Public-private partnerships: Recent developments in the US transportation sector

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Traditional funding sources in the United States are insufficient to meet the country's surface transportation needs and the gap continues to grow. As a result, state and local agencies are increasingly including PPPs as part of their strategy to address mobility. Private sector developers are responding with a growing interest in the US PPP market. While the use of PPPs in the US continues to expand, the benefits of PPPs, however, are not universally accepted.

The increasing struggle to bridge the gap

The year 2007 is proving to be pivotal in assessing the future of public-private partnerships (PPPs) in US transportation. The gap between needs for new capacity and resources to provide it remains real, indeed critical. State and regional highway agencies – those responsible for delivering projects for added mobility – continue to struggle with this reality and see the future, if nothing changes, as increasingly bleak.

As just one element, the US Department of Transportation (USDOT) currently projects that the balance in the Highway Trust Fund – the recipient of federal gas taxes and other dedicated revenues – will be negative by over US$200m in 2009 because, as US Transportation Secretary Mary Peters has warned, "we are spending more than we take in."[2] The American Association of State Highway and Transportation Officials projects that, without an increase in federal user fee charges, USDOT will be forced by 2010 to reduce its federal apportionment to the states by 42% from the 2009 obligation level.[3]

Thus, more and more, USDOT, state legislatures, governors and highway agency officials are exploring PPP concepts. Indeed, several large, precedent-setting transactions have closed in the last year and several more are poised to move forward. Nevertheless, as Standard & Poors has pointed out in a recent report, as need and interest grows in PPP applications, challenges have arisen in certain quarters, including opposition from selected federal and state lawmakers.[4] Concerns include whether PPPs create more value than publicly financed toll roads; offer the government the full value of public transportation assets; essentially create unregulated monopolies resulting in outsourcing the responsibility for raising tolls to the private sector; represent a loss of control due to their long duration; and limit the government's rights with respect to unplanned facilities.[5] Despite these arguments, many states have determined that PPPs are valuable tools and are moving forward with PPP statutes and procurements.

This article discusses recent developments in the United States in transportation infrastructure development using PPPs.

Recent federal developments

As the need for a serious change in course becomes more apparent to many, the attention on PPPs is becoming much more focused. Among the federal forums addressing PPPs are new congressional advisory commissions, new use of the federal PPP programmes and recent congressional hearings.

Congressional advisory commissions

Pursuant to the 2005 transportation funding authorisation bill, Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU), the Secretary of Transportation established a National Surface Transportation Policy and Revenue Study Commission (the Revenue Commission)[6] and a National Surface Transportation Infrastructure Financing Commission (the Financing Commission).[7]

The Revenue Commission's mandate includes: a comprehensive study of the current condition and future needs of the surface transportation system and of the revenue sources available to fund the system over the next 30 years; assessing improvements needed for emergency preparedness and evacuation using the system; and alternatives for addressing environmental concerns associated with the future development of the system. Although current law calls for the Revenue Commission to submit its recommendation to Congress by July 1, 2007, it is more likely to complete its report by the end of 2007.

The Financing Commission[8] is tasked with completing a study projecting future Highway Trust

Fund revenues and the extent of any shortfalls of these revenues in meeting future highway and transit needs, and considering alternative approaches for generating revenues and methods of financing. The Financing Commission has until April 2009 to transmit its final report to Congress, but it may act faster to allow its conclusions to be considered in USDOT's next reauthorisation proposal.

Both Commissions are likely to make recommendations on the potential role of PPP transactions in the transportation sector.

Private activity bonds

In 2005 SAFETEA-LU created a US$15bn programme permitting applicants to combine PPP transactions with tax-exempt private activity bonds (PABs). Several projects are queuing up to access the allotment.

The Texas Department of Transportation (TxDOT) was the first applicant to receive approval to issue PABs. In October 2006, the USDOT authorised TxDOT to issue up to US$1.86bn of PABs to help finance the construction of SH 121 north of Dallas. Other projects that have applied include: the Port of Miami Tunnel Project, for a US$900m bond allocation; the Missouri Department of Transportation (MoDOT), which is seeking an allocation of US$600m to repair or replace about 800 bridges; and the Knik Arm Bridge and Toll Authority (KABATA), which is applying for an allocation of US$500m.

