TESTIMONY BEFORE THE JOINT TRANSPORTATION COMMITTEES OF THE COLORADO GENERAL ASSEMBLY

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HOUSE COMMITTEE ROOM 0107

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Good afternoon, I am Frank Rapoport, senior partner at the law firm of McKenna Long & Aldridge LLP and the leader of the firm's Public-Private Partnerships practice. I work out of McKenna's Philadelphia office. With me are Lino Lipinsky and Dick Kaufman, who are known to many of you and who are attorneys in McKenna's Denver office.[1]

McKenna is a leader in the field of public-private partnerships, or P3s. Our private sector clients partner with the public sector in areas as diverse as transportation, infrastructure, project finance, housing, education and public health. For example, our client Balfour Beatty Communities is one of the nation's largest developers of privatized military housing, including the highly successful project at Fort Carson that is now in its second phase. We currently represent one of two shortlisted teams competing for the

[1] The contributions of my colleagues Penny Cobey, Lino Lipinsky, and Richard Kaufman to this testimony are gratefully acknowledged.

design and project management contract for a substantial toll road in California. Our leadership in this field is further evidenced by our chairmanship of the widely praised California Infrastructure Summit that took place last December in Anaheim. This will be followed by another multi-state summit scheduled for New York in May. We hope Colorado will want to host a similar western states summit.

We understand that both Committees are seeking creative ideas and legislative strategies in working with the private sector to unlock the value inherent in present or future state transportation projects. We have counseled clients in this sector for many years and most recently testified before the New York State Assets Maximization Committee on asset maximization strategies for public school buildings.

My testimony to you today will cover three related subjects. First, I will talk generally about our new President's economic stimulus plan, with some attention to its implications for Colorado. Second, I will look at the existing P3 experience in Colorado, particularly your very successful "FasTracks" transit project to date. Third and finally, I will talk about the best way to structure P3 projects under TABOR, and discuss Senator Gibbs's and Representative Rice's FASTER bill and other legislative options that would maximize P3 opportunities in this state.

Like many others, I initially had great hopes for the economic recovery package as a catalyst for major infrastructure projects. As the legislative details become more apparent, however, it is becoming clear that the primary goal is to boost the economy and create jobs, rather than establish a plan for transportation infrastructure investment. Although congressional debate on the bill is still underway, it appears at present that out of the $825 billion package, $550 billion involves new spending. (The

remainder is tax relief.) Of that $550 billion, less than $30 billion, or barely seven percent, is likely to be designated at this time for highway projects. Of that $30 billion, it appears that Colorado is likely to get at most $500 million. Yet, as you know, last year Governor Ritter's blue ribbon panel estimated that Colorado's long-term transportation needs will amount to around $1.5 billion a year, with a minimum target of $500 million annually.

Where is the money going to come from? Historically Colorado has relied on federal and state gas-tax receipts as the chief means of financing road maintenance and construction. That reliance appears increasingly problematic today, as President Obama and congressional Democrats call for better auto fuel economy and fund research into alternative fuels. Further, a report released late last year by the Brookings Institution found that since 2006 the number of vehicle-miles traveled in Colorado has dropped 7.1 percent, the third highest drop in the nation. The FASTER bill includes authorization for "mileage-based revenue," or MBR, pilot plans under which drivers would pay a tax based on the number of miles they travel, an innovative approach that has already been tested in Oregon and a handful of other states. MBR, however, presents a number of challenges, including the need for extensive technology development and installation, challenges that are not raised by other funding options.

Raising the federal and state gas tax, respectively, as well as indexing them to inflation, would be another way to generate revenue, assuming that the possible associated TABOR issues can be resolved. The National Surface Transportation Infrastructure Financing Commission, a 15-member panel created by Congress, will be issuing a report by the end of this month recommending an increase of ten cents, or almost 50 percent, in the federal gas tax, as the first phase of an eventual move to

mileage-based revenue. The handwriting is on the wall, however: our days of funding efficient transportation infrastructure primarily through the gas tax are coming to an end. Adjusted for inflation, fuel taxes overall are not generating much more revenue today than they were in the mid-1990's, and the state of our infrastructure is getting steadily worse. Our current mechanism for financing highway construction and maintenance, in short, is simply not sustainable.

Gas tax receipts are eroding, federal funding remains far from adequate, and TABOR drastically limits state borrowing authority. However, there is a financial lifeline for Colorado: private equity investment and creation of public-private partnerships to drive highway construction and repair. Morgan Stanley has estimated that over $180 billion of private capital is currently available for P3 investment, including over 30 infrastructure investment funds. Macquarie Infrastructure Group, based in Australia, is one of the largest developers of toll roads in the world and has invested in properties totaling almost $8.6 billion in asset value, including four in the United States (Dulles Greenway, Chicago Skyway, the Indiana Toll Road, and California's South Bay Expressway). I could name many other such funds. And these investors are actively looking for deals.

