

**UNDERSTANDING CONTEMPORARY
PUBLIC PRIVATE HIGHWAY TRANS-
ACTIONS: THE FUTURE OF INFRA-
STRUCTURE FINANCE?**

(109-75)

HEARING
BEFORE THE
SUBCOMMITTEE ON
HIGHWAYS, TRANSIT AND PIPELINES
OF THE
COMMITTEE ON
TRANSPORTATION AND
INFRASTRUCTURE
HOUSE OF REPRESENTATIVES
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HEARING ON UNDERSTANDING CONTEMPORARY PUBLIC PRIVATE HIGHWAY TRANSACTIONS: THE FUTURE OF INFRASTRUCTURE FINANCE?

Wednesday, May 24, 2006

HOUSE OF REPRESENTATIVES, COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE, SUBCOMMITTEE ON HIGHWAYS, TRANSIT AND PIPELINES, WASHINGTON, D.C.

The subcommittee met, pursuant to call, at 9:30 a.m., in Room 2167, Rayburn House Office Building, Hon. Thomas E. Petri [chairman of the subcommittee] presiding.

Mr. PETRI. Good morning. The Subcommittee will come to order. I would like to welcome all of our members and our witnesses to today's hearing on "Understanding Contemporary Public Private Highway Transactions: The Future of Infrastructure Finance?"

We have a joint session of Congress, as I think everyone is aware, with the Prime Minister of Israel, which begins at 11 this morning, so we had to move the starting time for the hearing up to 9:30 from 10:00, which I think has inconvenienced a number of our members who will be arriving shortly, but who had other meetings scheduled.

In the interest of getting through our first panel before the joint session begins, I encourage members to submit their opening statements for the record, which will be kept open for submissions by members and others for 30 days. And they can also give their opening statements after the session, if they would prefer.

In the interest of hearing from the Governors and allowing enough time for members to ask questions, I have abbreviated this opening statement.

The hearing is intended to provide members of the Subcommittee with information regarding contemporary public-private highway transactions. Recent high-profile lease agreements for highway toll facilities in Indiana, Virginia, and Chicago have brought these issues to the forefront of the debate on the future of infrastructure financing. Our witnesses will explain why State and local governments may find private involvement in highway financing attractive. They will also focus on how a particular method, namely, long-term lease of existing non-Federal toll facilities to private operators, is structured.

This hearing will be the first in a series of hearings on public-private partnership. We have two very interesting panels for today's hearing. Our first panel is comprised of two Governors who

have first-hand experience with public-private highway transactions, Governor Mitch Daniels from Indiana, Governor Kaine from Virginia. Indiana is in the process of finalizing a long-term lease agreement on the Indiana Toll Road. Virginia has public-private partnerships on highway projects in Richmond and in Northern Virginia.

The second panel is comprised of experts on how these public-private partnerships are structured. I encourage all of our members to return for the second panel, after the joint session, as these witnesses will provide valuable insight on this new transportation financing concept.

And that second panel will begin at what time? Right after the session, around 11:30 today.

Now I yield to Mr. DeFazio for an opening statement.

Mr. DEFAZIO. Thank you, Mr. Chairman. Mr. Chairman, the subject matter is, indeed, fascinating and this is an important day. The Commission that we created in SAFETEA-LU to look at future and alternate sources of funding will hold its first meeting today, unfortunately, at the same time as we will be meeting here. We are on parallel tracks, I guess. But this is, as you said, the first of a number.

There are a number of questions that are raised by the private-public partnerships. Basically, I break it down into two areas. One would be investments in projects that have not made State or Federal priority lists for whatever reason, whether there is just inadequate funds and they are high priorities or they are projects that don't meet the highest priorities in those States, but they are still desirable to move forward. These projects are new construction. And then, as we are going to hear today, questions about assuming the obligations to operate existing assets and monetizing those assets up front.

The questions that pertain to these projects I think are somewhat different, but in the end what we need to know is what sort of net public benefit we are creating and how we are going to continue to have a coordinated and integrated national transportation network when these projects are constructed, because obviously the private companies want to optimize their investment. Sometimes it requires up-front restrictions on the public bodies in terms of non-compete clauses regarding alternate routes.

My State was looking at tolling existing routes in order to try and have a neutral—you know, make a neutral playing field for the newly constructed project. I think that will be very objectionable to my State legislature.

But there are a host of questions like that, and in the interest of hearing from the panel and directing more specific questions, I will suspend with my opening statement at this point.

Mr. PETRI. Thank you very much.

We will now turn to the first panel, comprised of the Honorable Tom Kaine, Governor of Virginia, and the Honorable Mitch Daniels, Governor of Indiana.

I think, before we turn to you, gentlemen, I would like to recognize a very active, aggressive, and effective member of Congress and of this Committee representing Southern Indiana, Mike Sodrel,

who wanted to present to the Committee his Governor, Governor Daniels.

Mr. SODREL. Thank you, Mr. Chairman.

Welcome, Governor, my governor.

Mr. Chairman and members of the Subcommittee, it is a great pleasure to introduce to you Indiana's 49th Governor. He has been serving as our Governor since January 2005 and has brought a lot of changes to Indiana in his short tenure as chief executive of our State. I think members of this Subcommittee are familiar with the service he performed as Director of the Office of Management and Budget under President Bush, but Governor Daniels has a distinguished resume in both the public and private sector. He has been successful in both walks of life because of his strong Hoosier values and hard work.

During his career in public service, he was an advisor to former Indianapolis Mayor Richard Lugar and later became his chief of staff when Senator Lugar was elected to the U.S. Senate. In addition, Governor Daniels was a senior advisor to President Ronald Reagan.

His success carried over into the private sector. Governor Daniels served as president for North American Operations of an Indiana-based company, Eli Lilly and Company. He also served as CEO of the Hudson Institute.

Mr. Chairman, Governor Daniels has a wealth of experience to offer this Subcommittee today to discuss an issue not just facing Hoosiers, but America as a whole: financing the construction of our transportation infrastructure. The Highway Trust Fund is set to go into a deficit situation by 2010. There are many reasons for this trend, but instead of focusing on why we face the problem, I think we should focus on how we solve it. That is why Governor Daniels is here today. He will be able to share a unique experience he recently spearheaded back home that offers an alternative to solving the infrastructure crisis we face as a Nation.

Indiana was experiencing a shortfall in its highway trust fund before he entered office. Governor Daniels had basically three options: you can raise taxes substantially, you can do without the infrastructure, or you can find an alternative that did not raise taxes and still allowed roads and bridges to be built. He was able to accomplish the last item by seeking a public-private partnership, and Indiana will begin investing this year almost \$4 billion for infrastructure development and create jobs for Hoosiers.

As many of you know, I was a truck driver and was in the trucking industry before serving in Congress, and I can tell you I am not a big fan of tolls or fuel taxes. The drivers and operators of heavy duty vehicle already pay user fees and excise taxes to move goods over our highways. The thought of asking them to pay increased tolls is not a pleasant one.

However, I believe this debate is as much about credibility in government as it is financing our infrastructure. If we raise fuel taxes and tolls, we must guarantee those receipts are used only for its intended purposes: to build and maintain roads and bridges. We should not be raising tolls or fuel excise taxes to spend later on community pools, horse trails, city parks, or other unrelated transportation projects. Governor Daniels' Major Moves Program en-

tures that proceeds of the lease agreement are used solely for transportation infrastructure development.

The U.S. highway system is vital to our economy and our national security. If you want to see what a country looks like without adequate transportation infrastructure, I suggest you visit Afghanistan. I visited the country, and I can tell you the roads are in sad shape. It can take almost an hour to drive 10 or 15 miles, holding up transportation of goods and restricting their economy, and it is very difficult to have a robust economy if you don't have adequate transportation.

If we don't find a more successful way to fund our future infrastructure needs, our economy can face similar challenges.

With that said, Mr. Chairman, I want to thank you for having this hearing and for inviting my Governor to testify on his experience, and I yield back the balance of my time.

Mr. PETRI. Thank you.

Gentlemen, we appreciate the prepared statements that you have submitted, and we ask you to summarize them for approximately five minutes, beginning with Governor Daniels.

TESTIMONY OF THE HONORABLE TIM KAINE, GOVERNOR OF THE COMMONWEALTH OF VIRGINIA; THE HONORABLE MITCH DANIELS, GOVERNOR OF THE STATE OF INDIANA

Governor DANIELS. Mr Chairman and Congressman DeFazio, I appreciate the opportunity. I will summarize the material I have sent you, and I will start just by venturing to say that I imagine everyone in the room agrees about the nature of the problem and probably its dimension. It is a national problem ultimately requiring national action. I think that you have invited Governor Kaine and me here today to talk about ways in which we have wrestled with it and attempted to address this very practical dilemma of a transportation shortfall at the State level.

Indiana's share of the national shortfall we reckon to be around \$3 billion over the next 10 years. Our State has been filled with empty promises over the recent decades. We have had necessary and important projects on the books, money spent sometimes to plan and certainly to talk about them, and no action and none in prospect. This is especially important to a State like ours. The State nickname is "The Crossroads of America." Located where we are and with more interstate highways intersecting in our State than anywhere else, transportation logistics and distribution are a critical part of our hopes for an economic resurgence.

We looked at every option to address our shortfall, more than 30, as I recall, the conventional ones of taxing and borrowing, and also some fee-based revenue sources. None of them remotely came close to closing the gap that we found on our arrival in office, and that is what led us to look at the public-private partnership, or P3, approach. We secured passage in our legislature of, first of all, permission to build our largest single project, which is the completion of I-69 from northeast to southwest in our State through a partnership, if one can be reached.

Secondly, as already has been mentioned, we went and asked the market if anyone was interested in operating our existing toll road under contract, under a long-term lease. I looked at this toll road,

in a business sense, as an underperforming asset. It had lost money five of the last seven years; never paid off its long-time debt; tolls were at the levels—had not changed since 1985; we had tolls as low as 15 cents in booths where it cost 34 cents to collect the toll; and it was by every measure the least expensive toll road in America.

We did ask the market. The result was that we received four bids. The winning, our highest bid, was \$3.8 billion, and I should say it includes commitments that will lead to a much better toll road, additional billions invested over the years in upgrades and technology that are long overdue. We reckon this bid to be approximately three times the net present value of the road in State hands and run by public authorities in the way it has been run in the past.

What is the result? I like Congressman DeFazio's question about net public value or net public benefit. When the transaction closes, we will deposit a check for \$3.8 billion. We will begin collecting interest, parenthetically, at the rate of a half a million dollars a day. All of this will be reinvested. We considered it a cardinal principle from the beginning that, if we were to do such a transaction, we would be liberating capital value from an underperforming capital asset, and that should not be spent on any priority of the moment, however high, but should be reinvested in the long-term future of our State, in hard, public assets that we will leave to our children and grandchildren.

And last week, with the benefit of this program, and only because of this project, which we call Major Moves, we announced a regular road building year in Indiana this year. We will break that record next year and every year for the next ten. Twelve billion dollars in total, a quadrupling of new construction over the previous record, more than 70 years of acceleration of projects that were already scheduled to be built, and other projects that might never have been built will now happen.

We don't know what single step we could have taken to create more long-term jobs and hope in our State. The value of infrastructure and its necessity to a modern economy is well known in this room, and I thank the Committee for raising this question to the level you have. I certainly want to say how grateful I am to be here with the Governor of Virginia. We studied his State, Mayor Daley's actions in Chicago, and others very carefully before taking the steps we did.

Mr. PETRI. Thank you.

Governor Kaine.

Governor Kaine. Thank you, Mr. Chairman, members of the Subcommittee. It is an honor to be here today talking about this critical issue. I think Virginia is a logical choice to be here because we now have two decades of experience in private financing of transportation infrastructure.

Just briefly, background. The Governor of Virginia is responsible for the third largest highway system in the United States, 70,000 miles; the fastest growing port on the east coast; some of the fastest growing airports and public transit systems in the Country. I was formerly the mayor of Richmond and had local roads, toll roads, bus system, port, airport, and passenger rail under my juris-

diction. Obviously, we have to work very closely together. The responsibilities require a constant stream of very difficult decisions, all very much in the public eye, and all subject to review by Federal agencies, local governments, advocacy groups and the legislative branches of government.

If I can give you a single message today about two decades of experience in Virginia dealing with public-private financing of transportation structure, it would be that no one size fits all. What works in Northern Virginia or Richmond is different than what works in Southwest or Southern Virginia, and certainly wouldn't automatically apply to Indiana or Illinois or any other State. These are business deals that have a very specific quality to them.