Despite the obvious value of this new programme, certain tax law issues restrict taking full advantage of PABs. Under current law, only about 25% of private activity bond proceeds can be used to acquire land, which could deter greenfield PPP transactions. In addition, tax rules that require 95% of the proceeds of PABs to be used for capital costs limit their use for long-term lease and concession payments and preclude deferring interest payments on the bonds during project start-up when cash flows are ramping up. PABs are subject to the US Alternative Minimum Tax, with the result that interest rates on PABs are slightly higher than on other tax exempt bonds. Finally, a straight-line depreciation requirement in connection with PABs reduces the tax advantages that otherwise could be realised from accelerated depreciation. Some agencies plan to encourage Congress to cure these inhibitions by passing technical corrections to the PABs authorising language.

TIFIA

The Transportation Infrastructure Finance and Innovation Act of 1998 (TIFIA) established a programme granting USDOT the ability to provide credit assistance to eligible transportation projects of national or regional significance on very favourable terms. Using Special Experimental Project No. 15 (SEP-15), a mechanism intended to encourage experimentation in the project development process,[9] TxDOT applied for US$700m in TIFIA loans for the SH 121.[10] The SEP-15 allowed TxDOT to act as the initial applicant for TIFIA credit assistance in order to jump-start the application process and make the commitment available to proposers to incorporate in their finance plans. Upon award, the selected developer may complete the TIFIA credit assistance process and execute a credit agreement with USDOT. In SH 121, Cintra, the initially selected developer, included the US$700m TIFIA loan in its base case but is prepared to close its financing without closing on the TIFIA loan, in which case the TIFIA loan could be used to refinance a portion of the bank loans.

KABATA has submitted an SEP-15 to USDOT for a TIFIA programme similar to the TxDOT experiment, but with variations that would allow the proposers to negotiate individually with the TIFIA Joint Program Office prior to submission of their proposals. Other recent TIFIA applications include a US$517m TIFIA request for the Intercounty Connector by the Maryland Transportation Authority and Maryland State Highway Administration (estimated project cost of US$2.5bn) and a US$150m TIFIA request for the Richmond Airport Connector by Transurban (895) US Holdings LLC (estimated project cost of US$598m),[11] which would be the first use of TIFIA to refinance existing debt.

Congressional hearings

While the states continue to learn about, experiment with and debate the merits of PPPs, a member of Congress has latched onto the Chicago Skyway and Indiana Tollroad asset leases as the foundation for criticising PPPs as a whole. Congressman Peter DeFazio (D-Oregon), chairman of the Highways and Transit Subcommittee of the House Transportation and Infrastructure Committee, held three hearings between May 2006 and April 2007, receiving testimony from a range of witnesses on the subject. The ability of Congress to effect limitations on these transactions is dependent upon the federal role in a given project, such as its use of federal funds, TIFIA and/or PABs. As of this date, no bill has been introduced in the House or Senate with this purpose and the Senate has not held any hearings on the issue.

Recent state PPP activity

Greenfield toll concessions

The Texas PPP programme continued to be the most robust in the country, but is subject to legislative opposition as of this writing. Of great significance, TxDOT completed negotiations with Cintra-Zachry to build the remaining 40 miles of SH 130 between San Antonio and Austin in the summer 2006 with commercial close in March 2007. The agreement requires a US$1.3bn private investment, includes a US$25m upfront concession payment which will be used for other projects in the Austin-San Antonio region and gives the state a share of the toll revenue over the next 50 years estimated at approximately US$1.6bn. This was the state's first concession agreement and the first US toll concession agreement in over a decade.

