PPP legislation.

Current estimates for North American concessions to be sold in the next few years approach $50 billion, with roads accounting for more than 80% of the pipeline, followed by bridges & tunnels (10%), healthcare (5%) and ports (3%). Discussions among state and local officials nationwide suggest that the actual number could be substantially higher than that, with some estimates at nearly double that amount. UBS has set forth in Appendix A the pipeline of projects currently expected to come to the market.

While this initial list of impending transactions may appear long, very few of the listed transactions are close to offerings and most represent greenfield (new construction) assets. The most well developed, active and aggressive program for implementing public-private partnerships in the U.S. is currently being implemented in Texas, with a focus on greenfield toll road development. Given the two-tiered nature of the current market, with existing/mature asset sales attracting a different investor audience from greenfield development concessions, UBS expects little if any loss of demand by targeted investors for the State's toll road assets to the Texas or other greenfield programs. Mature assets such as the State's toll road assets may attract interest from toll road operators, financial sponsors and infrastructure funds, while greenfield projects may be attractive also to construction and engineering firms.

There are several states currently exploring PPPs relating to their lottery systems. The State of Illinois conducted a public RFP for financial advisory services relating to its lottery in July-August 2006. Given extremely strong investor interest in lottery systems generally and the availability of capital to support such transactions, as well as the limited development of PPP programs in other States, UBS would not expect the potential near-term competing supply of lottery transactions to impede the State's ability to attract a favorable valuation for its lottery, should it determine to pursue a transaction for all or part of those Assets.

Airports represent another Asset Class that is generating increasing interest as a PPP candidate. The U.S. Federal Aviation Administration ("FAA") has approved a pilot program, permitting up to five U.S. airports to be sold or leased. Chicago Midway Airport has submitted an application to the FAA to be part of the program and has preliminarily had its application accepted by the FAA, which effectively reserves for Midway the only slot for a "hub" airport. Stewart International Airport in New York has already been privatized. Three other non-hub airports may be privatized under this program.

Transaction Size Limits

Investor appetite for the State's Assets will vary by Asset Class. UBS believes that the size of the Assets being considered by the State will not be a limiting factor in the current infrastructure market. Infrastructure assets are generally acquired through highly leveraged structures. By using highly leveraged structures, bidders are able to reduce their average weighted cost of capital, which results in higher purchase prices. UBS's experience suggests that debt:equity ratios are approaching 80:20, and even higher in certain cases.

Equity investment generally forms a relatively limited component of the acquisition price and there is currently very strong availability of equity funds in the market for these types of assets. For large projects or assets that may exceed the capacity of a single investor, it is common to form consortia or partnerships to split the equity investment. Other things being equal, relatively larger assets tend to attract greater interest than smaller assets since investors must make similar time commitments for the acquisition of either, and larger assets have the potential to make a more meaningful impact in their investment portfolios.

There are some Asset Classes that, by their nature, are small in size and will attract a more specialized audience. Examples include real estate development rights at transit stations, or naming rights. The viability of these Assets as PPP candidates, given their size, must be considered on a case-by-case basis.

Sector Interest

Different assets attract different investors

The State is considering Assets in a wide range of sectors. Each of these sectors has specific characteristics that will attract different investors. It is important to note that not all of the Assets considered by the State, even within the same Asset Class, will be equally perceived by investors. Some Assets will generate more interest from the private sector than others. The State should begin the Program with the most attractive Assets and follow up with the less attractive ones. The first transactions will be followed especially closely by the investor community. A successful first transaction will create momentum and increase the interest of investors for subsequent transactions. However, a negative first experience may hinder the interest of investors in the remaining processes. Prioritization of Assets will be key for the success of the Program.

The matrix in the following pages summarizes the investment profile and the expected investor interest in each of the Assets considered.

Market Conditions/Investor Review

	Tier 1 Assets				
	Atlantic City Expressway	Development Rights at NJ Transit Stations	Garden State Parkway [1]	New Jersey Lottery	New Jersey Turnpike [1]
Investment Profile					
Predictable earnings and cash flow	+++	–	+++	+++	+++
Potential for clear regulatory framework	+++	NA	+++	++	+++
Monopoly characteristics	+++	++	+++	+++	+++
Growth potential	++	++	+++	+++	+++
Low volatility	+++	++	+++	++	+++
Low correlation of returns compared to other asset classes	+++	+	+++	+	+++
Marketable asset size	++	+++	++	+++	++
Capital expenditures	++	+++	++	++	++
Potential for O&M enhancements	+++	NA	++	+	+++
Yield potential	++	NA	++	+++	+++
Expected Investor Interest					
Strategic/industry acquirers	+++	++	+++	+++	+++
Financial sponsors	++	+	++	+++	++
Listed/public equity investors	+++	+	+++	+++	+++
Infrastructure funds	+++	NA	+++	+++	+++
Bank debt providers	+++	++	+++	+++	+++
Debt capital markets	+++	++	+++	+++	+++

+++ Very Favorable ++ Favorable + Somewhat Favorable – Somewhat Unfavorable – – Unfavorable – – – Very Unfavorable

NA: Not Applicable

Note:

1 Included in NJ Turnpike Authority Assets which are not individually available without total NJ Turnpike Authority debt defeasance

The Process

A PPP process involves significant effort from investors as they dedicate substantial resources (economic, technical and human) in the preparation of their bids. Therefore, it is important for the State to develop a well orchestrated process which takes this into account and facilitates bid preparation. A well designed and executed PPP process that satisfies the demands from the investors will translate into higher valuations for the State and will be key for the overall success of the transaction.