I will focus a little bit on the highway issue because I know that is the main concern of the Committee, but some of the most exciting public-private partnerships we have now in Virginia are in non-highway programs: port expansion, airport expansion, private landowners paying the first quarter of a Metrorail extension to Dulles Airport, and freight railroads meeting defined public benefits as a condition of State capital investment.

With this sort of broader context out of the way, let me now get into what we have learned in two decades of public-private financing. First, public-private partnerships in the road area are not free; someone has to pay a toll or a tax, share in the risk of a project, or dedicate private funds that might otherwise go to private profitability. So there are sometimes discussions about public-private as if it is a way to avoid paying the piper. There is a piper to be paid, and the only question is how, if you want to invest in infrastructure.

Second, the public sector has got an obligation to ensure that a public-private partnership addresses a very specific public need. For example, we believe that public-private partnerships—and we are pushing them vigorously in Virginia, primarily through tolling, but through some other mechanisms as well—could address about 20 percent of Virginia's unmet transportation need. However, we can't, and shouldn't, ignore the remaining 80 percent of the unmet transportation need.

Third, the benefits of public-private partnerships should accrue to the toll payers or the taxpayers or the risk takers in proportion to their contributions, and that is what makes all these deals special: you have got to have a serious business model. Not the customary method that we sometimes use of making everybody a little bit happy, but real-life business decisions that are different for each project.

And then, fourth, the decision to enter into a public-private partnership, as well as implementation, has to be open to the public. This can be a challenge because you have to protect bargaining rights and proprietary information of private providers, but at the same time you have to do that in an overall framework that promotes transparency and accountability.

Finally, even within public-private financing of highway projects, it is really important to be innovative and look at multi-modal opportunities, which we are focused on. Just to give you a couple of examples: our private partnership programs on the roadside are starting to integrate a number of very innovative land use mecha-

nisms to make sure that we are planning the right way before we implement projects; a Pocahontas Parkway, which is our first highway concession, and the third in the Country, in the Richmond area provided for access to the Richmond airport, linking road and airport improvements; we are working on HOT Lane projects on I-95, I-395, and I-495 in Northern Virginia. Some of you may have had the pleasure of using those corridors or experienced challenges there, and we are going to integrate the different transportation modes in those projects. We have got a current solicitation for a highway in Southeastern Virginia, Route 460, that will bring together, hopefully, as we reach a deal, highway infrastructure, freight rail improvements, and intermodal service to the Port of Virginia, the Atlantic Fleet in Norfolk, and metropolitan areas of Richmond and Hampton Roads; and, then, finally, the Dulles Corridor program we are working on right now, a large and complicated and very exciting project, brings together and funds connections among Metrorail, the Dulles Airport, and the Dulles Toll Road, which is a significant element in the national highway system and the economic fate of this region. Finally, we have a transportation opportunity loan fund that we are using to capitalize and incentivize private participation in projects such as Route 28 here in Northern Virginia.

I will just conclude in the opening by acknowledging that Virginia has a special relationship with the Federal Government and your projects. Like all States, we are stewards of Federal funds, transit systems funded by the Federal Government. We are home to the Atlantic Fleet, the Pentagon, and the majority of the Federal workforce in Washington, and we take our stewardship and partnership role with you very seriously and appreciate the chance to be with you today.

Mr. PETRI. Thank you.

We will begin questioning with my colleague, Mr. DeFazio from Oregon.

Mr. DEFAZIO. Thank you, Mr. Chairman.

Governor Daniels, I guess the question that overshadows all this is why wouldn't the public, the State of Indiana, undertake this on its own? Why wouldn't you use—this is not a new development, so there is no risk. You have been operating it successfully; it is a known entity.

Macquarie, a foreign entity, has come in and they expect that they can give you this rather large up-front payment and still get an investment rate of return between 12.5 percent and 13.5 percent, which means if the government were operating it and you could borrow the money at the same rate, and you didn't want the excess profits that they are getting, you could have lower tolls.

So I guess the question is why wouldn't the State do it and continue to operate a coordinated system? Why wouldn't the State use the asset to go out and borrow the money and set up a fee schedule that would show the investors that there would be no risk, that is, the toll increases that you have granted to Macquarie?

Governor DANIELS. First, I like collecting interest better than paying interest.

Mr. DEFAZIO. You what?

Governor DANIELS. I like collecting interest better than paying interest.

Mr. DEFAZIO. Well, how about profits? They are going to get 12.5 percent profit a year. Wouldn't you like to collect that?

Governor DANIELS. Not a dirty word in our State, Congressman. Let me just say you—

Mr. DEFAZIO. No, I know, but, I mean, what if that benefit accrued to the public, Governor?

Governor DANIELS. Well, first of all, the entire history of the Indiana toll road documents that we would never achieve this level of benefit—

Mr. DEFAZIO. If I could. So you are saying that there is no political will to raise the tolls, but if you enter into a binding contract which gives a private entity the right to infinitely raise tolls, then it will happen, but politically you couldn't go out and say we are going to raise the tolls, you can say we have contracted to a foreign entity, they have the right of 2 percent CPI or GDP, whatever is higher, and that is better? And they get 12.5 percent profit on top of it?

Governor DANIELS. Well, you are a busy man, Congressman. I don't expect you to understand our State, but since 19—

Mr. DEFAZIO. No, sir, I am just asking a question. Is it outsourcing political will?

Governor DANIELS. I am trying to give you an answer.

Mr. DEFAZIO. Are we outsourcing political will to a private entity here?

Governor DANIELS. Well, it is not a partisan statement, it is a statement of fact.....

Mr. DEFAZIO. I didn't say anything partisan. What do you say?

Governor DANIELS. No, no, the one I am about to make, if you will give me that chance.

Mr. DEFAZIO. Okay. Sure.

Governor DANIELS. Governors of both parties declined to raise tolls by 1 cent since 1985. You make an assumption about human nature that all future governors will be different than all past governors, and—

Mr. DEFAZIO. But didn't you raise the tolls before you entered into the agreement with Macquarie?

Governor DANIELS. We were going to raise the tolls whether there was a suitable offer or not.

Mr. DEFAZIO. All right.

Governor DANIELS. This is a very important point. We could no longer go on with a road that was deteriorating, that was becoming congested, that had no new technology, of the kind that is now the rule in American toll roads. So we put into motion a modernization, I am going to say, of these antique tolls before we had any idea whether we would receive the kind of offer that we did. By any calculation, the most generous calculation anybody made, assuming changes in future political behavior, was not half as much money as we were offered.

Now, you say excess profits, which is a—

Mr. DEFAZIO. No, I didn't say excess. They are expecting a rate of return of 12.5 percent. That is a pretty nice rate of return on that investment.

Governor DANIELS. Well, you used the word excess, but I will just indicate that I have no idea if they will make any profit at all, and I don't much care. The point is that we have locked in and limited their ability to raise prices. The only way they will make money on that road is by building a road that pleases its customers and that increases volume there, and the risk has been entirely transferred to them.

Mr. DEFAZIO. Right. But if I could, to that point, they say inter-urban road, minimal bypass risk. That kind of speaks—you know, they feel there is a monopoly or a near monopoly so that they can raise rates, and you reference that. I don't know if you are familiar with—and, granted, what they did in Chicago is really outrageous, because they have diverted the money to other purposes, and I congratulate you on using the money for transportation infrastructure. But in an analysis of that, a gentleman by the name Charles Foote—excuse me—well, Northwest Financial Group—since these are very long-term agreements, they looked for something they could use as a parallel. They went back to the construction of the Holland Tunnel, 1927. They applied the same rents that Macquarie is demanding. They have an identical agreement with Chicago that they have with you, 2 percent GDP or CPI. And under that, if you used, with the minimum floor, the dollar toll would have escalated, using the minimums, to 185.13. If you use CPI only, it 11.42, and GDP would be 49.45.

So I don't think it is much of a limit that we are putting in here, unless our economy isn't going to grow or we are not going to have inflation. It is going to be quite a potentially high escalation if you look at what happened with the Holland Tunnel analysis.

Governor DANIELS. Well, you are overlooking the fact that the tolls on our toll road are less than half of those today on competing roads. Even after the increase is phased in over the next several years, we will still be cheaper. The inflationary increases you are talking about, the limits you are talking about, wouldn't even be available until then.

Mr. DEFAZIO. Well, starting in 2010 they apply this new factor, is that correct?

Governor DANIELS. Yes, but in 2010 we will still be cheaper than the tolls on competing roads are today, let alone what they may be by then. So it will all come down ultimately to value to the motorist. If people charge too much, folks will find other ways of getting around.

Mr. DEFAZIO. But they don't seem to think there are competing—minimal bypass risk, they are saying. So they don't seem to think there are real competing routes. What are—

Governor DANIELS. Well, in order to maintain a minimal risk, they will have to build a road that doesn't take four days to travel across, and I believe, in pursuit of future customers, they will do that.

You know, but your whole question I think misses an enormous point, which is that even if—which is ludicrous—we could have captured this much value over time in our State, we could not have achieved, we would have missed the opportunity to build roads we need today, roads that are decades overdue, and bridges in our State that we have been waiting for for far too long. And I am just

not willing to wait 10 years or 20 or 30, even assuming that future governors magically are transformed into good businessmen.

Mr. DEFAZIO. Okay, just one other, Mr. Chairman. In Ohio, when truck tolls were increased to 18 cents a mile, there was a huge diversion of truck traffic onto secondary roads, and the State was able to roll back those tolls. In this case you won't control the tolls, and in 2010 your truck charge will be 20.04 cents per mile. So if there is a huge diversion of traffic onto secondary roads, how are you going to get Macquarie to roll back their tolls?

Governor DANIELS. First of all, 20 cents five years from now will still be dramatically less than in Illinois, for instance, or in most States in the Country. The Indiana toll road at that level will still be a bargain. But—

Mr. DEFAZIO. Well, you are assuming there won't be competition and other people might not lower their tolls. But, in any case, just if you could, I mean, does the State have a contingency if there is something you didn't anticipate that happens because of the private ownership? I am worried about the coordination between the private and the public sector. They are there to make money; you are there to benefit the public and minimize congestion. And if those two come in conflict, do you have a way to control what they do or revisit anything they might have caused inadvertently?

Governor DANIELS. The three-inch document that binds them requires them to maintain a traffic flow which is equal to or better than today's, in other words, add lanes and maybe other technology to make this road better than it is today.

Mr. DEFAZIO. But does it require traffic or just capacity?

Mr. PETRI. I think—

Mr. DEFAZIO. Okay, thank you, Mr. Chairman.

Mr. PETRI. We will attempt to have another round, but time is limited and there are a number of members who would like to ask questions as well.

Mr. Sodrel.

Mr. SODREL. Thank you, Mr. Chairman.

Based on your experiences, what are the biggest obstacles in putting together these public-private partnerships? I might ask of both our witnesses. Governor Kaine, if you want to start.

Governor Kaine. Good question. Finding routes that have significant enough volume to entice the private sector to be interested, that is a key one. A number of parts of the State we have transportation needs, but we don't have traffic volumes that would be sufficient to get the private sector involved. So that is always a key issue up front.

When you have corridors where there is sufficient volume just weighing the decision about public investment that you might be able to make versus a private participant that is going to expect a profit motive. Those are hard business decisions. One of the things we have to weigh is debt limitations. Limitations on State debt that sometimes, theoretically, we might like to do a project on State debt, but if we have a debt imitation problem, that is one where we then look to the private sector to try to come in and advance us.

So I would say probably the biggest challenge that we have next to the volume of traffic challenge is capturing the right deal. There

are things we want to do in rural parts of Virginia to help economic development, where we just don't have a volume that would support tolls, but in areas like Northern Virginia, where there is the volume, it is just the kind of hard business decision about what is the right way to do it. We don't have any project that looks like any other project, even in Virginia, the particulars are all varied, and being able to make a smart business decision about, yes, this makes sense, let us go down this path and do it.

I authorized a loan recently out of a transportation capitalization fund we have to complete a public-private partnership to construct interchanges on Route 28 out near Dulles. One of the reasons for that loan is we had the private sector there doing some of the interchanges and they were at a critical mass, and rather than have them go away and then try to get them back after construction costs had gone up a lot, we felt like a loan that would enable them to stay working and taking advantage of their current working conditions would be helpful.

But I would say the biggest obstacle is just kind of knowing what the right deal is at the time and not having a one-size-fits-all approach.