In February 2007, the Texas Transportation Commission approved the award of a second toll concession agreement, this time for the SH 121 project (a just completed segment and an extension to be completed) in the North Dallas area. The selected Cintra-led consortium, besting bids from two other consortia, will pay: an upfront concession payment of US$2.1bn; US$560m for construction of the extension; US$700m in lease payments over the next 49 years; and US$1.7bn for operation and maintenance. Texas intends to use the initial money generated to fund other road projects in the region. In March, however, TxDOT agreed to delay the signing of the contract so that the North Texas Tollway Authority (NTTA), which runs the Dallas North Tollway and President George Bush Turnpike, could present an alternative submission to build and operate SH 121. The North Central Texas Regional Transportation Council (RTC) will consider an offer by NTTA against Cintra's offer if it receives it by May 25.[12] The Texas legislature may extend this date.

The SH 161 Toll Road Project includes the design, construction, maintenance and operation of a proposed north-south limited access tollway to extend the existing SH 161 from SH 183 to IH 20, again in the North Dallas area. The initial project will include 11.5 miles of tollway with four main lanes between IH 20 and IH 30 and six main lanes between IH 30 and SH 183. A request for qualifications attracted 10 significant teams, from which TxDOT shortlisted four. As with SH 121, NTTA may seek to deliver the project through its own resources, an option the Texas legislature may address.

The Knik Arm Crossing Project is planned to be a toll bridge of about two miles across Knik Arm to join the Port of Anchorage and Port MacKenzie areas and approximately 18 miles of associated approach and other roadways. Approximately US$129m in public funds have been allocated to the project. The total construction cost is estimated at US$400m-US$600m. In April 2007 KABATA shortlisted two teams, one led by Macquarie and one led by Bouygues. KABATA expects to issue the RFP in the summer 2007 and award by spring 2008.

In the aftermath of the Indiana Tollroad lease transaction in 2006, Indiana Governor Mitch Daniels proposed this past year to pursue concessions for two new tollroads. The Indiana Commerce Connector would be a new 75-80 mile outer loop around the north-east, east and south sides of Indianapolis, with an approximate cost of US$1bn–US$1.5bn. The proposed 63-mile Illiana Expressway is planned as an interstate linking Illinois' I-57 with Indiana's I-94. Faced with mounting public opposition, however, Governor Daniels has dropped for now the Commerce Connector proposal and scaled back the proposed Illiana Expressway in Northwestern Indiana.

Managed lanes

Some regions have determined that value pricing will be an important tool to:

- manage traffic flow and add predictability;
- optimise performance (speed, throughput);
- address environmental requirements such as air quality; and
- address a widening funding gap.

The Dallas-Fort Worth region of Texas has included managed lanes as a critical component of its strategy to achieve mobility and air conformity in the region and provide necessary funding. TxDOT is currently developing two managed lanes projects in that region as PPPs. The IH 635 Managed Lanes Project will include the construction and operation of approximately 17 miles of managed lanes on the IH 635 and IH 35E corridors at an estimated construction cost of over US$1bn. TxDOT has available up to US$700m in public funds to contribute to the project. In summer 2007, TxDOT expects to issue an RFP to the currently shortlisted teams led by Dragados/Zachry, Cintra and Fluor/Transurban.

The North Tarrant Express Project involves approximately 36 miles of managed lanes, additional general purpose lanes and frontage roads in the Fort Worth area. The first 6-mile segment along IH 820, estimated at US$400m-US$500m, is being proposed as a concession project. TxDOT issued a request for qualifications in December 2006 and seven teams submitted qualifications in March 2007. TxDOT anticipates shortlisting in May 2007 and issuing a final RFP in fall 2007.

In January 2006, the Georgia Department of Transportation (GDOT) signed a letter of intent to negotiate with a Bechtel Infrastructure-led joint venture to develop managed lanes in the existing I-75/I-575 Northwest Corridor. The parties are currently performing engineering and other studies to establish project feasibility.

On October 24, 2006, the Virginia Department of Transportation (VDOT) signed an interim agreement with Fluor/Transurban to expand and modify portions of the existing two-lane, reversible HOV system on I-95 and I-395 to create a three-lane reversible Bus/HOV/HOT Lane system. The project would span 28 miles with an estimated cost of US$900m. Construction of the project is scheduled for 2008 and the northern phase of the project is anticipated to open in 2010.