In a PPP process, investors like:

- **Clear information on the process.** Investors want to know upfront the requirements and conditions of the process, deliverables, timeline and clear evaluation criteria
- **Clear information on the asset.** Investors want to have as much information as possible on the asset. This information should cover regulatory and operational aspects of the asset as well as major risks to be considered. The information should be clear, concise and consistent. Investors will price all the information available in their bids. Gaps in the information will result in lower bidding prices
- **Certainty.** Investors want consistency and stability on the condition and information available throughout the process. Changes in the rules of the process and in the information of the asset results in uncertainty and hence lower bids
- **Tailored process.** The process should, where possible, accommodate the characteristics of the different groups of buyers. For example, some infrastructure funds may need longer time for the due diligence than strategic buyers or financial sponsors

In anticipation of the substantial amount of work that will need to be done during the process, UBS recommends that the State begin as early as possible with the preparation of a comprehensive data room in order to have it fully available in advance of launching of the process.

SECTION 9

Study Results

Study Results

The scope of work for Phase 1 of the Program calls for a review of a broad range of Assets. It also requires an asset/liability study to be performed. Based on such analysis, the Project Team is to create a prioritization of candidates that would optimize the State's benefits from the Program. This Report documents and reviews the work done during Phase 1 in order to accomplish these tasks. The information below presents the results of such work. The Project Team provides the State with a preliminary prioritization of Assets. It is important to note several key points about this prioritization:

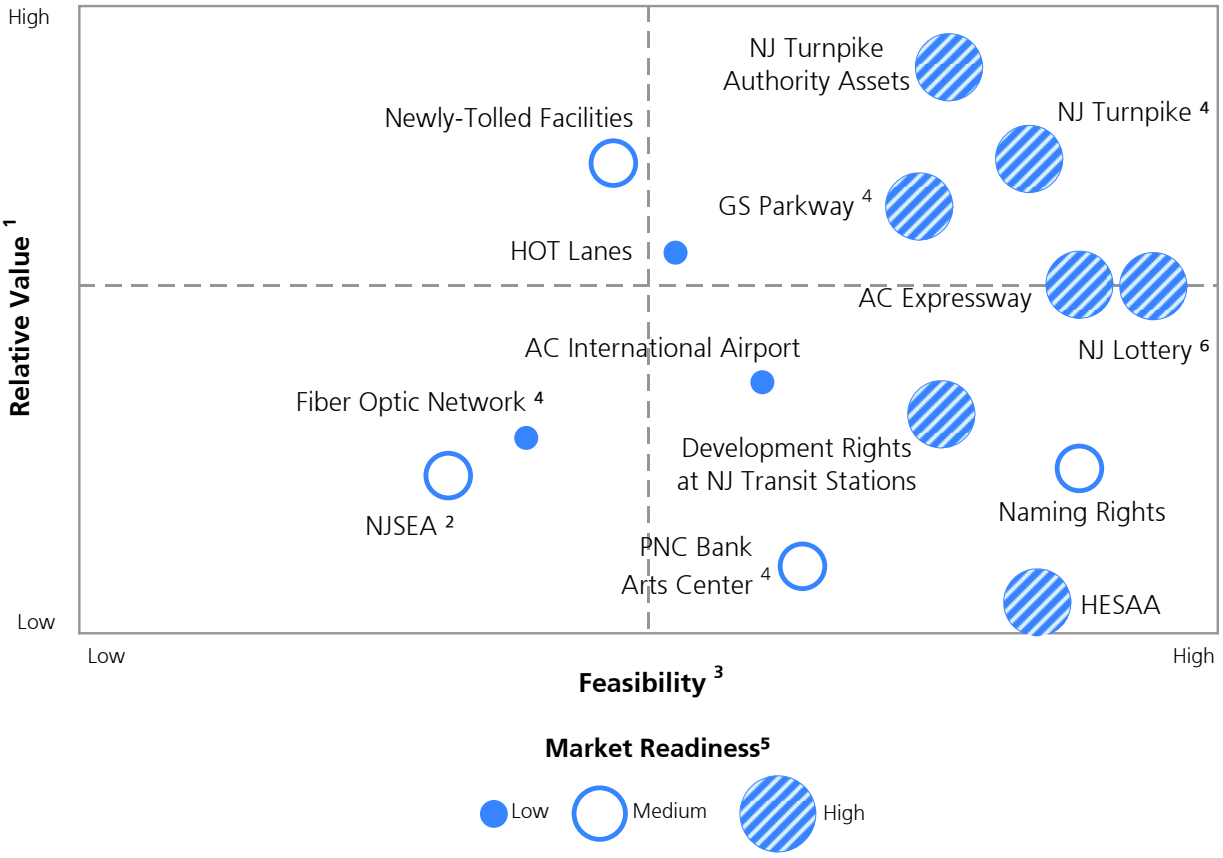
- No decision has been made as to the method of extracting excess value from an Asset, whether public or private, that will occur if the State determines to move forward
- The State has yet to make many important decisions regarding the value drivers of these Assets, and those decisions will have a meaningful impact on valuations
- A period of additional study and information gathering is necessary to position these projects to generate the maximum benefit for the State
- Although thorough analysis regarding efficient use of proceeds has been developed, no recommendations about use of proceeds are made

All of these activities will be components of Phase 2 of the Program, should the State determine to pursue Phase 2, which would be aimed at positioning the State to enter the PPP markets properly to achieve optimal results.

The final analysis of Assets for further investigation is summarized in the chart below. The chart indicates three critical features for each Asset considered.