Mr. SODREL. Governor Daniels?

Governor DANIELS. I think that says it well. In our case, I think maybe the novelty. Virginia is a 20-year, I think the Governor said, veteran of these approaches, and it was new in our case. And this probably led to some folks misunderstanding the size of the opportunity or the long-term value. I think what our comments reflect is we are simply trying to solve a practical problem here.

In our State, there was never an alternative proposed—zero—and there has not been to this day to closing the gap we had. And I don't know what options at the national level the Committee may consider, but they are not easy to identify. As you say, there is some limit to what fuel taxes ought to be, or other fees, and that is what I think leads folks like us to look for these alternatives and in some cases, selectively, they apply.

Mr. SODREL. Thank you, Mr. Chairman.

Mr. PETRI. Thank you.

Ms. Schwartz?

Ms. SCHWARTZ. Thank you, Mr. Chairman.

And I am from Pennsylvania, so we just heard an announcement from our Governor that he is interested in looking at this. It is sort of as open as that. So my interest in this is to really find out from you—and I think the questions tried to be asked in a way is, one, what is the downside? And if you could be a little more specific about this.

I mean, I understand the upside: you are going to be able to get private investment to do the capital improvements, create roads in high-volume, profitable areas, which then, of course, leaves the public sector to take care of areas that are not profitable. So you are still going to have a problem at the State level. How are you going to find the capital dollars to improve the roads in areas that are not profitable?

So one of my questions is does that just put a greater burden on the State, leaving only the areas that are really problematic, if you want to put it that way, at least from a financial point of view?

And, secondly, what happens when it doesn't work out so well? When in fact the profits don't come the way they might, or the tolls go up so much that they don't get the profits they want to, and you are in a 99-year deal here. So can you just give us some advice a little bit on the downside, what isn't working, what we ought to be looking out for, ways in which we at the Federal level ought to be watching this a little more carefully if we should at all?

My guess is that you might have different answers on that, but if you could give us a little guidance on it, it would be helpful.

Governor Kaine. I think one of the down sides, Congresswoman, is there are those who believe public-private partnership could be kind of a magic language. I see this from a political standpoint where it makes some that I deal with in Virginia government and the public think, well, we can do it all by public-private partnership.

And that is a little bit of a political downside and we don't think that that is accurate. The U.S. Chamber of Commerce did a study. They are favorable to the notion of public-private partnerships, but they believe that the tolling and other financing mechanisms in these partnerships could address about 20 percent of our unmet need, but not the remaining 80 percent. You used the example earlier in a high-density corridor with a lot of traffic, much tougher in a rural part of the State.

So public-private partnership isn't a magic word that you can just say and then it solves all the transportation financing challenges. You know, I am dealing with my legislature much as Congress is now, trying to find long-term funding solutions. We are aggressive on public-private partnerships. We also believe that we need more core revenue into our transportation funding so that we can take care of our other needs, particularly some of the rural parts of the State.

So I think that that is a political downside. But I don't believe that that political downside outweighs the fact that these can be very good deals. They can help you deal with limitations on State debt capacity, they can get you the creative energies of financing partners that you don't have at the State level. But you just have to know when a deal works and when it doesn't.

We have had experience with doing public-private deals where the scenario you raised as the second half of your question came to pass, that the ridership projections didn't pan out. This was on a piece of new infrastructure, so there were other options for people to travel around the Richmond metropolitan area. They chose not to take this new infrastructure because the tolls were too high. And we had to then step in, get involved in that deal. We refinanced it with another private partner, put some pretty significant limitations on tolls. We also put in a walkaway clause for convenience that we could use if we needed to. We learned a lot from the first deal, so that the second deal was a lot better negotiated. So that is a downside.

Ms. Schwartz. But you really raise a very important point, which is the tolls can go too high and the market isn't interested in paying those kind of tolls, they go elsewhere. So they either put more of a burden on other public roads that are not so that we end up seeing this beautiful new road that isn't getting used, they can

say, fine, companies do that all the time, and you walk away. They walk away. We see that. But it is a bigger problem, it seems to me, that if we have actually sanctioned this project and they walk away from a large road that is not being used. So I think your point that it has got to be an opportunity for oversight for renegotiation so that, in fact, your role as Governors, our role, of course, in protecting the public's interest. I mean, the whole issue here is these are now private roads.

People still, I think, our constituents would perceive a problem not being able to get on our roads. So if we end up having this two system of nice fancy roads, too expensive, maybe, for most of us to use, and other roads that are still not well maintained, is it a question of political will that we just haven't created the political will in the State level to make the kind of—or the Federal level to make the kind of investments to have roads people can afford that are well maintained?

Governor Kaine. I think political will, being willing to invest is a huge issue, certainly is in my State, certainly is federally. That is a big piece of it. It is a little bit easier in dealing with a project that you are not as "concerned are the tolls going to be too high" if it is in an area where there are clear, other viable ways that people can get around, that the pay private option isn't the only way that they can get from point A to point B. That makes you feel a little more comfortable in doing a deal on a new piece of infrastructure. Hey, if folks want to use it, they can; they will have to pay to use it, but if they don't, they can continue to use the road network that we have that we are trying hard to maintain.

Ms. Schwartz. I think my time is up, but sort of interesting challenges. I think it is a whole new world out there that you are suggesting, and I think there are a lot of lessons to be learned from that we ought to keep a careful on at the Federal level.

Mr. Petri. The reason we are having this hearing, in part, the Indiana toll road exists not to serve Indiana, really. I mean, you would not have a toll road across Northern Indiana if there was not an Ohio on one side and Illinois and the whole national economy. So this is an opportunity Indiana has to upgrade that, extract some money from it and improve infrastructure across Indiana. It is an opportunity other States don't necessarily have, and other regions, so that becomes a national concern.

And I guess I have a couple of questions. One is if Federal policy changes or laws change or we do different things in the infrastructure area that may impact this contract, are there escape clauses, or is this in any way a constraint on what we are doing, a risk that Indiana is assuming? How does the Federal program interface with this private contract that Indiana has entered into with—as far as this public facility is concerned?

Governor Daniels. In no way I can foresee right now, Mr. Chairman. This road was constructed by the State of Indiana with bonds that the State of Indiana let and is still paying off. We will finally retire them because of this latest transaction. So I don't foresee that happening. It is an important point to us that two-thirds of the traffic on the road, two-thirds of the tolls paid on the road are paid by out-of-State motorists today. That is another reason we

found this effective from our State standpoint, an effective way to close our gap.

Mr. PETRI. We have a lot of transportation hot spots all around the United States. One of the areas of greatest demand actually is out in California, which has particular problems because of Proposition 13 and a variety of other constraints on their ability to raise revenue. So we have had, repeatedly, regions in California coming out here, talking about how they have convinced their voters, despite the anti-tax climate and everything else, to impose taxes upon themselves by two-thirds votes for billions of dollars in just one individual county, Riverside County, California, for example. And they not only do it once, they do it every four or five years. But they do it through very painful, difficult, complicated political leadership involving building coalitions, meeting a variety of needs, and, finally, achieving enough of a consensus to go forward, something that was attempted in Northern Virginia. It is very complicated and they are still working toward that.

But it is a good model as to what—and the bottom line, though, is—and I would like your comments on this—that when you go through that process, you end up with public support and understanding of the need for this infrastructure. If you short-circuit that, despite the interim pain, you may, over a very long period of time, be undermining our economy because there is not real public support for infrastructure, you are extracting it from the private sector, using it at sort of cheap because they are not paying for it as it is going forward directly, and the public understanding and appreciation of this role of government is gradually being diminished, and it could make us less vital as a polity, so to speak.

Could either of you comment on that? Is this an expedient that is necessary in the short-run but unwise in the long-run, or is this the way of the future?

Governor DANIELS. Well, that is an interesting question. I don't deny the importance of abstractions like public appreciation. I am trying to build it all the time. I think it is fairly obvious to most citizens of a State like ours, but I am constantly talking, and have long before this transaction, about the central importance of public assets, transportation infrastructure of all kinds, to the future success of our State.

I wasn't prepared to wait years to try to build this. We had coalitions, all right. We had every group that spoke on this subject, including strong support of building trades unions, for instance, all of local government, and we will continue trying to rally people to this notion, because as Governor Kaine says, this is not a complete solution, and we have many other hurdles to cross to have the kind of transportation network that we want.

But, again, to return to what I said again, people keep asking about risks and so forth. Does no one notice the risk of inaction, the enormous cost of inaction? And we had already paid it for decades in our case, waiting for an I-69, waiting for a north central to northern corridor we call 31, waiting for a transverse road we call the Hoosier Heartland Corridor. And no one seems to have calculated the cost, the lost jobs and the economic activity, that Indiana paid for sitting around waiting for a miracle under the old system.

So I support strongly, and I hope to contribute in my days in this job, to an ever-stronger appreciation by people about the importance of roads and bridges and about the fact that they are never free. We are only talking about which way to pay for them, and the extent to which users should pay more directly or spread it to everyone. And that is a useful debate, but I didn't want to have it for years and leave office leaving the same empty promises behind.

Governor Kaine. Mr. Chair, if I could just answer the same question. It could be a matter of political expediency if we promote the notion that public-private partnerships are going to be the full answer, because they are not. And one of the things that I find frustrating is that, you know, there are some who will talk about public-private partnerships as if that means that the State doesn't have to be a leader.

I am involved in a very, very difficult special session now about State funding for transportation, but I still have some real optimism that we will get there. The timing is up in the air. But public-private partnerships are part of the solution; local empowerment is part of the solution; coming, hat in hand, to the Federal Government is part of the solution. But the State also has to make some, you know, hard decisions about the level of our investment.

And if we push the notion that public-private partnerships are going to be the salvation of it and that no one else has to make any hard political decisions, then we will have used an expediency that is inaccurate. It can solve a very important chunk of our problem, but much of the problem will still be on our shoulders in terms of making some hard political calls.

Mr. PETRI. Thank you.

Mr. Pascrell?

Mr. PASCRELL. Thank you, Mr. Chairman. Mr. Chairman, I find it interesting when we are—to find out what is the best way we can get the most out of a public asset. I think that is at the core of what we are talking about, whether we are talking about privatizing a road or privatizing a water system. I want to know what the public is going to get out of this. I think that is the rub in all of this.

I believe in a market economy, but privatization of the infrastructure, to me, is very serious business. If we privatize the road, would that road be eligible for Federal dollar directly? What form of subsidizing does this take?

You know, New Jersey has looked at a very similar plan. At this point, has rejected it, for the most part. You are having on the gubernatorial level. We have problems on the Federal level dealing with our trust fund. The trust fund, by 2009, will be in the red by \$2.3 billion. We have a very serious problem, on the Federal level, maintaining our leverage here. And, as you see, we are really anxious to deal with it.

On top of that, States are facing severe constraints with their own budgets. My home State of New Jersey toll roads have been ubiquitous since 1950s. The Turnpike and the Garden State Parkway bring the State \$829 million from tolls annually. These are temporary tolls, at least they were supposed to be—like the tolls on the George Washington Bridge. Temporary tolls on the George

Washington Bridge. But they have become a staple for transportation financing.

The Federal-State partnership I believe has been a productive one for financing and planning our Nation's roads. Privatization roadways may result in a loss of control over management and the operation of the facilities, like toll rate setting or even the improvement of the other roads in the geographic proximity. So we are a long way from resolving, and this is an option.

In the biggest highway privatization deal in U.S. history, Indiana signed an agreement last month, as you know, to turn the 157-mile Indiana toll road over to a foreign consortium—ah, that rings a bell—and it will operate for a profit for the next 75 years. Under the lease, the Spanish-Australian consortium, Cintra Macquarie, will pay the State \$3.8 billion up front and will be responsible for operating and maintaining the highway. It will get to keep the toll revenue it collects. It is my understanding that this is already a toll road, so the initial construction of the road is presumably already paid for.

I have a couple of questions. Will the lease make up for lost revenue, toll revenue normally received by the State? How about the Federal Highway matching funds? What plans are there to ease congestion, since this is going to be a private road owned by a foreign consortium; was this a motivating factor? What steps, if any, have been taken to ensure our homeland security when contracting with a foreign interest on a vital piece of our Nation's infrastructure? Governor Daniels, I would ask you to respond to that. That is four questions I asked.