Availability payment concessions

Like a toll development concession, an availability payment concession involves the design, finance, construction and operation of a project. Instead of the project charging tolls, however, the project's financing is based on the owner making regular payments, from other resources, based on traffic counts and/or performance measures over the term of the concession agreement. While widely used in the United Kingdom and elsewhere in Europe, this tool is new to the US, but in 2007 that is likely to change.

The Florida Department of Transportation (FDOT) is completing a procurement that will lead to the first availability payment concession in the country. The subject of the procurement is the development and operation of a new tunnel and other roadway improvements to provide a new access to the Port of Miami from the MacArthur Causeway and I-395, with construction costs estimated in excess of US$1.3bn. FDOT will pay US$100m during construction, US$350m upon project completion and the balance as annual availability payments contingent upon lane availability and service quality over a 30-year operating period. On May 2, 2007, FDOT selected a Bouygues-led team as the apparent best value proposer offering a US$33m maximum availability payment over ACS Infrastructure/Odebrecht and FCC Construccion/Morgan Stanley, which offered maximum availability payments of US$40m and US$63m, respectively. The maximum availability payments offered by all three teams were well below the US$68m limit set by FDOT.

The San Francisco Bay Area Rapid Transit District (BART) is currently procuring the development of a 3.2-mile long automated guideway transit system that will link BART to the Oakland International Airport. BART anticipates that it will pay the chosen concessionaire via availability payments. In September 2006, BART shortlisted three teams to bid on the project.

MoDOT is currently procuring the Missouri Safe and Sound Bridge Improvement Program. Under this programme, MoDOT plans to award a 25-year concession agreement to repair or replace and maintain over 800 bridges in every county in Missouri.

Truck only toll lanes

Proponents of truck only toll lanes advocate such facilities to improve mobility, improve safety and create value by allowing longer trucks. Trucking companies often oppose tolls, however, particularly because their shipping contracts often do not allow reimbursement for tolls.

In response to an unsolicited proposal from Goldman Sachs to develop truck-only toll lanes along I-285 and I-20, GDOT sought and received in October 2006 competing proposals from four consortia led by Skanska/ARCADIS, Transurban/Fluor, Moreland Altobelli and Cintra. While Goldman Sachs withdrew its proposal, GDOT is currently evaluating the other proposals.

Pre-development agreements

Pre-development agreements involve bringing in a private developer early in the project development process in order to benefit from the private developer's expertise in optimising a project. The private sector's involvement is divided into two phases. The first or pre-development phase typically involves analysing the feasibility of various technical, commercial and financial options for a project. If at the conclusion of the pre-development phase the project is determined to be feasible, the parties will decide whether they want to proceed into the second or implementation phase. The implementation phase involves constructing the project and may involve operations. This phase could be governed by a concession or other form of agreement.

Owners have found pre-development agreements advantageous for many reasons, including:

- The private sector invests its time and money to define the project, often entirely or partially at risk.
- The private sector contributes its innovation and experience in the project definition.
- The project definition process includes a focus on producing a result that is financially feasible as well as a result that is technically, politically and environmentally feasible.

In March 2005, TxDOT entered into the I-35/Trans-Texas Corridor pre-development agreement with Cintra-Zachry for the long-term planning and development of the TTC-35 corridor. The corridor generally parallels I-35 extending from north of Dallas/Fort Worth to Mexico and covers the potential construction of separate automobile and truck toll facilities, passenger and freight rail facilities and utilities along the TTC-35 corridor. See the discussion under "Greenfield toll concessions" above for a description of the first project being undertaken under that agreement. Cintra has applied to TxDOT to undertake a second project, Loop 9 in the Dallas area, which TxDOT is currently analysing.

The I-69/Trans-Texas Corridor is a planned multimodal transportation facility extending from Northeast Texas to the border with Mexico at Laredo and/or the Rio Grande Valley with a possible connection to the Texas Gulf Coast. The conceptual design includes tolled truck and vehicle lanes, high-speed passenger rail, commuter rail, freight rail, utility infrastructure and possible intermodal facilities. Early in 2006, TxDOT issued a request for qualifications for a corridor developer and in September 2006 shortlisted a team headed by Zachry/Dragados and a team headed by Cintra. In late summer TxDOT expects to issue the final RFP.