- **Feasibility.** An Asset's distance along the horizontal axis represents its feasibility as a PPP candidate. Feasibility is meant to include a measure of the market acceptance for the asset, risk profile and lack of complexity. The further to the right on the horizontal axis, the higher the level of feasibility
- **Value.** The Asset's height on the vertical axis represents its relative value, net of any direct debt supported by the Asset's revenue stream
- **Market Readiness.** The size of the circle representing an Asset is intended to convey its readiness in terms of data availability, due diligence completion and lack of unresolved business/legal issues

Study Results



Notes:
1 Relative value net of any directly associated debt
2 Reflects a group of 7 venues
3 Indicates likelihood of completion; Includes Market Acceptance, Risk Profiles and Relative Lack of Complexity
4 Included in NJ Turnpike Authority Assets which are not individually available without total NJ Turnpike Authority debt defeasance
5 Bubble size indicates the level of market readiness for each Asset
6 Value is net of projected reductions to General Fund contributions

When reviewing the Assets for consideration, UBS first analyzes an Asset's **Feasibility**. The evaluation matrices, in Section 3 of this Report, help the Project Team to develop guidance on which Asset Classes merit further consideration. Then within each Asset Class, the Project Team reviews specific Assets to determine if any specific facts surrounding that Asset make it a better or worse candidate. The feasibility of an Asset is influenced by future decisions of the State as to scope, control, regulation, etc. Additionally, resolution of currently outstanding issues, such as the conclusion of negotiations on business contracts, can also affect the Feasibility. As PPP structures are reviewed for each Asset, the feasibility of implementation may shift.

Relative Value is assessed, if possible, based on the preliminary data evaluated during the due diligence sessions. Many important drivers of value, such as parameters surrounding pricing, risk allocation and asset scope are yet to be determined by the State. The Project Team's Phase 1 analysis therefore is highly theoretical and indicative of the relative stature of individual assets. As better data become available and the State resolves important issues such as risk profile and transaction structures to be adopted, these relative values may move significantly.

Market Readiness is an important characteristic for each Asset. The better the quality of information available, the more accurately an asset can be valued. If any Assets are offered to the private sector, the risk premium bidders charge in their offering price will be reduced (i.e., stronger prices) if accurate and complete information is made available during the bidding process. The accuracy of the determination of feasibility and value can be altered significantly by the State as more precise or up-to-date data become available. In Section 10, UBS makes recommendations on data collection and development.

Following the analyses and evaluations outlined in the prior sections, the Project Team segregates the pool of Assets into tiers based on recommended further action. These Tiers are:

- **Tier 1** – Assets having sound commercial viability; those likely to be the preferred candidates for a near-term transaction
  - Atlantic City Expressway
  - Development Rights at New Jersey Transit Stations
  - Garden State Parkway
  - New Jersey Lottery
  - New Jersey Turnpike
- **Tier 2** – Assets that appear promising but for which additional information is required before a more definitive assessment is made
  - Atlantic City International Airport
  - Fiber Optic Network
  - HOT Lanes
  - Naming Rights
  - Newly-Tolled Facilities
  - PNC Bank Arts Center
- **Tier 3** – Assets that are considered lower value candidates but that may benefit from private participation to reduce ongoing required State financial support and for which additional information is required
  - Light Rail Transit Lines
  - Newly–Tolled Facilities requiring extensive capital investment
- **Tier 4** – Assets that are not deemed suitable at this time but are candidates for later development or action
  - Assets of NJSEA
  - HESAA
  - NJ Water and Wastewater Authorities

Study Results

The goal of this portion of the analysis is to rank the potential Assets for further analysis and potential PPPs. Phase 1 accomplishes this ranking. At the conclusion of Phase 2, one or more Pathfinder Projects could be selected by the State from the Assets with the highest ranking in Phase 1. A Pathfinder Project is one of meaningful size that can be prepared for and brought to market relatively quickly, with significant market visibility and broad investor interest. This type of project will allow the State to establish its presence in the market with a successful first transaction, conveying to the market important information about the State's ability to run a successful process, the State's appetite for sharing or owning risk, its willingness and ability to complete a transaction, and its policy requirements for maintaining certain controls over infrastructure. Based on the above analysis, the Project Team recommends that the State review the Tier 1 Assets to determine one or more Pathfinder Projects. All of the Assets in Tier 1 are relatively feasible, valuable and ready. Individual Asset summaries are included in the following pages and provide further details on the status and viability of each of the Assets.

Conclusion

UBS has identified several Tier 1 Assets that could provide substantial current value to the State. In addition to these Assets, several Assets in Tier 2 have potentially significant values that can be calculated with some amount of additional information. The target Assets in Tier 1 and Tier 2 should move forward into Phase 2 for development.

Prior to considering any transactions involving these Assets, there is significant additional work to do. A portion of the work will be the responsibility of the State in terms of decision making on major policy issues. In particular the State must determine its position on the pricing, capital investment, operations and control of these Assets. In this Report, UBS identifies the top value drivers for the State to consider. Prior to a successful transaction involving any Asset, the State must provide and analyze additional information, prepare legislation, and make key policy decisions. The ground work has been done to analyze the financial implications of such policy decisions and the potential use of transaction proceeds. UBS recommends that the State proceed expeditiously into Phase 2 of the Program.

Atlantic City Expressway

Atlantic City Expressway is, in UBS's view, very attractive as a PPP candidate based upon the following considerations:

There is currently strong demand in the marketplace for toll-related assets. There is extensive information on the Expressway, due to its long operating history. The Asset would need updated and longer-term traffic and revenue and engineering studies to access the capital markets. Forecasts that are outdated could have a material impact on the value of the Asset. During a Phase 2 review of the Asset UBS would expect the following:

Issues for Consideration

- Toll rates are key to the maximization of revenues in this Asset. The level of tolls should be balanced against public policy considerations
- Transferring (subsidies are removed) ownership of the Expressway could potentially impact the Atlantic City International Airport
- Assignability of the EZ-Pass contract would need further investigation
- Potential environmental issues and concerns along the current right-of-way
- Management of existing work-force

Information Needed/Next Steps

- Engage a traffic and revenue consultant to project long-term traffic volumes for the Asset and determine appropriate toll elasticities on the road
- Policy decision is needed on the potential lessee's responsibilities towards existing unions, employees and employee benefits
- Consulting engineer's input is needed over the Asset's operating expenses
- The State will need to reach a policy decision regarding the required capital investments for a private sector participant. A consulting engineer's input is vital on estimates for the CapEx program. Further study is also needed on the cost of maintenance over a minimum 50 year horizon
- The State will need to establish the operating standards and safety requirements for the road, and implement a monitoring organization
- Investigate areas where the private sector could add value towards the operation and maintenance of the Asset

Development Rights at New Jersey Transit Stations

Development Rights at the Stations located along the NJ Transit's corridors are, in UBS's view, attractive as PPP candidates based upon the following considerations:

The high volume of foot traffic and regularity of the customer flow all argue for the valuable development of these locations.