Governor DANIELS. I don't know if I counted four, but let me deal with some of them. First of all, we need construction today; our toll road loses money fairly accounted for. And the second benefit in—I think you said earlier on what does the public get. Our public gets \$5 billion of new roads and bridges it wouldn't have had otherwise. That is what we get. We get a quadrupling of the new construction from current levels; we get projects that have been on the drawing boards of our State for a long time. That is what—

Mr. PASCRELL. Now, Governor, when you say the public gets \$5 billion—

Governor DANIELS. Four billion dollars plus interest.

Mr. PASCRELL. Yes. What do you mean the public gets it? The State treasury gets it, correct?

Governor DANIELS. Well,—

Mr. PASCRELL. And then are we supposed to use that money, the money that you get, how are you supposed to use that money, is that categorical money, is it universal money?

Governor DANIELS. You weren't here for the opening, Congressman, but I said—

Mr. PASCRELL. I read your statement.

Governor DANIELS. And I said that it was a cardinal principle for us that the money would not be spent on any purpose other than reinvestment in, we hope, the highest priority and the best chosen projects we can leave—

Mr. PASCRELL. Is that defined in the contract—

Governor DANIELS. Yes, it is.

Mr. PASCRELL. Is that defined in the contract that you established with the private company that—

Governor DANIELS. Well, they have nothing to do with that. It is defined in the law that we passed in the general assembly of our State. There was only one exception which I did agree to, and that was to immunize passenger cars from any increase. Think of it as a dividend back. So in 2016, the passenger motorists of Indiana will pay the same toll they paid in 1985. Pretty good deal; 15 cents at least at certain toll booths.

Mr. PASCRELL. And that toll money goes to the private consortium, correct?

Governor DANIELS. They will collect the tolls, and if there is any—and they may make money, they may not, but, again, the risk of that is entirely on them.

You asked about congestion. Good question, important to us. We have been struggling to prevent congestion from building on that road, haven't been able to do the maintenance and expansion that we like. They are bound to do that; they have committed to billions over the course of the lease. And as I frequently reminded people, that is written into the agreement. There is a definition of traffic flow, an A through E system, as I recall, and they are required to add capacity or to maintain or improve the speed with which traffic moves across that road. But I think it is important to note that that is really the State's second line of defense. The first line of defense is if that road becomes undrivable or less tolerable, they lose money, and they will be driven, in my opinion, by their own requirement, the market's requirement, to please their customers, to see that that never happens.

Mr. PASCRELL. Governor, just respond, in conclusion, about the Federal Highway matching funds. How about those funds?

Governor DANIELS. Well, I am not sure how they are—

Mr. PASCRELL. They are our tax dollars.

Governor DANIELS. Well, the toll road was built with Indiana dollars, and not Federal dollars; it was built with bonds. And maybe New Jersey's was the same, I don't know. But I am sorry if I am missing a point here, but I don't believe there is an implication with regard to, for instance, the return of dollars or anything like that. They were built with bonds the State borrowed against its own full faith and credit, and has continued to pay interest on all these years.

Mr. PASCRELL. When I talked about matching funds, you are changing ingresses and egresses along the highways constantly for safety reasons, etc., etc. Whose responsibility is that, and will there be matching Federal dollars you will seek, the company would seek, the consortium would seek?

Governor DANIELS. No. If you are talking about the toll road it is their responsibility out of their pocket.

Mr. PASCRELL. So they will not have the ability to seek Federal dollars?

Governor DANIELS. I guess anybody can come down here and ask, but that is not a question—

Mr. PETRI. We will have another round. Thank you.

Mr. Duncan.

Mr. DUNCAN. Well, thank you, Mr. Chairman, and I will be very brief. I have got just a couple of questions.

I was in a congressional delegation chaired by Chairman Rogers about two and a half years ago, and one of the places we went was Australia, and we met with one of the companies that is going to testify in the next panel, and I am a little bit curious. Do either one of you see a problem or have a concern about foreign companies leasing some of our major roads or investing in that way, and do you think the public would accept that type of thing if it was shown it was pretty good financial deal? I know they are doing that in some other countries. Have either one of you looked into that or considered that?

Governor Kaine. Congressman Duncan, we have, in Virginia, wrestled with that question. We have kind of a uniform principle that if we are dealing with an investment group that is foreign owned, that we require them to incorporate in the United States and have a U.S., on-the-ground presence that is incorporated here. That is at a minimum of what we look for.

One of the principles that we feel very strongly about—and, again, this is—this kind of changes deal to deal, because there are not just cookie cutters on these deals. But we want the value that is generated in a corridor to stay in that corridor, so we are not spending the money in the corridor on general fund activities it is for transportation; we are not spending it in other parts of the State, we want to keep it in the corridor. And even the notion will there be a profit margin that will go somewhere else, we weigh that issue and sometimes decide not to go with a private investor or even a foreign investor if there was a way we could keep every dollar of value in the corridor where the project takes place. But we resolve that question somewhat differently depending on the deal and who is coming to the table to offer it or participate. Sometimes you have a lot of interest, sometimes you have a little bit of interest, and we have to tailor it depending on the project.

Mr. DUNCAN. Is that similar to the way you handle it, Governor Daniels?

Governor DANIELS. Yes. I mean, this consortium is an American corporation that will have a board and there will be local representation on that. As I understand it, we will put an oversight commission in place at the State level to make sure that this very thick agreement is lived up to scrupulously. I personally insisted on a “buy Indiana” requirement on the consortium so that virtually all of their—certainly all of their hiring, but virtually all of their goods and services will be bought in our State.

And I guess, lastly, I am at a loss to know what to say about this concern about foreigners. For openers, Congressman, Australians have fought beside us in every war and died for the same freedoms we cherish, and I think it is an insult to them to suggest that somehow they would—some company from there, not a country, it is not a public entity we are dealing with—would in any way undermine that, not to mention it would undermine their own business interest to do something injurious to the interest of this Country.

I mean, I will just tell you on behalf of our State—and I bet New Jersey is no different—I consider a significant part of my job to

successfully compete for foreign investment. We are proud to have hundreds of companies in our State from Europe, from Japan, and elsewhere, and I consider it a victory for Indiana when those dollars come here and put Hoosiers to work, as opposed to go somewhere else. So maybe the mind could conjure some situation that ought to be guarded against, but it is not this one.

Mr. DUNCAN. Well, I think those are very good answers. Let me quickly ask you about something else.

I chaired the Aviation Subcommittee for six years and we found that, well, the worst example was the main runway at the Atlanta Airport took 14 years from conception to completion, but only 99 days of actual construction, and we found that highway projects and all these projects take three or four times as long as they should because of all these environmental laws and rules and regulations. We tried to put some environmental streamlining in the last highway bill, but do any of you—have you seen problems like that and do you have any specific suggestions about how we could speed those processes up?

Governor KAINE. Congressman, I have to admit I am still pretty new on the governor job; I have just been in for four months, so I haven't experienced problems yet that would give me suggestions. You know, we do have one significant public-private partnership under consideration dealing with Interstate 81 in the western half of Virginia, and there are some serious environmental issues raised by the citizenry in that area concerning that infrastructure we are having to work through in public comment. Thus far, it has seemed to me that the environmental issues are significant enough that we ought to be considering them, but I don't have any particular suggestions about that here today.

Mr. DUNCAN. All right. All right, my time is up. Thank you very much.

Mr. PETRI. Ms. Carson.

Ms. CARSON. Thank you very much, Mr. Chairman, and thank you very much, Ranking Member DeFazio, for holding this hearing.

Welcome to the two Governors who are here to enlighten the Committee on this public-private partnership and explain in detail what all these toll roads are going to do for America once they are turned over to private enterprise.

Indiana is the crossroads of America, and, like the rest of America, Indiana is in dire need of transportation investment. I personally feel like transportation is one of the greatest investments that any public entity could make on behalf of its citizens. I have my reservations about leasing all of our toll roads to private investors to raise money, but we in Indiana can certainly all agree that we have some critical projects that need funding and that will provide high-paying jobs, hopefully, with excellent results for Hoosiers. And while I have the floor, because I probably won't ever get it again from the Chairman, with the contract contains a clause that prohibits Indiana to build or improve roads that might compete with the Indiana toll road, will the contract do that? According to the GAO report, all previous public-private and toll leasing partnerships range on that from 30 to 50 years. Why is Indiana on a 75-year contract, so much longer than the rest? And if this 75-year deal goes through, it will earn \$3.8 billion for the State, but the

total cost of your 10-year plan is \$11.8 billion. Doesn't that even come close to funding the project, or does it?

I know you thought I was going to be mean to you, but I am not, I am welcoming my Governor here, and appreciate very much you taking the time. And I will yield back and let you answer my questions.

Governor DANIELS. Thank you, Julia. Always fun to see you.

The answers are, yes, we have a non-compete clause. I think they are fairly typical. Ours is pretty narrow, it says no interstate quality road within 10 miles of the toll road. There is nothing on the books, in the plans, in the dreams of Indiana. In fact, the only road that could be used or corridor that could be used conceivably to touch that clause, every mayor along it is determined will never be expanded; it would bulldoze through the middle of their towns. So we don't believe we gave up a thing in the non-compete clause.

The 75-year question is a good and frequent question, and the answer has to do with tax law, frankly. We still own this road, and always will; this is a lease, not a sale. And for the tax advantages in various jurisdictions of a lease to pass along to investors, as I understand it, depreciation and interest costs and other deductions, that lease has to be of a certain term. The Chicago lease is 99 years, which struck me, as it would anyone, as an extraordinary time period. We were told by counsel that they were nervous at anything less than—at 50 years or less, and opted for a midpoint. I don't know, and you would have to ask an expert, whether something shorter than 75 could still achieve the value for Indiana that we achieved. But I know that if the lease had been much shorter than that, it wouldn't have been 3.8, it might not have been 2.8 or 1.8 or anything really worth accepting.

Lastly, yes, 3.8 is less than 12 billion, but that is the gap we were talking about. Somewhere I even brought a chart, I don't know. Without that money, Congressman Carson, we would have continued, as we have in Indiana, limping along, funding less than half the new construction we need. We are going to quadruple new construction as we catch up. And we have done less of the maintenance we need, less of the preservation we need, just continued to sort of put patches on a system that really needed to be rebuilt. So it makes all the difference in the world between the hand-to-mouth world we have been living in and actually funding—in advance, I should say—the plans that we have always dreamed about.

Mr. PETRI. Thank you.

Mr. Coble.

Mr. COBLE. Thank you, Mr. Chairman.

Governors, good to have you all with us.

Mr. Chairman, I apologize. I had two other meetings, so I am a belated arrival.

My colleague, my friend from Tennessee, read my mind. I was going to ask you all about the foreign transportation operators, but I think you all adequately responded to that. That appears to be hot copy now.

Let me ask you this, gentlemen. How realistic or fair is it—strike that. Let me say it a different way. Advocates of toll roads oftentimes say the good future is that you realize revenue from out-of-State motorists, which, of course, is realistic. Opponents, of course,

won't know toll roads at all to be in existence. How realistic or fair, Governors, is it to have a toll road in one portion of the State and use the proceeds therefrom to construct projects in other portions of the State? In other words, you are having motorists on the eastern end of Virginia or Indiana paying the toll, and then you divert those monies to the western end of Virginia or Indiana to construct new projects. How realistic and fair is it, (a); and, (b), is it difficult to sell to the public taxpayers?

Governor DANIELS. I will give you our experience. A very realistic and fair question, one of the first ones we asked. In our case, we committed 34 percent of the value that we are going to receive to 7 counties out of 92, those 7 being the ones the toll road passes through. Thirty-four percent is the amount of tolls paid by all Indiana motorists from all 92 counties. I am up there frequently, and the tolls that I might pay or a motorist from anywhere else might pay would be in the 34 percent figure.

And with just your question in mind, we said that the areas which have been host to and supported this road these years ought to come first, and we gave them every penny of value that any Indiana motorist created in this arrangement. Actually, it is far more than that, because some of the major projects that will directly benefit that part of our State will connect it to other parts of the State, and I am not even counting that in the calculation.

So that is the way we addressed it. It was batted around extensively in the legislature, how much is fair, and that, I think, became the consensus point of view.

Governor KAINE. Congressman, in Virginia we have a very fixed rule that we don't take any value out of the corridor where it is raised. We have to use it for transportation in the corridor where it is raised. All the transportation investments do not have to be highway, they can be transit or rail, but the value has to stay in the corridor.

And we are involved in a complicated one right now, the discussion about the Dulles Toll Road and rail to Dulles. That may well be the most valuable corridor, in terms of its density of use, in Virginia, and there would be opportunities to use revenues from that corridor to do projects elsewhere in the State, but I have taken the position that Northern Virginia commuters shouldn't be paying tolls and then not getting the benefit of the tolls they are getting. So we, by law, do not ship value to any other part of the State other than the corridor where it is raised.