Let's consider some of the P3 deals that have worked. Any project that will generate a reliable revenue stream, such as a toll road or a utility, is a natural candidate for private sector financing. One of the best is right here in Colorado: Colorado FasTracks. Right now, about nine percent of the cost of this project is projected to be privately funded as part of a public private partnership. The fact that three highly qualified international teams are competing for the Eagle P3 commuter rail project, a design-build-

finance-operate-maintain contract, is an absolute vote of confidence from the market as to the viability of this project as a P3.

Jefferson County, Broomfield and Arvada have also boldly welcomed P3 in their plans to develop a 14-mile, high-speed tollway. If the project waited for public funding, it would likely not go out for bid until at least 2035. The only way to make the project happen in the near term, the Jefferson Parkway Public Highway Authority has concluded, is to find a private-sector partner willing to fund the infrastructure investment in exchange for a long-term operating lease and the right to collect tolls. This structure shifts considerable risk to the private sector, most obviously the risk that the toll road will not meet its usage projections.

In addition to toll revenue, P3's can be financed through availability payments. In these projects, the public sector collects the toll or other revenue, then compensates the P3 developer based on previously agreed upon performance metrics—having the project open and "available" while also meeting maintenance targets, for example. Risk is shifted to the private sector by making compensation dependent on acceptable long term "life-cycle" operations of the highway, and performance of tasks such as snowplowing, accident clearance, and maintaining traffic flow.

Let's look at experiences in two other states. In 2007 Missouri announced the Safe and Sound Bridge Improvement program, under which, in an effort to attract private capital, 802 structurally deficient bridges would be bundled and put out for proposals as a single project. The total cost of repairs was estimated at over $1 billion. The winning bidder was a consortium anchored by a private sector developer. According to the resulting P3 agreement, the state would not pay the costs of repair until the consortium hit specific milestones (first payment after 150 bridges repaired,

with succeeding payments at 300 bridges, 500 bridges, and project completion). Further payments were linked to the consortium's agreement to maintain the bridges for 25 years. Thus considerable risk was transferred to the private consortium, which had to obtain its own financing.

Unfortunately, deterioration in the financial markets by fall of 2008 led Missouri to change the project structure. The state had budgeted $50 million per year for financing costs; proposals were coming in at $65-74 million per year. Rather than absorb this increased cost, the state decided to issue bonds to cover the cost of the program, and take on responsibility for long-term maintenance. Time will tell whether this was a prudent decision.

In Virginia, a state that pioneered the use of P3 in transportation projects, the Capital Beltway HOT Lanes project , currently under construction, has been financed through a package consisting of federal Private Activity Bonds (PABs), 30%; a federal TIFIA (Transportation Infrastructure Finance and Innovation Act) loan, 30%; state VDOT funds, 22%; and private equity, 18%. Projections show that equity should be able to yield a return of 13%, making it quite likely that the state funding, had it not been available, could have been replaced by private capital. This is an encouraging sign for Colorado, where enterprises established under FASTER will be prohibited by TABOR from accepting state and local government funding in excess of 10 percent of total revenues. The P3 developer for the Virginia initiative has guaranteed that a minimum 45 MPH speed will be maintained on the HOT lanes at all times, and project debt is secured by toll revenues.

One of the major advantages of P3 as an infrastructure improvement strategy is that it shifts project focus from initial delivery to life cycle

delivery. In traditional design-bid-build procurement, life cycle costs (operation and maintenance, energy, and borrowing costs) are not part of the evaluation process, and public agencies often ignore such costs when approving projects. As a result operation and maintenance costs are often deferred, resulting in lower levels of service, damage to equipment, additional energy consumption and a shortened useful life.

In contrast, when the private sector is made responsible for the operation, maintenance and financing of a project over a period of years, operation and maintenance costs are built into project finance models from the outset. Competition for contract award ensures that satisfactory plans for regular maintenance and energy conservation are developed and priced. It has been estimated that competitive pricing for long-term operations and maintenance can typically produce savings of 10-20 percent of life cycle costs.

The advantages of public-private partnerships in today's economy are compelling. How, then, should P3's be structured in Colorado, and what can be done, legislatively, to maximize their utility in this state?

In Colorado, unlike certain other states, the P3 challenge is not one of authorization. Public-private partnerships in the transportation area have been explicitly authorized by at least three statutes pertaining to the Colorado Department of Transportation or the Regional Transportation Districts. FASTER explicitly authorizes their use in highway and bridge projects as well. The challenge in Colorado is creating P3 structures that comply with TABOR's limitations on public revenues and borrowing.

We believe that Senator Gibbs's and Representative Rice's new bill is right on target in setting up so-called "enterprises" to meet Colorado's highway transportation needs without running afoul of TABOR. TABOR's

limits are not applicable to "enterprises," meaning government-owned businesses, authorized to issue their own revenue bonds, that receive less than 10 percent of annual revenue in grants from all Colorado state and local governments combined. The enterprise must be an independent, self-supporting, government-owned business that receives revenue in return for providing goods or services. Public highway authorities, such as the E-470 Public Highway Authority, are designated as enterprises by Colorado law and are permitted to set fees and contracts for construction without regard to TABOR limits. The 10 percent restriction on state funding is a substantial but not an insurmountable challenge.