NJ Transit has a developed program of seeking private and other municipal partners in the redevelopment of transit station neighborhoods. They have begun participation in several redevelopment projects at major stations. The State, in general, has complete and accurate information available. A program to unify the State's risk profile among projects and to maximize the innovation and investment in these areas may be appropriate.

Issues for Consideration

- Interaction with multiple local government bodies and private parties make these projects complex and often slow
- Interaction with Amtrak will be necessary at certain locations
- Non-comparable bids are frequently offered by developers
- Development impacts on surrounding areas will need to be reviewed
- Multiple opportunities with relatively smaller individual revenue potential

Information Needed/Next Steps

- Complete review of existing agreements related to current stations
- Review of zoning and other development restrictions in the area
- Integration of Transit Line development or changes with station development
- Separate valuations of Naming rights and Station development to determine optimal offering package

New Jersey Lottery

The State Lottery is, in UBS's view, extremely attractive as a PPP candidate based upon the following considerations:

The Lottery is a State-owned operation that is currently operated as an independent enterprise. UBS believes that a regulatory framework would have to be established prior to a transaction in order to provide the State with the requisite assurance that the Lottery would be operated under the highest standards. Upon the establishment of such a framework, UBS believes that the Lottery provides an asset that is in a good state of readiness with regard to a PPP.

UBS considers that the Lottery would be very well received by the marketplace. The strengths of the Lottery include, but are not limited to: (i) stand-alone, monopolistic operation, (ii) heavily product/service driven, (iii) innovation potential, (iv) long-term availability, (v) minimum social impact, and (vi) manageable size.

The Lottery is extremely sound from an economic perspective, with no debt and very strong cash flow generation coupled with favorable growth prospects.

The annual sales volume and consistent growth of the Lottery provide an opportunity for the State to capture significant value in the current market.

Issues for Consideration

- Social control issues relating to engaging in a PPP for a State-run lottery
- Potential resistance from Casino Industry
- Trade-off of annual net receipts from Lottery to the General Fund in return for upfront (one-time) transaction receipts

Information Needed/Next Steps

- Develop proper regulatory framework to adequately monitor the Lottery while not unduly impeding the operations and excessively impacting the value
- Develop legislation to address PPP opportunity
- Perform detailed market analysis to assess regional demographics and marketing opportunities

New Jersey Turnpike/Garden State Parkway

New Jersey Turnpike and Garden State Parkway are, in UBS's view, extremely attractive as PPP candidates based upon the following considerations:

Both the Turnpike and the Parkway have very attractive characteristics for potential PPPs: long operating history, well-diversified traffic base, position as critical links in the nation's highway system, and current demand in the marketplace for toll-related assets. The market has also proven its readiness for this type of asset. The Turnpike is particularly attractive given its relatively stronger commercial characteristics.

There is extensive information on the Turnpike and the Parkway, due to their long operating histories. However, because of the sheer volume of transactions and revenues generated by these Assets, forecasts that are outdated could have a material impact on the value of the Assets. UBS recommends updating all traffic and revenue information. During a Phase 2 review of these Assets UBS would expect the following:

Issues for Consideration

- Enhanced traffic and revenue forecasts over a minimum 50 year investment horizon; studies should include suggested level of toll increases, affordability levels and value of time
- Assignability of the EZ-Pass contract would need to be further investigated
- Review of each Asset's CapEx program over the 50-year period and establish a view on mandatory CapEx. The level of CapEx can have a material impact on the value of the Assets
- Potential environmental issues and concerns along the current right-of-way and facility
- Control of toll level is a policy issue that requires consideration and further discussion

Information Needed/Next Steps

- Engage a traffic and revenue consultant to project traffic volumes for both New Jersey Turnpike and Garden State Parkway; determine appropriate toll elasticities on both roads
- Policy decision is needed on the potential lessee's responsibilities towards existing unions, employees and employee benefits
- Consulting engineer's input is needed for each of the Asset's operating expenses
- The State will need to reach a policy decision regarding required capital projects for a private sector participant. A consulting engineer's input is vital on estimates for the CapEx program. Further study is also needed on the cost of maintenance over a minimum 50 year horizon
- The State will need to establish the operating standards and safety requirement for the roads and a monitoring organization
- Investigate ways in which the private sector could add value and reduce the operation and maintenance of each of the Assets

Atlantic City International Airport

Atlantic City International Airport is currently, in UBS's view, attractive as a PPP candidate based upon the following considerations:

Despite being a loss-generating airport and significantly subsidized, ACIA would be able to attract private sector interest given the strong demand for U.S. airports. ACIA could be the first footprint in the U.S. for international airport investors. In order to do so ACIA will require either (i) a significant turnaround under existing ownership prior to the transfer to the private sector or (ii) the development of new regulation that allows the private sector to introduce the operating measures needed to turn it around.

The market is very interested in airports as an Asset Class. Investors are looking for an entry point into the U.S. airport market. However, besides the issues described above, new regulation would need to be resolved ahead of a transaction for ACIA. The FAA has approved a pilot program permitting up to five U.S. airports to be sold or leased. Chicago Midway Airport has submitted an application to the FAA to be part of the program and has preliminarily had its application accepted by the FAA, which effectively reserves for Midway the only slot for a "hub" airport. Stewart International Airport in New York has already been privatized. Three other non-hub airports may be privatized under this program. ACIA would need to secure one of the remaining slots or await the conclusion of the pilot program.