Mr. COBLE. Gentlemen, do you see that this is a partisan issue for either one of you, I mean, Democrat and Republican?

Governor DANIELS. I think it definitively is not. This is—

Mr. COBLE. I would think it would not be either.

Governor DANIELS. This is a debate, as I see it, between—about a practical solution to a problem, and, frankly, I find the objections to it ideological and not pragmatic. I think it is a debate between—I think governors tend to be fairly pragmatic because that is the nature of our job, it really permits nothing else.

I will say it did become partisan in our State, and I am sorry it did, and I tried hard to prevent that. But aside from some members of our Black Caucus who voted for the bill, it did become partisan, but I don't think other debates need to be. I just simply look

around. Most of the activity has happened under Democratic governors and mayors; Mayor Daley in Chicago, the last couple governors of Virginia, and now in Illinois and now in Pennsylvania.

So honest people can differ about the practicalities of this approach. I think well done; they speak loudly for themselves. But this whole matter of solving our national infrastructure problem I would hope would be the least partisan of our debates. The need for it is something that affects us all and we are simply talking about the best way to get to a good outcome.

Mr. COBLE. Governor?

Governor KAINE. Congressman, if I could say I would agree with what Governor Daniels says. I do not think it is partisan. I think it can be ideological, though, because, again, the one danger I see in this discussion—and I am a proud proponent of using these partnerships when they are right. There can be an ideological danger because there are some who say public-private partnerships are going to solve 100 percent of our transportation financing challenges, and that is an ideological position that some advance that is just wrong.

I believe that these partnerships have the capacity to solve a healthy percentage, 20, 25 percent of our challenges. They are not going to solve challenges in rural parts of the State or places where there is not sufficient density of traffic. And so there is no substitute, then, for State leaders and Federal leaders having reliable sources of infrastructure funding in addition to public-private. So it can be ideological that way, but I agree, the Dems and Republicans mayors and governors, you know, we are deal makers and we are going to look for the best way to advance a need to serve our citizens, and in some cases this is the best way.

Mr. COBLE. Well, you all have sought employment, as have we, where the word partisan is not unknown, and I thought that was a pertinent question. Gentlemen, thank you all for being with us.

Thank you, Mr. Chairman.

Mr. PETRI. Thank you.

Mr. Michaud.

Mr. MICHAUD. Thank you very much, Mr. Chairman and Ranking Member, for having this hearing.

I want to welcome both Governors here. I have several questions for both of you, if you can answer them. My first is I understand that while there has been controversy related to project labor agreements, I believe that they are effective at keeping project costs down and ahead of schedule, in a timely manner. Where can we as a Committee find an analysis of project labor agreements as it relates to highway and bridge construction as far as the cost-effectiveness?

My second question is what happens to the Davis-Bacon Act when you look at public-private sector investment?

The third question is, Governor Daniels, you had mentioned about working with the building trades, and I assume that has been successful, you moved forward.

I guess my question to Governor Kaine would be have you worked with the building trades as you move forward on these public-private sector agreements?

My next question is on weight limits on public-private sector roads. What is the weight limits on those roads?

And my last question is, Governor Kaine, you had mentioned that they are paid primarily through tolling and other ways. My question would be what are the other ways.

Thank you.

Governor Kaine. Just to tackle the specific questions directed, other than tolling, what are ways we pay for public-private partnerships? We have a significant project near the Dulles Toll Road, it is Route 28; 10 interchanges, a sizeable project. The way we have done that in a public-private venture without tolls is that adjoining landowners, the value of whose land would be benefitted by the project, have agreed to pay an enhanced property tax assessment, with the guarantee that all those monies would go into corridor improvements.

And that will be a feature of funding the rail expansion to Dulles as well. There will be tolls, but there will also be property owners who, by a vote, have agreed to have a special assessment that they would be assessed to help with the infrastructure improvements.

On some of the labor related questions, we have not done project labor agreements in Virginia. Our PPTA projects tend to be on Federal roads where the Davis-Bacon Act applies, so that law does apply to most of the PPTAs that we have looked at.

And then, finally, in terms of our working relationship with the building trades on some of these projects, the one that I am very involved in now is the rail expansion to Dulles, and we have made a decision, after a fairly careful review, that the right project manager for that project is the Metropolitan Washington Airports Authority, and they have a long history of working with building trades on capital construction projects at the two airports under their jurisdiction. So while we are still working on the details, there is a comfort level, I think, among the labor community with the way that the deal is being structured and the big picture, because it is a known relationship; they are doing work at the airport right now.

Governor Daniels. Quickly, no PLA required on the transaction we did, and, as a practical matter, I think it is all but certain, it is just the nature of the marketplace in our State, that this work will be done by union contractors; if not every penny of it, very close.

Davis-Bacon will apply whenever Federal dollars are involved. That will be most of the projects we do. We will certainly take these proceeds and, as I explained, fill out the huge gap that we faced. But in most cases it will be a mix of funds, as I understand it or it will be on a Federal road directly, so Davis-Bacon should apply in virtually every case, if not all.

And on weight limits and all other such things, Congressman, we specified at least the current standards, whether it is congestion, traffic flow, everything down to snow removal and how long it takes to get a dead animal off the road is covered, and we specified at least today's standards, which we have been struggling to maintain because the road is, at today's toll levels, is not really covering its full cost.

Mr. Michaud. So is that 100,000 pounds or 80,000 pounds?

Governor DANIELS. You are above my pay grade now.

Governor KAINE. Yes, I am not sure either. I am sorry, I can't answer that, Congressman Michaud.

Mr. MICHAUD. Okay. On the Davis-Bacon, so you said it applies for where Federal dollars are used. But on these public-private partnerships, are all those agreements that both States have, are there any Federal dollars involved in that or are they primarily just private sector dollars? And if they are, do you apply Davis-Bacon to that?

Governor DANIELS. Well, of course, today we have not constructed one, so we have not encountered this yet. The one we are looking at and have authority for would absolutely have Davis-Bacon involved, for both reasons: it would be a Federal corridor, I-69, and we don't imagine that tolls could defray more than a significant fraction of the cost. So there would be a lot of Federal dollars used on the project, and Davis-Bacon absolutely would be required.

Governor KAINE. And the projects that we are looking at are all part of the Federal system as well, and Davis-Bacon applies to them.

Mr. MICHAUD. Okay. Thank you very much.

Mr. PETRI. Thank you. We are going to have to wrap the hearing up fairly shortly, but Mr. Shuster.

Mr. SHUSTER. Thank you, Mr. Chairman.

And thank both you Governors for being here today. And I thank, Governor Daniels, you are correct in your statement that infrastructure shouldn't be a partisan issue. In this Committee we try not to make it that way.

The question I have for Governor Kaine, congestion is why we are—and I know, driving down here to Washington from Pennsylvania, I deal with it every week. My question is, though, about alternatives to building roads. Does the railroad offer—and I know here in Virginia you have talked about that 81 corridor rail line running along there; there are discussions going on. How much of an impact do you think that will have and is that a real relief to getting freight off of highways onto the railroad tracks?

Governor KAINE. Certainly. Thank you for the question, Congressman. We do believe rail offers two very important solutions for us as we tackle congestion. The first, in some of the high-density corridors—Richmond, Washington, and ultimately Richmond to the Virginia Beach-Hampton Roads area—instead of more congestion on Interstate 64 and Interstate 95, there is rail corridor there. We do have a State-funded rail system, the Virginia Railway Express in the I-95 corridor down to Fredericksburg, and we will continue to expand that so that passengers will have some option other than being on the road.

And, second, with respect to the freight rail systems in Virginia, Congress, in the transportation bill last year, did a significant amount of funding for the Heartland Corridor project, which is an upgrade of the freight rail system essentially from the Port of Virginia all the way out to Chicago, allowing double stacking of freight containers, and we are very engaged in that; just announced an intermodal facility in the Roanoke area, because every double stack we can put on takes about three trucks off Interstate 64 through

the tunnel in Hampton Roads, and so we believe east to west along that corridor. And then also potentially north to south along Interstate 81, the dedicated rail fund that we have put into our budget for the first time in Virginia history will enable us to make some capital investments for guaranteed investments and returns by our freight rail partners, and that we can then use those investments to reduce congestion.

So we do see, you know, these things all tying together, and enhancing rail, both passenger and freight, is going to be one of our strategies to congestion reduction.

Mr. SHUSTER. Well, thank you for insight on that.

Governor Daniels, I know that selling or leasing assets, infrastructure assets I think is something we need to be looking at, and I know you have done that in Indiana. The question I have is in Ohio they raised the rates on the Ohio Turnpike by about 18 cents and truck traffic significantly went onto the secondary roads, and I guess Ohio had to go back and adjust those to get them back on the Ohio Turnpike. In your lease agreement do you have a clause in there that will—because I understand in 2010 Indiana is going up by 20 cents. If that same kind of diversion goes on, what can you do to address that in your lease?

Governor DANIELS. Well, obviously, we studied the issue of diversion very carefully and, of course, so did the investor. If people divert, it comes out of their hide and they lose money. So they have every interest—their interest is exactly aligned with the State's in trying to have a road which is free-flowing and encourages people and seems to be a bargain at the price.

Congressman, our tolls are antiquated, they haven't changed since 1985, they are a fraction of the tolls in Ohio, Pennsylvania, Illinois. Even after the increase they will be well below those. Even after—even a few years from now they will be below the level that I understand Ohio is about to return to. And we visited very carefully with every sector of the trucking industry and, in fact, changed our initial proposal. We had put a proposal in the regulatory process—incidentally, you don't have to pass a bill in our State to change the tolls, this could have been done any time in 20 years administratively. And we put a rule in the process, which we subsequently modified, to guard against diversion, and we have been told by the leaders of the trucking industry they are quite comfortable starting with this very low base and then stepping in over the course of years, tolls which will still, as I say, make us, we think, very competitive.

I look at this as an issue of competitive pricing. You only shoot yourself in the foot if you—as perhaps some other States have. If you raise the price of something too far, your customers find another option at some stage, and I hope we have been careful to avoid that.

Mr. SHUSTER. Well, thanks for the answer, and appreciate your being here today and look forward to working with both of you as we move forward on these issues. Thank you.

Thank you, Mr. Chairman.

Mr. PETRI. Governor Kaine, Governor Daniels, thank you for your leadership in helping to meet our Nation's vital infrastructure needs. We are looking to your experience and example, and that of

others, as we struggle at the national level to maintain our competitiveness and provide for our population going forward.

I thank you for your flexibility as well in adjusting the schedule of this hearing.

The hearing is recessed until 12:30. Well, we will start 15 minutes after the Prime Minister of Israel concludes.

[Recess.]

A F T E R N O O N S E S S I O N

Mr. PETRI. The Subcommittee will come to order.

We will now introduce our second panel. We will hear today from Bryan Grote, a Principal with Mercator Advisors, LLC; D.J. Gribbin, who is the Director of Macquarie Holdings, USA, Inc.; Mark Florian, Managing Director of Goldman, Sachs and Company; Karen J. Hedlund, a partner with Nossaman, Guthner, Knox, Elliot; John Foote, Senior Fellow at the Kennedy School of Government; and the Honorable Matthew Garrett, Director, Oregon Department of Transportation.

We welcome you all. We thank you for the prepared statements that you and your organizations have prepared and submitted for the record. They will make a real contribution. And, as you know, our Committee puts them out; they are available for public review, and this is a subject that a lot of people are studying and reviewing all around our Country, and we appreciate that effort doubly as well.

I think, if it is all right, we will start with the Director of the Oregon Department of Transportation, Mr. Garrett.

TESTIMONY OF BRYAN GROTE, PRINCIPAL, MERCATOR ADVISORS, LLC; MARK FLORIAN, MANAGING DIRECTOR, GOLDMAN, SACHS & CO.; D.J. GRIBBIN, DIRECTOR, MACQUARIE HOLDINGS (USA) INC.; KAREN J. HEDLUND, PARTNER, NOSSAMAN, GUTHNER, KNOX, ELLIOT, LLP; JOHN FOOTE, SENIOR FELLOW, KENNEDY SCHOOL OF GOVERNMENT, HARVARD UNIVERSITY; THE HONORABLE MATTHEW GARRETT, DIRECTOR, OREGON DEPARTMENT OF TRANSPORTATION

Mr. GARRETT. Chairman Petri, Ranking Member DeFazio, Chairman Young, I am Matthew Garrett. I am the Director of the Oregon Department of Transportation, and I truly appreciate the opportunity to share some thoughts with you on our efforts related to public-private partnerships.