As noted in an excellent study just released by the National Governors Association, public-private partnerships can raise policy concerns. Voters may worry that P3's will lead to higher tolls for roads and less public control over key transportation assets. These concerns can readily be dealt with by devising project specific concession agreements that address all of the state's and public's objectives. For example, the agreement can stipulate when tolls may be raised and establish a maximum limit. The agreement can also set performance metrics and penalties that enhance public control, and define emergencies that would justify the temporary elimination of tolls. Substantial public outreach in the early stages of a P3 project, and dedication to transparency in structuring and operations, will go a long way toward addressing public concerns.

In structuring a public private partnership, we recommend that the following key issues be addressed:

1. Control over the toll structure, as noted earlier. Will there be public oversight of such increases?

2. Non-compete clauses. P3 developers may ask for a guarantee that no toll-free or competing road or bridge will be built within a certain distance to divert traffic from their project. These prohibitions have been hotly debated, and certain states, such as Georgia, have outlawed them by statute. In Colorado, the developer of the Northwest Parkway has claimed that the proposed Jefferson Parkway will violate a non-compete agreement. If the dispute leads to litigation, construction of the Jefferson Parkway may be delayed for years.

3. Public or private utility access along the project corridor. Such access may be important to planners interested in developing a bus service or a transit facility at a later date.

4. Term of the lease. Typically P3 developers will want a very long lease in order to ensure return on their investment and enjoy the tax benefits of depreciation. However, it can be very difficult for public agencies to predict their own needs that far in advance. It is also difficult to convince the public that a private-sector entity should control toll rates for 75 years.

5. Revenue allocations. In many states the decision as to whether project revenues should be devoted solely to transportation projects, or made available for non-transportation uses, can be highly charged. By creating enterprises, however, the sponsors of FASTER have ensured that such revenues will be segregated from general funds and used only for transportation or bridge projects.

6. Value-For-Money Reports. These reports, sometimes referred to as "Public-Sector Comparitor" Reports, are not only commonly used in other countries, including the UK and Canada, they are typically mandated prior to selecting the P3 contracting method. These reports analyze the

efficiency of D-B-F-O (or P3's) on a "life-cycle" basis compared against other delivery methods on a project specific basis. They are also an extremely useful tool in proving the "business case" and the goal of looking out for the public and taxpayers interest when it comes to a sometimes reluctant legislature and/or public.

7. Performance Bonds. The requirement for these on public projects in CO is state law, just as in almost every other state. On the average construction project they are need to look out for the public interest because substantial public funds are being expended during construction. On P3 projects however, as in everywhere else in the world, bonds should not required by the public sector because the private sector financial entity is expending payments during construction, not the public sector. In short, the risk of non-performance by the construction entity has been shifted to the private sector, that being the funder for the project. Therefore, performance bonds are not only a waste of money for the public sector to require, but they limit competition due to the limited number of large and financially sound contractors able to complete these typically large-scale projects.

The congressional Infrastructure Financing Commission, mentioned earlier, has recognized the role of state and local governments in funding transportation infrastructure and will recommend, in its final report due this month, a number of steps to assist states in these efforts. These include (a) allowing tolling of the nation's interstate highways; (b) authorizing "gap financing" for projects that cannot be fully supported through toll financing alone; (c) reauthorizing the existing federal credit (TIFIA) program at a higher volume than the current 33% of eligible project costs; and (d) continuing and expanding the private activity bond (PAB) program. This

recommended federal assistance will provide welcome relief to shrinking state transportation budgets and, in Colorado, will not raise TABOR problems.

In closing, I encourage the General Assembly to continue and expand existing authority for P3 transportation projects in Colorado, beginning with FASTER. Federal money will actually have an adverse effect on transportation planning if it is viewed as a prime funding source. Federal funds are limited and no state today, including Colorado, can assume that Uncle Sam will meet its transportation needs. Instead, federal funds should be viewed as seed money, ideally used to identify and initially develop complex projects that will ultimately be brought to life through partnerships with the private sector.

Thank you for this opportunity to discuss these important topics with you today.

RESOURCES

1. "Innovative State Transportation Funding and Financing: Policy Options for States," National Governors Association Center for Best Practices, 2008.

http://www.nga.org/Files/pdf/0901TRANSPORTATIONFUNDING.PDF

2. "Benefits of Private Investment in Infrastructure," Kearsarge Global Advisors, January 2009.

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3. "Current Toll Road Activity in the U.S.: A Survey and Analysis," U.S. Department of Transportation, Office of Transportation Policy Studies, January 2009.

http://www.fhwa.dot.gov/ppp/pdf/2008_toll_activity_white_paper.pdf

4. City and Financial Conferences, California Infrastructure Summit (2008), North-East States Infrastructure Summit (2009).

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