The net value of ACIA is limited due to its small size and current operating losses. UBS does not expect the State to generate significant net proceeds from a PPP for it without a significant alteration in its business plan. However, UBS believes that further analysis is required to assess the full potential of ACIA under a private sector scenario.

Issues for Consideration

- Form of contracts with existing airlines
- Strong dependence on a single airline
- Ability to negotiate better terms with some stakeholders including airlines, personnel and firefighters
- Ability to operate the airport on a for-profit basis
- Regulatory framework for airport public-private partnerships
- Potential split from other South Jersey Transportation Authority Assets

Information Needed/Next Steps

- Independent feasibility/market study from airport consultants
- Participate in, or track developments of, the FAA pilot program

Fiber Optic Network

The Fiber Optic Network is, in UBS's view, potentially attractive as a PPP candidate based upon the following considerations:

The M&A environment for fiber optic assets has been robust and the current market presents an excellent opportunity for PPP. UBS understands the State's Fiber Optic Network is comprised of two network rings running the length of the Garden State Parkway, the New Jersey State Turnpike, and the Atlantic City Expressway. The State network spans over 440 fiber route miles, including 360 miles of CWDM (course wave division multiplexing) for the local bus network ring and 440 miles of DWDM (dense wave division multiplexing) for the long haul backbone ring.

Issues for Consideration

- The State's network contains multiple systems and equipment types and includes some non-typical fiber counts in parts of the network. The number of prospective buyers may therefore be limited
- Incremental investment would be required to meet NEBS compliance standards
- A number of other fiber optic networks may be for sale in the near term
- There are at least two other providers owning fiber-optic network facilities in the State: Verizon (Bell Atlantic) and AboveNet. Other telecom providers (PPP Telecom, NEON, Level 3, XO Communications, Broadwing) have similar footprints running along the same routes

Information Needed/Next Steps

- Confirm ownership structure of the State's fiber network facilities and sale/transfer authorization
- Gather additional technical details about competing networks
- Develop contract framework to optimize use of existing/available network capacity
- Identify existing customer base/current network usage, determine the total number of on-net buildings connected to the State's fiber optic network; perform detailed market analysis to assess demographic and marketing opportunities
- Gather additional detail regarding the network's operating revenues/costs and CapEx requirements
- Determine post-transaction relationship between the State and an acquirer; key issues include whether the buyer has the ability to monitor, maintain, repair, extend, and expand the network and determine when/how it is accessed/directed

HOT Lanes[1]

HOT Lanes are, in UBS's view, very attractive as PPP candidates based upon the following considerations:

HOT Lanes are very attractive Assets based on strong market readiness to fund these Assets, their demonstrated market feasibility and positive prospects in achieving net value to the State. The State currently does not have adequate traffic and revenue information to value these Assets.

Recent Federal legislation allows for the tolling of interstate highways under several programs of (i) Value Pricing Program – applies to projects that employ congestion pricing methodologies (i.e., imposing a toll on a HOV lane to convert it to an HOT lane) and (ii) Express Lane Program – and permits tolling of Interstates to add Interstate lanes to reduce congestion (HOT lanes, or express lanes). The Value Pricing Program and the Express Lanes Program present themselves as possible options for the State simultaneously to manage and reduce congestion while generating incremental road revenues. These programs could also be attractive because the State already owns the right-of-way for several selected projects and could set up an electronic tolling system within these right-of-ways. The State could also apply a variable tolling regime approach to manage road congestion by raising tolls at peak commuting hours.

Issues for Consideration

- Socio-political issues (including political resistance) introducing higher tolling rates in existing roads currently tolled
- CapEx program may be sizeable (capital intensive), as certain roads may require additional lanes (possibly more that 1 per direction)
- Lane widening would require additional land (permitting issues; acquisition)
- Requires thorough maintenance program and coordination with the operator of the entire road to eliminate any disruption to the traffic flow
- The involvement of a private developer/operator of HOT lanes would require an open tender
- The State would need to consider appropriate and suitable tolling rates that would "decongest" the roads
- Tolling technology and enforcement need careful consideration and management
- Tolling of these roads could potentially create congestion on the surrounding local and regional road network as motorists may use non-toll alternatives

Information Needed/Next Steps

- Extensive and comprehensive traffic and revenue studies on demand analysis. Perform impact analysis on the surrounding roads and competing transportation alternatives. Assess the maintenance requirements on those roads
- Analyze the legal requirements that permit the implementation of HOT and EXPRESS lanes by the State and/or the prospects of transferring such tolling rights to the private sector
- Technical advisors are needed to study, review and analyze the necessary CapEx required and related construction parameters (construction schedules; timetables; process)
- Review and study technology options suitable for HOT lane projects
- Review any policy decisions associated with the application of HOT lanes

Note:

1 High occupancy/toll ("HOT" Lanes)—a user may pay a toll to use the lane if they are not in a high occupancy (greater than two people) vehicle

Naming Rights

The selling of naming rights/sponsorship opportunities are, in UBS's view, attractive as PPP candidates based upon the following considerations:

In general, the State has a vast inventory of Assets under consideration for naming rights/sponsorship opportunities. A large number of these Assets appear to be readily available to be marketed to potential bidders.

To date, naming rights agreements have been most prevalent in the area of sports and entertainment venues, a market which has matured over the past 20 years. Recently, state and local governments and authorities have begun looking at naming rights arrangements for some of the Assets being considered by the State. UBS believes that the market will be very receptive to the inventory identified by the State.

Given the sheer volume and the diverse nature of the Assets under consideration, the market value of these opportunities will need to be investigated further pending the results of market studies and the development of a full marketing plan.