I will tell you Oregon has engaged in the public-private partnership conversation out of necessity. We are challenged on many levels. We are challenged by growth in our major metropolitan areas, we are challenged by the congestion and the economic implications that it brings—and this was validated by a study done by the Portland Business Alliance called “The Cost of Congestion,” businesses actually saying they are having to make business decisions affecting where they build their warehouses, where they and how they staff their various shifts. Bottom line, issues that, in the end, have implication to their bottom line. So the cost of congestion is much more than just a transportation conversation, it is an economic conversation.

We are challenged by an aging infrastructure and we are challenged financially. And this was validated by our current Oregon

Transportation Plan. That plan is our 25 year policy and vision document that has identified an annual \$1.3 billion shortfall that is needed in order for us just to properly maintain and grow the State's transportation system.

Simply put, Oregon's transportation infrastructure needs far exceed our revenues. These realities demand that we look beyond the traditional funding mechanisms we have available at the State.

Our approach has taken two pathways. The first—and this is a conversation that has already played in front of this Committee, the road user finance fee. Our efforts to look into the future, to look at an alternative to the gas tax and move toward a per mile tax, a true user fee. This pilot project is engaged, we are about a month into a year-long trial where we have identified 280 folks who have placed transponders in their cars. We have identified two gas stations in the greater Portland Metro area that have transponders on their equipment, and we are starting to tally the vehicle miles traveled between fill ups, so to speak. Look forward to sharing these thoughts about a year from now, as the report and the assessment plays itself out come April of 2007.

The second pathway we are walking down is indeed our focus today, public-private partnerships. In 2003 we received legislative authority or direction to be much more aggressive in engaging the private sector in terms of innovative design, innovative delivery, financing. Bottom line, speed, delivery, leveraging private sources of capital to expand the highway system was the direction and the tenor and tone of the conversation from our State legislature.

We have been somewhat strategic in our approach. Oregon has focused on three public-private projects. They are major capacity projects, projects that would be considered mega-projects to Oregon having costs associated into about the half billion dollar price range. They have been on project lists for decades. Just our financial streams haven't been robust enough to fund these type of projects..

Thus, we are looking at reintroducing tolling. We are looking at value capture, as well as access to private equity capital to help augment the existing revenue streams, thus allowing us to fully fund and construct these type of projects. We are currently engaged in the pre-development phase with a consortium of companies led by the Macquarie Infrastructure Group. This effort is to evaluate the financial and the technical feasibility of the various options to build these projects. Their work in this pre-development phase will bring the projects to a point where they can secure private sector funding.

In addition to demonstrating the technical and feasibility or, excuse me, financial feasibility, it must be shown that it is acceptable to the public. This is extremely important to my commission, to my Governor, that third leg of the stool: what is the feeling of the public at large and how does that influence the conversation, because, when all is said and done, the public will tell us whether the need for the projects are compelling enough to walk down this new avenue for funding.

Now, should this be accomplished, playing out a scenario that we move through this first phase, our private partner would earn the exclusive right to enter negotiations with ODOT to implement a

contract to build and perhaps operate the facility. Those are negotiations that will take place into the future.

Now, even turning to public-private partnerships, we are not giving up our role as the stewards of the public interest. ODOT would retain control over the direction of the projects. All these projects will comply with all the Federal and State requirements. We will not lower the bar on land use issues, on environmental issues, on labor issues.

Let me conclude by saying that I have mentioned the challenges of feeding this transportation appetite. It is formidable, to say the least, and we see the public-private partnership as a strategic and surgical tool to be used. It is a piece of the solution, it is not the whole solution.

With that, Mr. Chairman, I am happy to answer any questions.

Mr. PETRI. Thank you.

Mr. Grote.

Mr. GROTE. Thank you, Mr. Chairman and Mr. DeFazio and Chairman Young. My name is Bryan Grote. I am a principal with Mercator Advisors. My company helps develop financial plans for major projects. We also work with government agencies to design and evaluate financial assistance programs.

Over the last 15 years, public officials have begun turning to the private sector to share management responsibility and supplement government resources for transportation infrastructure. In my remarks today, I am going to briefly focus on three questions to help summarize the nature and extent of public-private highway transactions, and hopefully to put PPPs in a useful context for examining their potential to generate new capital.

What types of PPPs are being employed? The generic term, public-private partnership, encompasses a wide range of relationships, contractual, through which public entities and private entities collaborate in the delivery, operation, financing, and/or ownership of an infrastructure project. Different arrangements can be thought of from a spectrum: traditional government delivery at one end to the private concession model at the other. In my written testimony, Exhibit 1 illustrates a basic array of the possible arrangements.

PPPs appear to be best suited for those large, complex projects with acknowledged need and strong support. Private sector involvement can provide substantial benefits in terms of accelerating development, taking on construction and performance risk, providing efficient operation and superior service, introducing new technologies, and even attracting new capital.

So how much private investment can be generated by PPPs? Some arrangements involve projects capable of generating their own revenues, whether direct user charges like tolls or indirect beneficiary fees, what people call value capture, such as development impact fees or special district assessments. They are of particular interest. They do have the potential to generate new resources for capital investment.

But despite the visibility of several large toll-backed financings in recent years, highway capital investment in the U.S. is still dominated by traditional public funding. About 94 percent of the nearly 750 billion invested in highway capital nationwide between 1993 and 2005 has come in the form of either public grant funding

or tax supported bonds. Only about 6 percent has been in the form of what could be considered private, that is, non-tax supported investment, through toll-funded grants, tax-exempt toll revenue bonds, or taxable debt and equity capital.

While their national investment effect is modest thus far, the usefulness of PPPs in advancing particular projects, especially things like major corridors and urban connectors, is considerable and growing. Nationwide, some 21 billion of investment in 43 highway facilities has been accomplished using various public-private templates over the last dozen years. California, Florida, Texas, and Virginia are leaders in this field, having accounted for 50 percent of that total dollar volume.

So why might a concession or long-term franchise approach make sense for some projects? The rationale for using concession type approaches lies with the revenue risk profiles of the projects being financed. Large start-up toll projects tend to face significant construction and revenue ramp-up risks. But in the long run these projects generally are able to generate net revenues in excess of operating and maintenance requirements. The more flexible and patient capital provided through private concessions may better match these project profiles than the municipal market.

Also, as we have seen with the Chicago Skyway and the Indiana Toll Road lease transactions, such a capital structure can monetize up front sometimes a significantly larger sum from a given revenue stream than a traditional municipal bond approach.

This Subcommittee has been at the forefront of efforts to bolster Federal support for PPP approaches in recent years, from design build contracting and environmental streamlining, to providing greater flexibility to charge tolls and implement pricing, most recently to enabling lower cost debt financing for certain public-private highway and intermodal projects with private activity bonds. Continuing to focus on improved asset management and service performance, and to support private investment in user-backed facilities, perhaps through tools such as governmental seed capital, credit enhancement and tax subsidies, will help project sponsors utilize PPPs to their best advantage, and that is in addressing important public infrastructure needs.

Thank you for your time this afternoon.

Mr. PETRI. Thank you. And I apologize for not saying Grote.

Mr. Florian.

Mr. FLORIAN. Thank you, Mr. Chairman and Subcommittee members, for the opportunity to speak today. I am Mark Florian. I am a managing director at Goldman, Sachs and manage our infrastructure advisory business. I had the privilege of serving Mayor Daley and his staff in the sale of the Chicago Skyway Concession as their advisor, and the privilege of serving Governor Daniels and his staff in the sale of a long-term concession in the Indiana Toll Road.

I am going to frame my comments in three or four different buckets: one, what is the problem that we face in transportation finance today; second, what is a PPP, or a public-private partnership, and how can that potentially be a solution; third, why are they viable in today's market; and, finally, how do you protect the public and the public good.

The problem, as we have all identified, is that there is a widening gap between transportation needs and funding sources. As you know, the Federal Government was actually quite generous in the 1950s and 1960s in providing a national highway system, and that system now needs renewal as it is very expensive to maintain that existing system. Second, there is congestion in the system, there are pinch points. We have all seen it, we have all experienced it. We need more capacity in our transportation system. Third, construction inflation. Construction inflation, just in the last few years because of steel costs and other costs, has been in the order of 8 percent to 12 percent. As a result, we have an accelerating need for investment.

At the same time, the primary funding vehicle, as you all know, is motor fuel taxes, which are pennies per gallon. It is a volume-based tax, it does not increase with inflation or with need. So the gap is yawning and growing bigger.

One potential solution is a public-private partnership. As you have heard today, a public-private partnership really is a long-term lease of a road. The private operator takes all the operating and maintenance risk, while also taking on all the capital expenditures that are necessary for the road. In the case of the State of Indiana, they expect that over a 75-year term of the lease the private operator, will spend \$4.5 billion, on maintaining the road and expanding it. In return, the private operator gets the toll revenue.

The public governmental body keeps the right to enforce the contract and all the operating standards, which are quite detailed in the case of Chicago, over 300 pages of operating standards created to ensure that the road is operated properly. The public body maintains control over the tolls and is in a position to constantly monitor the operation. What happens if the private operator does not perform? They do have an opportunity to cure the issue. If they do not, the municipality, the government takes back the road. It is a very powerful hammer to make sure that the operating standards are abided by.

Why is this viable today? Well, there are a couple different factors that drive this. First, around the world there are many private entities that have a lot of domain expertise in managing these types of facilities. It is also very typical in Europe, if you want to build a new road facility, that the government would ask the private sector to come in, give proposals to build a facility and to maintain it over a 50 year or longer period of time. So there is a lot of domain expertise. There is also a lot of expertise in the United States with regard to these types of facilities.

Secondly, these types of private entities are supported by a tremendous influx of dollars from pension funds and other investors that want to invest in infrastructure assets, and they want to do this because they are long-term assets that provide a steady stream of revenue. It is a very, very attractive investment as a slice of a pension fund or other investment pool. In fact, there has been over \$50 billion dollars allocated in the last few years to invest in this type of infrastructure, which creates a lot of demand, and ultimately better pricing for the governmental bodies that are interested in possibly entering into these transactions.

How do you protect the public? In the concession or lease agreement, which is typically 100 or 150 pages, there are many different triggers that the public body retains. One is the term of the contract; the second is the limits on tolls; and third is operating standards, as I referenced before, where it is very, very detailed. As Governor Daniels mentioned, it gets down to even how quickly do you clean graffiti or a dead squirrel off the road—and also capital mandates, how much maintenance capital has to be expended and how does the road have to be expanded by the private operator over the term. This is a living and breathing document. It truly is a public-private partnership, and, therefore, the public body is integrally involved in the management of the road over the long term.

Finally, in conclusion, I think this is a very viable alternative for our transportation industry in this Country; it fills a critical need. It is not the panacea for all ills, it is just a piece of the puzzle. And I think we have already seen examples and will see examples of success in this area in the future. Thank you.

Mr. PETRI. Thank you.

Mr. Gribbin.

Mr. GRIBBIN. Thank you, Mr. Chairman, Ranking Member DeFazio. Thank you for this opportunity to join this panel to discuss the future of infrastructure finance.

For those not familiar with Macquarie, we are a leader in the ownership and management of important infrastructure assets around the world. Macquarie has operations in 24 countries and 16 offices here in the United States. Our Infrastructure Division manages a \$24 billion portfolio, which includes investments in over 90 assets in more than 20 different countries around the world.

In my time here today, I will briefly outline how the private sector can play a role, and potentially a significant role, in helping overcome the lack of funding for highway infrastructure.

What brings us here today really are two fascinating transactions: the long-term concessions contracts for the Indiana Toll Road and the Chicago Skyway. Allow me, given the brevity of time here, to focus just on Indiana.

The State, after this concession agreement, commissioned an independent audit of the toll road to study what the road would be worth had it stayed in public hands. The study found that the toll road would be worth approximately \$1.8 billion if tolls had been raised and the concession in fact had remained with the Indiana Finance Authority.

Yet, Statewide Mobility Partners, a Macquarie Cintra partnership, has signed a concession agreement offering \$3.8 billion. So how do we explain the \$2 billion difference? I think it can be explained as an economic concept of dead capital.