The remaining segments of the North Tarrant Express, described above, are planned to be developed under a pre-development agreement. Total construction cost of all segments is in excess of US$2bn.

Since January 2006, the Oregon Department of Transportation (ODOT) has been in the pre-development phase of three projects with a Macquarie-led team. The three projects are: Sunrise Corridor Improvement Project, which includes a five-mile, limited-access four-lane facility from I-205 east to Rock Creek Junction; Newberg-Dundee Transportation Improvement Project, which includes an 11-mile bypass to Highway 99W through the Newberg-Dundee area; and South I-205 Corridor Project, which includes adding one or two lanes in each direction from I-5 to either Oregon 212/224 or I-84 and widening the Abernethy Bridge over the Willamette River. In December 2006 and January 2007, Macquarie concluded that, as a toll concession, the South I-205 Corridor Project is feasible, the Sunrise Corridor Improvement Project is not feasible and the Newberg-Dundee Transportation Improvement Project is potentially feasible but more refinement and analysis is needed. ODOT and Macquarie are engaged in follow-up studies intended to frame, if possible, optimally feasible packages.

Long-term leases

Long-term leases, popularised by the recent Chicago Skyway and Indiana Toll Road concessions, are actively being considered by many states. Proponents believe these types of transactions unlock value in toll roads by maximising the strengths of the public and private sectors.

In June 2006, VDOT completed an asset transfer and refinancing of the Pocahontas Parkway (also known as the Route 895 Connector) in the Richmond area with Transurban (895) LLC under a 99-year concession agreement. The transaction, involving a new US$611m financing for an underperforming road, paid back the original tax-exempt revenue bonds issued by a non-profit corporation; recouped for VDOT all its prior capital, operating and maintenance expenses; relieved VDOT of liability for future expenses; and committed Transurban to design, construct, operate and maintain an approximately US$50m connector road to the Richmond Airport, subject to Transurban's closing of a TIFIA refinancing.

The same month, Cintra and Macquarie commenced its 75-year lease to operate and maintain the Indiana Toll Road for an upfront payment of US$3.85bn.

In April 2007, Colorado's Northwest Parkway Public Highway Authority selected a team of Brisa Auto-Estradas and Companhia de Concessões Rodoviarias for exclusive talks to operate the 11-mile toll road forming the northwest part of a beltway around Denver under a long-term leasing arrangement. The Parkway's construction was originally financed with US$416.4m in bonds to be paid back with toll revenue over 35 years. The Authority opted to pursue this transaction after the road's revenues proved to be substantially short of projections and it was unsuccessful in refinancing the debt in the municipal tax-exempt markets.

New Jersey is currently considering monetising various assets, including the Atlantic City Expressway, Garden State Parkway and New Jersey Turnpike. Pennsylvania Governor Ed Rendell is proposing to lease or privatise its 172-mile Pennsylvania Turnpike, supported by a strong endorsement from United States Transportation Secretary Mary Peters.

New and pending legislation

Alaska

Passed in 2006, new legislation allows the Knik Arm Bridge to be financed, designed, constructed, maintained and/or operated under a PPP arrangement.

Arizona

Competing bills authorising PPPs are tied up in the House rules committee, making it unlikely legislation will be passed in 2007.

California

Enacted in 2006, new legislation enables the California Department of Transportation, in collaboration with regional transportation agencies, to enter into a total of four PPP projects for new facilities. Under the enacted law, only commercial vehicles may be tolled and individual agreements can be vetoed by the legislature. The legislature, with the encouragement of the governor's office, is presently considering a new bill (SB 61) that would remove those restrictions for additional projects.

Florida

A bill (HB985) passed the Florida House of Representatives in April 2007 authorising the state to lease existing toll facilities (except the Florida Turnpike System) to private concessionaires for up to 75 years.

Mississippi

The Mississippi legislature passed a bill (SB 2375) in April 2007, sponsored by Republican Senator Charlie Ross, that allows governmental entities to build toll roads and bridges in partnership with the private sector. The Mississippi bill requires that they be new roads, that free alternatives exist and that tolls end after 30 years.