Issues for Consideration

- Policy issues relating to sale of naming rights/sponsorships for publicly-owned Assets
- Public reaction to commercialization
- Public reaction to potentially renaming facilities previously named by the State
- Legislative considerations

Information Needed/Next Steps

- Complete a detailed inventory of available Assets
- Retention of a marketing consultant to evaluate the values of various Assets
- Development of a marketing strategy specific to each Asset
- Optimize revenues through the customization of packages (term, scope)

Newly–Tolled Facilities

Newly–Tolled Facilities are, in UBS's view, attractive as PPP candidates based upon the following considerations:

Highways offer a potential opportunity for the State DOT to raise significant Title 23[1] capital. However, UBS notes that information is limited on these Assets, requiring additional study.

Recent Federal legislation allows for the tolling of interstate highways under several programs including the Interstate Toll Pilot Program, Reconstruction and Rehabilitation Pilot Program and the Construction Toll Pilot Program. These programs allow the State to apply and collect tolls on an Interstate Facility for reconstruction or rehabilitation if it can demonstrate that the road could not be adequately maintained or improved without the collection of tolls in order to fund the expansion and construction of new ones.

A very simplified analysis shows that at rates similar to those on other toll facilities in the State, significant capital could be generated.

Issues for Consideration

- Socio-political issues (including political resistance) in converting free-ways into tolled roads
- CapEx program may be sizeable, as road users would expect these Interstate roads to be tolled to be safe, reliable and provide quality service (with good maintenance)
- The State would have to set up a new public entity to collect tolls and manage the roads; unless it plans to have private operators perform this duty. Regardless a public entity would have to monitor public safety, maintenance and contract compliance
- Enforcement issues associated with electronic tolling should be analyzed
- Cash toll booths on interchanges would require additional land and costs (permitting issues, timing, etc.)
- Tolling of these roads could potentially create congestion on the surrounding local and regional road network as motorists may use non-toll alternatives

Information Needed/Next Steps

- Traffic and revenue consultant to evaluate the impact of tolling previously free roads. Analysis of the value of time and driving habits in the road. Analysis and review of the competing routes
- A technical advisor or engineering consultant to study design options and prepare construction cost estimates for electronic tolling equipment and maintenance and CapEx requirements
- Analyze and address any state and federal legal requirements to be able to apply such tolling

Note:

1 Title 23 is the section of the U.S. Code governing the Federal funding and operation of interstate highways, state highways, bridges, toll roads and other roadway facilities

PNC Bank Arts Center

The PNC Bank Arts Center is, in UBS's view, attractive as a PPP candidate based upon the following considerations:

The Arts Center is currently leased to a private operator through 2017 evidencing commercial attractiveness to this Asset via the existing private sector participation arrangements, but deterring any current transaction.

As the facility is already leased to a private operator, there is a proven business model in existence. Offering the facility under a longer term lease may establish incremental commercial value in the Asset, including the transfer of any tax benefits to the private operator. However, since the current lease runs through 2017, this Asset would be a longer term consideration.

Issues for Consideration

- Can the current lease be amended with additional term, modified and/or terminated?
- The facility is currently named pursuant to a separate naming agreement with PNC Bank
- Position of the existing operator vis-à-vis a different type of a commercial arrangement that would add incremental value to the State
- Further development potential cannot be converted into upfront cash payable to the State. Potential has no "real estate" development characteristics

Information Needed/Next Steps

- The facility is currently named pursuant to a separate naming agreement with PNC Bank; a review of provisions of the agreement is necessary
- Review legal rights of the State over the Arts Center. Can this Asset be sold and if yes, investigate the market value – procure appropriate appraisers
- Examine and investigate merit of expanding the Arts Center (land rights and potential for additional development)
- Review the operational aspects of the Arts Center

New Jersey Sports and Exposition Authority

The Assets of the NJSEA are, in UBS's view, modestly unattractive as PPP candidates based upon the following considerations:

The Assets of the NJSEA are in various stages of contractual obligation. Each Asset has a significant amount of debt associated with it in addition to various other potential impediments to a PPP process.

In general, because of their stand-alone nature, the majority of the NJSEA's Assets would lend themselves to a possible PPP opportunity. However, the age of the facilities, various existing contractual obligations, pending agreements and/or ongoing subsidies associated with the Assets all provide potential impediments at this time. From an economic perspective, these Assets have a significant amount of debt; many have minimal or negative operating cash flow and limited growth potential.

While further information and projections related to each independent Asset would have to be analyzed, the combination of outstanding debt, existing contractual arrangements and other ancillary issues lead UBS to believe that there is not an opportunity to garner significant net value at this time from these Assets.

Issues for Consideration

- Ability and cost associated with breaking existing agreements
- Legal and policy implications of continued subsidy of privately owned/operated asset
- Historic "story" nature of specific Assets; change of use consideration on tax-exempt debt
- Value of underlying real estate

Information Needed/Next Steps

- Detailed operating history and forecasts of individual Assets
- Independent feasibility/market study to confirm projections and identify market opportunities
- Copies of all contractual agreements and other agreements relating to the facilities
- Engineer's report relating to remaining expected life of Assets and necessary capital repair and replacement

New Jersey Higher Education Student Assistance Authority

The HESAA 1998 Trust Estate Loan Portfolio is, in UBS's view, unattractive as a PPP candidate based upon the following considerations:

The HESAA's Assets are predominately student loans, both non-federally guaranteed, unsecured consumer loans (supplemental loans) and federally guaranteed as to principal and interest (FFELP) loans. Information necessary to ready the loan portfolio for sale is readily available or easily accessible.

The HESAA's 1998 Trust Estate currently contains over $ 1.07 billion or 80% of HESAA's total portfolio of loans including 85% supplemental (non-federally guaranteed) loans and 15% FFELP (federally guaranteed) loans. This successful commercial loan portfolio would draw significant interest from banks and finance companies.