In writing about poverty in the developing world, renowned economist Hernando de Soto explains the concept of dead capital. Dead or captive capital is comprised of investments made within a legal structure that prohibits those investments from being used as capital. For example, de Soto pointed to workers in developing countries who invested in building homes on land which they did not have title to. Those workers' investments are captive capital; they cannot borrow against their investment and it is very difficult for them to sell. The homes have value but that value is legally cap-

tive. De Soto estimates that trillions of dollars are locked up in investments of this type, investments that could be used to develop businesses, create jobs, and lift people out of poverty.

Highway infrastructure here in the United States is analogous. Inadequate markets and inflexible legal systems in this Country have locked up billions of taxpayer dollars and our transportation infrastructure, billions of dollar that could be used to create jobs and fuel economic growth. Fortunately, concession agreements have demonstrated that, with modest changes, the captive capital invested in these assets can be freed.

So how did Indiana liberate \$2 billion, which is a significant sum, in captive capital? The partnership was able to find additional value in this asset in two ways. First, a dead equity financing model allowed the partnership to pay more for the asset than the State's traditional bond financing approach; and, secondly, private sector operators are able to achieve more efficient operations through innovation and timely investment in maintenance.

Let me focus on the first point. The traditional bond financing approach has layers of conservatism built into it which tend to undervalue the asset. In addition, bond covenants require a debt coverage ratio; that is, revenues of the asset must exceed debt payments by a defined percentage. The debt coverage ratio provides a cushion for investors, but it prevents that cushion from being used to help finance the asset.

By contrast, a debt equity model is able to use the equity investment as the cushion and, as a result, the debt equity financiers are able to free up more capital than those using traditional bond financing, producing a significantly greater payment to the owner.

In my written testimony I cover a number of the benefits to the concession model. Let me just cover three here. First, and kind of the most obvious, is that concession models, as mentioned before, can free up billions of dollars in capital for other investments, or can be used to help make projects that are not viable viable because of the additional financing it provides.

Second, concession agreements also transfer operating and maintenance risks away from the public, eliminating future liabilities. Some people miss this point. They think if they lose the toll revenue stream, how will the State then maintain the facility. Well, all the maintenance liabilities for that facility go to the concessionaire. The State, or in the case of Indiana, Indiana Financing Authority or the City of Chicago had no liability, now have no liability under the concession agreement to maintain or expand those facilities.

Finally, concession agreements create positive incentives for improved operations and better service.

Well, Mr. Chairman, members of this Committee, thank you for holding this hearing today. At the appropriate time, I will be pleased to answer any questions you may have.

Mr. PETRI. Thank you.

Ms. Hedlund.

Ms. HEDLUND. Thank you, Mr. Chairman, Ranking Member DeFazio. My name is Karen Hedlund, and I a member of the law firm of Nossaman, Guthner, Knox & Elliott. My firm has had the great privilege of advising over a dozen State departments of trans-

portation and local transportation agencies on public-private partnerships primarily for new projects.

In the spirit of the day, I might also mention that I recently represented a U.S. company competing for a transit project in the State of Israel.

The Skyway and the Indiana Toll Road deals are the ones that have garnered the big headlines, but, in actuality, most of the PPP activity in the States has involved financing new transportation facilities, and this is where I am going to focus my remarks. I want to address how the States are crafting their legislation, how they procure private investment, some of the lessons learned from past endeavors, and the critical role that is being played by the Federal Government.

Today, over 21 States have enacted important public-private partnership laws, and the list grows each year. Just in the last few months, Indiana, Utah, and Alaska have authorized PPPs. California, building on the success of the toll corridors in Orange County, has authorized additional PPPs to benefit goods movement projects. And PPP authority has been proposed in New York, Ohio, New Jersey, Pennsylvania, Missouri, and Illinois.

As detailed in my written statement, these laws and the related regulations provide specific guidance to the DOTs as to the procedures they should follow in procuring private partners, submission requirements, and evaluation criteria. They mandate competition and they require that contracts be awarded on the basis of best value, taking into account both short-and long-term commitments from the project sponsors.

This morning you heard about new projects that are being advanced in Virginia and Indiana, and this afternoon in Oregon. Other active States include Texas, the plans to use PPPs as the primary method for delivering new highway projects throughout the State. They have no less than 10 major projects in procurement.

Florida is seeking concession proposals for a tunnel under Biscayne Bay that will speed port traffic directly to the interstate highway system and get container trucks off the streets in Downtown Miami.

Georgia is considering PPP proposals for HOT Lanes, truck only toll lanes, and BRT lanes to relieve the heavy congestion around Atlanta.

What are the lessons that have been learned from the earlier PPP endeavors? Well, the earliest franchise laws were premised on the notion that private toll roads shouldn't require any contribution of public funds and a corollary to this that was alluded to day was that the opportunities for private investment should only be offered for projects that are low on the State's priority list. Today, however, the States understand that few new projects can be financed solely on the basis of toll revenues. New projects are not cash cows. The States also recognize that by combining both public and private investment dollars in highly congested corridors is the most effective tool to advance their most urgent projects over the shortest time horizon.

The States are now benefitting from substantial support from the Federal sector thanks to the forward-looking provisions that you in-

cluded in SAFETEA-LU, the \$15 billion in private activity bonds, improvements to TIFIA, and expanding the ability to innovatively finance new projects on our interstate highway systems that have become congested and deteriorated.

In addition, at Federal highways, under the leadership of former Administrator Mary Peters and former Chief Counsel Gribbin, they have helped to remove administrative barriers to public-private partnerships while maintaining very effective Federal oversight.

Finally, I would like to stress that, in our experience, the State DOTs take great care in managing these PPP procurements. These are time-intensive undertakings. They assign their most senior and qualified public servants to the task. They spend a lot of time thinking about the very questions that were asked this morning. They devote months of effort to developing procurement documents and getting input from all stakeholders, public and private. They know how to drive a hard bargain and always with the public interest as their one and only goal.

Thank you for inviting me to be here this morning, and I would be happy to answer any questions.

Mr. PETRI. Thank you.

Mr. Foote.

Mr. FOOTE. Good afternoon, and thank you for the opportunity to testify about the sale of concession rights for existing publicly owned highways to private investors.

There have been two such transactions in the last year, the Chicago Skyway and the Indiana Toll Road, and both have generated a great deal of interest from the press, the financial community, and, most importantly, State and local governments around the Country.

Over the last year, as a Senior Fellow at the Kennedy School of Government, and after 15 years as an executive of a company serving a toll road industry, I have been looking at these transactions through a public policy lens. In keeping with this, my role today is not to explain how these deals work or to recap the financial benefits that may accrue to the various parties. Instead, it is to lay out a framework to examine the public policy aspects of these sales. In other words, to answer the question: Are these concession sales in the public interest?

At this point, everyone in this room is familiar with the first of these concession sales, the Chicago Skyway. The winners in this deal are the taxpayers; the City of Chicago, who received a windfall equal to about one-third of the total size of the city's annual operating budget; the mayor and the city council, who were able to solve an immediate budget crisis without resorting to tax increases; and private investors who have what they hope will be an attractive investment.

While there are winners, there are also losers. In the case of the Skyway, the losers are the Skyway users, who will be paying significantly higher tolls than they would have paid under city ownership. The other loser is the region.

First, the Skyway users. Tolls on the Skyway will more than double in the next 12 years and continue to increase through the 99-year term of the concession. The increased revenues resulting from these toll hikes will be used by the private owner to service

the debt and equity for the financed \$1.8 billion purchase price. In effect, the future tolls created on the Skyway have been monetized to fund the operating budget of the City of Chicago.

The other loser is the region. First, not one dollar of the sales proceeds realized by Chicago was earmarked for investment in transportation projects, despite the fact that Chicago is one of the Country's most congested urban areas. The city also has abdicated the control of a major transportation artery, and along with it the ability to manage its regional transportation network in a coordinated fashion. To see how this might adversely impact the public interest, let me cite two examples.

Under the concession agreement, the private owner has the ability to use time of day pricing to discourage trucks from using the Skyway during daytime hours. One possible consequence of this is to force trucks onto neighboring roads, generating externalities—traffic, congestion, pollution—for which the private owner is not accountable and does not have to concern itself. Second, the alternative routes for drivers who do not want to use Skyway are non-tolled limited access roads that are currently operating at or near capacity, thus allowing Skyway to operate, in effect, as a monopoly.

What happens if a decision is made in the next several years to toll these alternative free roads in order to manage congestion? To do this effectively would require a coherent and coordinated regional toll policy. With the Skyway out of the public's control, this is no longer possible.

I have tried not to mask my opinion that the Chicago Skyway sales scores poorly in terms of the public interest. This low score is not because the Skyway is now in private hands, but because of the particular motivation for the sale and the intrinsic nature of the Skyway.

In contrast with the Skyway, the Indiana Toll Road situation has significantly different characteristics that, in my view, change the balance. First of all, the sale proceeds will be invested by the State to improve its transportation infrastructure. True, these new roads will be paid for, in effect by the people that use the Indiana Toll Road, but these users, as well as the taxpayers of Indiana, will benefit from an enhanced statewide transportation system. Second, given where the toll road is situated and its relationship with other roads, it is my opinion that there is not much opportunity for the owner's actions to impose cost on the surrounding communities. Also, the toll road is not part of a network of roads that would benefit from being managed in a coordinated fashion. For all these reasons, the Indiana Toll Road concession tilts in favor of the public interest.

The last point I want to make is that it is important for all of us to understand why investors are willing to pay large sums for these concessions. The reason is simply that these investors have been granted a franchise to increase tolls, an action that State and local governments are reluctant to take. These increases are not subject to voter approval and are the consequence what have been tagged the outsourcing of political will.

I am not arguing against the involvement of the private sector in the provision of public services such as transportation. The sale of existing roads should meet, however, three tests. First, a signifi-

cant portion of the proceeds of the sale should be reinvested in improving and enlarging the particular region's transportation infrastructure. Second, the private owner should be held accountable for the externalities, the non-cash costs of operating the toll road. And, finally, if the road is part of a regional network, the toll regulation needs to accommodate regional solutions.

Applying these tests may reduce the amount of money that can be raised by State and local governments through these sales. But maximizing the dollars should not be the sole objective. Improving the mobility of our citizens should be the overriding goal.

Thank you.

Mr. PETRI. Thank you.

Mr. Young.

Mr. YOUNG. Thank you, Mr. Chairman. Thanks for holding these hearings. I thank the witnesses.

I have repeated this slogan many times, that there is no free roads. And under TEA-LU, we have tried to set up a commission to recommend a solution to the financing of our problems. I do think that the private investment in roads is part of that solution. That is personal. I have been involved in Highway 81 in Virginia and a big supporter of.

I am sorry I wasn't here for Governor Kaine. I think that is one of our solutions when it comes to congestion, and I do think the private sector will have to play a major role, or the public has to stay and step up to the plate and say I am willing to pay for. I tried that and never got anywhere. I am disappointed in some States, my State is one. We charge 8 cents tax, the lowest of any State in the union, yet they want to have a highway system; and that concerns me.

But I do have three short questions for Mr. Gribbin, probably. What are some of the barriers you encounter in negotiating these agreements when you get into these agreements? What do you find the most difficult thing—anybody else can comment too—in this process?

Mr. GRIBBIN. Thank you, Mr. Chairman. I think one of the larger barriers is the fact that this is new. Governor Daniels touched on this during his testimony. The public is used to these assets being held in public hands; they don't really understand kind of the costs and benefits of moving them to the private sector. There tends to be, in the case of Indiana, particularly a fair amount of fear of how things will change, and will we still have access to the road and will there be significant diversion. I think what will happen over the course of time, as people get more comfortable with these transactions, as they have on projects around the world, that those barriers will be dropped.

Another barrier, coming from working for a company that does work around the world, is the United States, as you know, has very diverse political decision-making. We spread power out. So every State has its own set of rules, communities get involved. Everyone really, kind of from the homeowner to the White House can have a say in how a road is built, and that is a public policy decision, it is probably a good thing, but it does make it a little harder to penetrate this market.

Mr. YOUNG. Are you solely interested in concessions or existing toll ways, or are you interested in new capacity?

Mr. GRIBBIN. Mr. Chairman, we are actually interested in both. In fact, right now, as we speak, we are building the South Bay Expressway south of San Diego. It is an investment that Macquarie has made in a road out there that will be a greenfield project that will open up next year.

Mr. YOUNG. The case of the greenway here between Dulles and Leesburg, that was a private investment. I am sure you are aware of that.

Mr. GRIBBIN. Yes.