Nevada

The Nevada legislature is currently considering a bill that would create an interim committee to study the feasibility of implementing toll roads, toll lanes and high-occupancy lanes in Nevada (SB 392). Until recently, the Nevada Assembly was considering a bill that would have allowed state and local governments to contract with the private sector to build and operate toll roads.

New Jersey

A bill pending in the legislature, introduced in response to Governor Corzine's planning, would authorise the leasing of the state's turnpikes.

New York

The governor of New York is supporting a bill that would authorise the New York State Department of Transportation, the Thruway Authority and the Metropolitan Transportation Authority of the State of New York to enter into PPPs for transportation facilities.

Pennsylvania

A bill (HB 555) was introduced in March 2007 authorising leases of existing assets and solicited and unsolicited bids for PPP projects.

Tennessee

In February 2007, transportation committee chairs in both the House and the Senate introduced bills (HB 1205 and SB 347) authorising PPPs. A bill allowing conversion of HOV lanes to HOT lanes and long-term private greenfield toll road concession and lease agreements has been introduced in the Tennessee legislature (HB 1204 and SB 1152).

Texas

In April 2007, the House and Senate overwhelmingly passed bills that would add restrictions to private toll roads but each contained numerous and different provisions and exemptions for pending projects. It is too early, as of the date of publication, to know the outcome of this legislation. The situation in Texas is important because opponents of TxDOT's PPP programme articulate some of the same concerns and fears that officials in other jurisdictions are expressing.

Utah

Legislation effective in 2006 authorises the Utah Department of Transportation to enter into PPPs of tollway facilities upon approval from the Transportation Commission.[13]

Conclusion

PPPs continue to make significant inroads in 2007 as a tool for infrastructure development. Recent trends in the rapidly changing use of PPPs in the United States include:

- Continued support for PPPs by USDOT, but some criticism among certain members of the US Congress.
- Broader interest and use of PPPs by state and local governments, but some pushback by legislators in selected jurisdictions.
- The addition of availability payments as a viable form of PPP.
- Growing interest in PPPs in the United States by private firms.

Notes:

1 The views expressed in this article do not necessarily reflect the views of clients of the firm.

2 US Secretary of Transportation Mary Peters, Remarks to Congress, Department of Transportation Budget for Fiscal Year 2008 (Webcast), February 5, 2007. http://www.dot.gov/affairs/peters020507.htm.

3 American Association of State and Highway and Transportation Officials (AASHTO), Revenue Sources to Fund Transportation Needs, April 2007.

4 Matthew Hobby and Kurt Forsgren, *US Transportation's PPP Market Continues Down a Long and Winding Road*, Article published at http://www.standardandpoors.com (April 3, 2007).

5 For an example of the arguments articulated by PPP opponents, see the testimony of Dennis Enright (a principal and founder of NW Financial Group) at a recent House of Representatives subcommittee hearing titled "Public-Private Partnerships: Innovative Financing and Protecting the Public Interest." http://transportation.house.gov/hearings/Testimony.aspx?TID=235 (Feb. 13, 2007). For a response to these arguments, see Robert W. Poole, Jr., Tolling and Public-Private Partnerships in Texas: Separating Myth from Fact, Reason Foundation Working Paper, May 2007. http://www.bettertexasroads.org/documents/tollroads_050407.pdf.

6 Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users, Pub. L. No. 109-59, §1909(b), 119 Stat. 1144, 1471 (2005).

7 Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users, Pub. L. No. 109-59, §11142, 119 Stat. 1144, 1961 (2005).

8 Geoffrey S. Yarema, an author of this article, has been appointed as a member of the Financing Commission.

9 Brian Papernik and Brandon Davis, Innovation in Highway Delivery: Survey of SEP-14/SEP-15 Projects, Design-Build Dateline, April 2006.

10 The experiment also included the IH 635 and SH 161 projects.

11 See http://tifia.fhwa.dot.gov/.

12 The NTTA originally envisaged submitting a bid in November 2005 for the construction and financing of SH 121, but decided against this after it entered into a "protocol" agreement with TxDOT.

13 Utah Code Ann. Sections 72-6-201 through 206 (2006).

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