To a potential for-profit purchaser, the HESAA's 1998 Trust Estate loan portfolio is currently worth less than 100 cents on the dollar. The estimated gross proceeds from a sale would fall short of the cost of defeasing the existing debt after netting available deposits in Debt Service Reserve and Revenue Funds and taking into account the cost associated with optional call premiums and unwinding existing derivative transactions.

Issues for Consideration

- HESAA's loan portfolio is valued at a discount to par due to the taxable funding cost and required return on assets of for-profit purchasers
- HESAA's supplemental loans require custom tailored servicing systems, depressing the purchase price a potential buyer would be willing to pay for the Assets
- Currently, HESAA income from servicing supports grant and scholarship programs without annual State budgetary support

Information Needed/Next Steps

- Financial Statements of the HESAA for fiscal year 2006
- Updated portfolio data from HESAA with regard to the supplemental loans and from HESAA's two outside servicers with regard to FFELP Loans
- Arbitrage calculations related to the loans and the associated debt to be provided by outside consultant

New Jersey Water and Wastewater Authorities[1]

The New Jersey Water and Wastewater Assets, in UBS's view, are unattractive PPP candidates, based upon the following considerations:

The New Jersey Water and Wastewater Assets are managed by different government entities at operating margins that are well below those of comparable investor-owned utilities. The differing aged facilities already have significant debt outstanding and may require significant capital expenditures to ensure safety and reliability. Consequently, it appears that meaningful rate increases would be required to allow equity investors to achieve threshold equity returns. Also, the information available to date is inconsistent across the assets, with different accounting standards applied and non-comparable financial reports.

In general, as stand-alone candidates, the Assets are unattractive due to their small size and potential capital needs. However, the wide dispersion of Assets and different scale of Assets also suggest that the potential synergies associated with system-wide management will be difficult to achieve. There will likely be a limited class of investors that desire such a conglomeration of Assets.

While further information and more robust projections related to each Asset would have to be analyzed, it appears from currently available data that the high level of operating synergies and capital expenditures needed to bring the Assets to parity with investor-owned peers would imply a lower valuation than the current debt outstanding and/or significant rate increases.

Issues for Consideration

- Deviations in accounting standards among water and sewerage systems limit the integrity of a system-wide valuation
- Potentially high costs associated with breaking existing agreements–as Assets funded by federal grants may need to pay a portion back
- Alternative Asset use considerations include the ability to consolidate and/or interconnect Assets to achieve economies of scale and scope as well as enhanced reliability
- Water and sewerage assets are among the most capital-intensive regulated industry, consequently it is essential to understand system maintenance requirements
- Regulatory framework related to allowing for timely return on and of capital will impact the likely buyer pool and system-wide Asset values
- Potential for significant rate increases should be explicitly considered
- Value of underlying real estate, alternative usage potential

Information Needed/Next Steps

- Detailed operating history and forecasts of individual Assets in conformance with GAAP or, at a minimum, a consistent application of municipal accounting standards
- Engineering study to establish Asset lives and the required levels of refurbishment and maintenance capital expenditures to preserve water quality and service reliability
- Copies of all contractual agreements and other agreements relating to the facilities

Note:

1 Includes Passaic Valley Sewerage Commission, Passaic Valley Water Commission, Rahway Valley Sewerage Authority, N.J. Water Supply authority, and N.J. District Water Supply Commission Wanaque (North and South)

SECTION 10

Next Steps

Next Steps—Phase 2

The initial next step is for the State to determine whether it is in the State's interest to proceed to the next phase. This determination is expected to be based not only on this Report, but on additional analyses and factors the State may wish to consider.

Should the State elect to proceed to Phase 2, outlined below are the work and steps recommended for this next phase. Generally speaking, Phase 2 should focus on in-depth due diligence and detailed assessment of the market value and specific PPP strategy of the Tier 1 and Tier 2 Assets identified during Phase 1. The objective of the Phase 2 work is to provide the State with the requisite detailed information, analysis, and strategic foundation to decide whether to proceed with the Phase 3 implementation stage.

UBS sets out below 15 recommended "work steps" that would comprise Phase 2. These work steps are generally, but not strictly, sequential. Several of the early steps will be started at the same time initially and work will be performed on many of these steps concurrently during the course of Phase 2. UBS's recommended Phase 2 work steps are:

1. Appointing an expanded set of advisors and consultants
2. Collecting detailed information on each asset and setting up data rooms
3. Establishing objectives for PPP for each Asset, recognizing that there may be different goals for different Assets
4. Selecting the most appropriate PPP structure for each Asset
5. Reviewing legal issues around each Asset
6. Performing valuations to derive an indicative value range for each Asset
7. Developing a comprehensive strategy regarding how the State could best use transaction proceeds, including detailed debt defeasance analyses
8. Preparing, implementing, and managing a public communications strategy
9. Identifying key policy issues and developing a framework to assist the State in assessing policy impacts of various PPP alternatives so that sound policy decisions can be made on a timely basis
10. Assessing the market's appetite and capacity for each Asset, including review of debt, equity, and credit enhancement providers
11. Performing a risk analysis and developing risk mitigation strategies, as appropriate, for each Asset
12. Establishing an optimal, comprehensive Asset tender strategy
13. Establishing an optimal PPP framework for each Asset
14. Developing and instituting an efficient, systematic process to resolve unexpected issues and make proper strategic adjustments
15. Establishing and managing the overall implementation timetable

APPENDIX A

U.S. Pipeline of Infrastructure Projects

Appendix A

U.S. Pipeline of Infrastructure Projects

Pipeline	State	Estimated Value ($mm)	Status	Timing
Knik Arm Bridge Project	AK	592	Pre-Approval	2006-2010
Dothan Toll Road	AL	NA	Pre-Approval	TBD
Montgomery Outer Loop Toll Road	AL	NA	Pre-Approval	TBD
Oakland Airport Connector (OAC)	CA	243	Pre-Approval	TBD
Super Slab	CO	NA	Pre-Approval	TBD
Road 301	DE	491	On Hold	Dead
Delaware Turnpike Highway Improvement Programme I-95	DE	227	On Hold	Dead
North Tampa East West Road	FL	149	In Tender	TBD
Miami Street Cars	FL	190	Pre-Approval	2006-2010
Miami Port Tunnel	FL	NA	Pre-Approval	TBD
I-95 Hotlanes Project	FL	311	In Tender	2006
I-285 Toll Road	GA	NA	Pre-Approval	TBD
Ga 400 Crossroads Region	GA	NA	In Tender	TBD
I-75/ I-575 Northwest Corridor Upgrade	GA	1,434	In Tender	2009
Ga 316 Toll Project	GA	1,195	On Hold	TBD
Midway Airport	IL	NA	Pre-Approval	TBD
Illinois Tollway	IL	NA	Pre-Approval	TBD
Chicago Downtown Public Parking System	IL	NA	In Tender	TBD
I-69 Evansville to Indianapolis Toll Road	IN	17,925	Pre-Approval	TBD
Express Toll Lanes	MD	NA	On Hold	TBD
Mississippi River Bridge	MO	920	Pre-Approval	TBD
Gaston County East-West Connector	NC	NA	Pre-Approval	TBD
Triangle Parkway	NC	78	Pre-Approval	TBD
Cape Fear Skyway	NC	442	Pre-Approval	TBD
Currituck Bridge	NC	NA	Pre-Approval	TBD
Reno to Carson City Extension	NV	NA	Pre-Approval	TBD
Boulder By Pass	NV	464	Pre-Approval	2006
Ohio Turnpike	OH	478	Pre-Approval	TBD
Columbia River Crossing	OR	NA	Pre-Approval	TBD
Newberg-Dundee Bypass	OR	NA	In Tender	TBD
South I-205 Corridor Improvements	OR	NA	In Tender	TBD
Sunrise Project	OR	NA	In Tender	TBD
Interstate 73	SC	NA	Pre-Approval	TBD
State Route 475 Knoxville Beltway Orange Route	TN	NA	Pre-Approval	TBD
SH 114/SH 121 "The Funnel"	TX	759	Pre-Approval	TBD
SH 161 Dallas County	TX	492	In Tender	TBD
Century Campus Housing	TX	190	Funded	TBD
Inner Loop (SH 178) from U.S. 54 to Loop 375	TX	NA	Pre-Approval	TBD
TTC 1-69	TX	NA	Pre-Approval	TBD
IH 635 (LBJ Freeway)	TX	1,314	In Tender	TBD
SH121	TX	287	In Tender	TBD
San Antonio Toll Roads Project	TX	1,195	In Tender	TBD
Trans-Texas Corridor: TTC-35 San Antonio to Rio Grande Valley	TX	NA	Pre-Approval	2025-2055

Appendix A

U.S. Pipeline of Infrastructure Projects

Pipeline	State	Estimated Value ($mm)	Status	Timing
Trans-Texas Corridor: TTC-35 Forth Worth Southwest - Northwest Connector	TX	NA	Pre-Approval	2025-2055
Trans-Texas Corridor: Austin to San Antonio HSL	TX	NA	Pre-Approval	2025-2055
Trans-Texas Corridor: Dallas to Austin HSL	TX	NA	Pre-Approval	2025-2055
Trans-Texas Corridor: Dallas to Austin Freight Rail	TX	NA	Pre-Approval	2025-2055
Trans-Texas Corridor: SH 130, Seg. 1 to 4	TX	NA	Pre-Approval	2010-2025
Trans-Texas Corridor: IH 10 Expansion, Seguin to San Antonio Southeast Loop	TX	NA	Pre-Approval	2010-2025
Trans-Texas Corridor: UP Railroad Relocation (MOPAC)	TX	NA	Pre-Approval	2009
Trans-Texas Corridor: TTC-35 San Antonio Southeast Loop	TX	NA	Pre-Approval	2008
Trans-Texas Corridor: TTC-35 Temple to Dallas SE Connector	TX	NA	Pre-Approval	2008
Trans-Texas Corridor: TTC-35, Georgetown to Temple	TX	NA	Pre-Approval	2008
Trans-Texas Corridor: TCC-35 Dallas Northeast Connector	TX	NA	Pre-Approval	2007
Trans-Texas Corridor: TTC-35 Dallas Southeast Connector	TX	NA	Pre-Approval	2006
Trans-Texas Corridor: SH130, Seg 5&6	TX	NA	Pre-Approval	TBD
Dallas-Fort Worth Toll Road (IH-820/SH-183 Managed Lane)	TX	987	In Tender	TBD
I-35 Trans Texas Corridor	TX	NA	In Tender	TBD
Mountain View Corridor	UT	2,510	Pre-Approval	TBD
Chesapeake Bay Bridge-Tunnel	VA	NA	Pre-Approval	TBD
U.S. Route 460 Corridor Improvements	VA	538	In Tender	2008-2014
Craney Island Terminal	VA	1,673	Pre-Approval	2006-2028
U.S. Route 460 Coalfields Connector	VA	NA	Pre-Approval	TBD
Dulles Toll Road Privatization	VA	1,195	On Hold	TBD
Midtown Tunnel Project (MTCP)	VA	NA	Pre-Approval	TBD
Third Hampton Roads Crossing	VA	3,585	In Tender	2013
I-81 Improvements to the Interstate 81 Corridor	VA	NA	In Tender	TBD
I-95 High Occupancy Toll (HOT) Lanes project	VA	900	In Tender	2006-2010

Source: Infranews

Note:
NA: Not Available

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