Mr. YOUNG. Have you looked into that possibility of approaching States or a corridor concept of doing a project that would be much larger than that, or is that on your drawing board?

Mr. GRIBBIN. Actually, the size of the facility is not really a determining factor. So we have looked at everything from relatively very small projects to projects the size of the Indiana Toll Road. We would be interested in if it fits the public policy objectives of that locality, any facility that has a revenue stream.

Mr. YOUNG. Well, you know, when they built that greenway, I thought they were absolutely idiots, but—and I was right the first year.

[Laughter.]

Mr. YOUNG. But it has turned to be a real going machine and a public license, because you have to drive from Route 7 up to Leesburg. It is a nightmare because of that growth out there, but they saw that growth coming and they have used that greenway, and it has worked out quite well. In fact, the people now are commuting to D.C. that are clear out past Leesburg, which would be an impossibility just on Route 7.

Have you got a team, have any of you got teams that looks at this potential growth factor and where you could purchase land and make a corridor available? Are you that far advanced or are you sort of behind—

Mr. GRIBBIN. No, actually, that is one of the driving factors that we look at, is we will look at, if it is an existing facility, potential traffic growth, and for new facilities. Obviously, what we want to find is a part of the Country where there is increasing demand over time. Macquarie is interested in kind of having mid-return, mid-risk investments. Our investors, for the most part, are pension funds that are looking for a stable return over the course of decades, and toll roads match that extremely well. And part of that is you are looking for that steady growth over time.

Mr. YOUNG. All right, I thank you.

One of the things, again, I stress, there are no free roads, and I do believe the number one problem, Mr. Chairman, we have in this Country is congestion. We talk about the high price of fuel. If we were able to move our cars and trucks on time, the price of fuel would diminish quite rapidly; the demand would go down, the supply would be available. It is sitting in traffic is killing us now more than anything else, and, of course, moving a product. I mean, every time—I used to be in that business, and any time I had to stay docked more than five minutes after I was supposed to leave, I usually left on time, but I was losing money. And in this world of mov-

ing goods, unstability of fuel costs, I think the elimination of congestion is so crucially important, and we are going to be looking—I am going to be looking at this not only the remaining of this year, but in the near future to see if we can't solve it. I do think that private investment is one of the major solutions, too. It may not be the only one, but one of the major solutions.

Thank you, Mr. Chairman. I will have to excuse myself; I have got a bunch of people upstairs in our other Committee room wanting to talk about other transportation problems, so thank you.

Mr. PETRI. Thank you.

Mr. DeFazio, any questions?

Mr. DEFAZIO. Thank you, Mr. Chairman.

It is a very interesting question. As I said earlier, I think, we need to try and see that we are balancing the public interest, and I see a place for private equity, but we have got to think of all the contingencies now. The job of the private folks is to maximize profits, and we have other tasks that we must engage in here in terms of public safety, you know, creating inadvertent effects, moving congestion from one point to another and that.

So, sort of that as background, I am just curious. Normally we would hear, well, the private sector does things more efficiently, so get government out. But as I look at Macquarie's statement on the Indiana road, essentially it says no significant cost savings are envisioned in terms of operating costs. In fact, there are some incremental—I mean, the improvements have an incremental cost, but beyond that you would have to carry the cost of insurance, which the State didn't because I guess they were self-insured.

So it seems to me it boils down to this question that I asked Governor Daniels, given the mandated increases in tolls in the contract, what if the government had mandated those same increases and then went out to borrow the money? And he didn't really answer that question, but I will put it again. But as I understood the answer here today, it was, well, because we are putting a significant amount of equity in, in addition to the debt financing, which means you can get a larger infusion of cash up front. But I guess my question is what percentage of the Chicago project and the Indiana project are equity versus debt? And as I also understand Chicago, initially there was one amount of equity, and then, once the project was finalized, some of that equity was turned to debt and that equity was withdrawn. So what is the percentage of equity that is in—and then Mr. Gribbin or Mr. Florian. Mr. Florian put the deals together, you are the financier. Whoever can—

Mr. GRIBBIN. Well, I will turn to him for the answer, if he gave it.

Mr. DEFAZIO. Oh, okay.

Mr. FLORIAN. The percentage of equity that is typically put in these projects—not only for Chicago Skyway, or the Indiana Toll Road, but for other project financings for these types of roads around the world—tends to be in the range of 75 percent debt, 25 percent equity.

Mr. DEFAZIO. But that would still seem to be larger than—I mean smaller than the difference between what is being stated as the monetized value for the state of the asset versus the private monetization.

Mr. FLORIAN. That is correct, sir. Part of it is that when equity investors invest in these types of assets they are looking for what they think the future growth of the asset will be. They tend to take a pretty optimistic view in terms of what that growth will be, and they pay in the concession agreement, for that future growth. Now, that being said, they are taking the risk as to whether or not that growth ever occurs.

Mr. DEFAZIO. Right. I have something here, I think it is a chart provided by Mr. Foote regarding the model for the sale of the Indiana Toll Road. I mean, you can't see it from there, obviously, but it has been attributed to you. And it is interesting to me when I look at some of the out years. And one of the points I was trying to make to Governor Daniels is you do forego a future revenue stream, which is being converted instead to private profits in this case. And he said, well, I don't want to pay interest, I want to collect interest. But obviously they are paying interest on at least 75 percent and expecting a return to equity on the other. I mean, they are not putting the equity in for a zero percent rate of return; I don't think their stockholders would be real thrilled, their shareholders.

So when I look at this, I mean, the numbers are pretty startling in the not too distant future. Say 2030, on the Indiana Toll Road, before taxes, it was over half a billion dollars a year in income, over and above operating costs and everything. Is that—

Mr. FOOTE. That appears to be the way the numbers work out based upon the toll increases as well as the projected traffic increases for the Indiana Toll Road, yes.

Mr. DEFAZIO. And you used pretty conservative assumptions here, you used 1.1 percent growth, 3 percent in years 5 to 15, 1.1 percent after.

Mr. FOOTE. These were the assumptions that the purchaser of the concession used.

Mr. DEFAZIO. So we are talking big numbers with pretty conservative assumptions. And then if we jump ahead to, say, 2050, it is a billion 458 in a year. And, again, this was obviously money that is going to be taxed at some level and then returned to the investors. But, again, the State is foregoing that future revenue stream to use at that point for whatever purposes it so desires, because this includes all of the improvement costs of the system, and this is net, right? So—

Mr. FOOTE. That is correct.

Mr. DEFAZIO. So but you think this project is a—you know, I mean, you said Chicago in particular because they converted the money to other purposes other than transportation infrastructure and other concerns you raised about moving the congestion and those things is not a very good deal for the region, but you think this is. I mean, you really think that the State shouldn't have looked at the option of monetizing this on their own and, therefore, trying to capture what becomes profit? Because there is no allegation here—the usual allegation I hear from people who want to privatize is government can't do it, we can save money on operating costs, and in this case that is net, the same.

Mr. FOOTE. Well, I think the Indiana Toll Road transaction does pass the three tests I put forward. But you are asking another

question, that is, whether or not, to use a term that was used earlier—whether or not the private sector is better able to liberate the dead capital or can the public sector do that. And I think under certain circumstances the public sector can come close to it and should be considered as an alternative, and I think, again, it may not maximize the amount of money that can be liberated, but I think if you lay in some of the other public policy issues or concerns, it might become a better deal for the public interest.

Mr. DEFAZIO. Mr. Gribbin, I have particular concern—I expressed it earlier—on the non-compete clauses. I just think of it this way, you know, I have got to protect the public interest, and if I were entering into this deal—Governor Daniels said, well, you have got to meet congestion standards. Okay, we understand that. But there are a couple of ways to meet a congestion standard. One is you add capacity; the other is you constrain demand. So since you have got a fairly generous, shall we say—they call it a cap, or floor, on future toll increases, what would there be to prevent your folks from—I mean, you have to maximize returns, and say your folks say, actually, if we add that extra lane because of the growth in traffic we are starting to bump up against a congestion standard that is going to mandate we do something, we don't really see in the time we will have the project that the return is going to be that great. But if we raise the tolls now, you will have less utilization and we will drop below the required standard, and then we figure we will move gradually back up. And, actually, we penciled that out as a net for us, we are going to come out ahead by driving traffic elsewhere with higher tolls.

Now, how would you answer that public policy question? I mean, because you are there to maximize profit, you are not there to take care of my congestion problems over here. And you have got the no-compete in your corridor. So how would you answer that?

Mr. GRIBBIN. I mean, the key to these agreements is aligning incentives between the public and private sector and making sure that we are all working together toward the same goals. That is why you have a large concession agreement that governs all types of operations. As far as congestion relief, it is actually very much in our interest to have no congestions on our roads, because we get more throughput. The more throughput you get, the more tolls we collect, the better off we do. In fact, in the Chicago Skyway, we just recently took that over and truck traffic is already up about 25 percent. Queues on Friday and Sundays have been cut from half an hour to about five minutes.

Mr. DEFAZIO. Well, that is the electronic toll collection I would assume that has been a tremendous—

Mr. GRIBBIN. Part of that is electronic toll collection. On the weekends, actually what we did is instead of collecting just at the toll booths, we stuck another guy out there in traffic and collected tolls on two cars at a time. Again, the State could have done that. But we are heavily incentivized to maximize throughput on the facility.

Mr. DEFAZIO. Right. But what I am getting at—and just grant me my question here, which is you are confronted at some point in the future, on the Indiana Toll Road, with the very expensive prospect that you would have to add another lane. Say it is in the thir-

tieth year of your concession. You have only got 45 years to go. Your people say, look, we are not going to get that money back, and it is going to be nowhere near the 12.5 percent rate of return; it is going to drag down our entire rate of return on the project. But there is an alternative here. We are kind of at the optimal level now, we are jamming as much through as we can. If we raise the tolls a little bit more, we may drop down a little, but, actually, since we are getting a higher per unit cost, we are going to make it up and pretty quickly we are going to bump back up to the edge of that required constraint to add capacity, and then maybe we will do—and you just sort of keep avoiding it by raising the tolls.

What would there be—since you don't have—I mean, this isn't economics, it is an externality. That is not your cost, the congestion that is created somewhere else, that is the State's cost, the local community's cost, and it is an economy that doesn't belong to you. So what would prevent that circumstance from happening? There is nothing that says you have to look at this in a coordinated way, looking at the alternate routes, looking at what congestion is created elsewhere. There is nothing to prevent that.

Mr. GRIBBIN. Well, there are two things that govern that externality. The first is the length of the concession agreement. A lot of people are critical of long congestion agreements, but 75 years forces us to act more like an owner than a renter, so we care about the life cycle cost of that asset.

Mr. DEFAZIO. Right. But I am positing this, say, in the thirtieth year out is when you are bumping against capacity.

Mr. GRIBBIN. That is the second thing, is that the concession agreement requires that we return the facility to its owner in a certain condition that is specified in the concession agreement, because similar to traffic congestion, you could also say, well, what happens if we just let the road run into ruin—

Mr. DEFAZIO. Right. No, we are not talking about—I am talking about you are very responsible, better pavement conditions and a lot of States don't—but what I am saying is if at some point your internal people say we could continue to have a higher rate of return if we didn't build another lane with the remaining term we have and we diverted traffic with higher tolls, what would stop that? Nothing. I mean, it is not your cost, right?

Mr. GRIBBIN. The concession agreement and the condition we have to turn the road back in to.

Mr. DEFAZIO. Yes, but the condition—we are not talking about condition. The condition doesn't say you have to add a lane, right?

Mr. Foote, would you want to address that from your more public policy perspective? I have got to worry about these things from the public policy side. You squeeze it here and it goes there.

Mr. FOOTE. Sure. Well, I am sure that these roads will be operated as a business, and use market dynamics to maximize profits, which is fine. But it may be that you get more profits by having fewer cars at a higher unit price, thus raising the possibility of externalities for which the private owner is not responsible.

Mr. DEFAZIO. Right. Okay. There is nothing to—I mean, you guys are there to make money. There is nothing there to condemn it. I am just saying we have to look at it in a bigger picture way here.

Mr. FOOTE. And, actually, Mr. Florian—

Mr. FLORIAN. Congressman, there is one provision that we put in the Indiana Toll Road concession which I think deals with the kind of challenge that you are grappling with here. The State can mandate improvements to the road at any point in time that it deems fit. Therefore, Macquarie and/or the State has the right to expand the road, put in new interchanges, or do whatever it deems necessary. Now, if the State—

Mr. DEFAZIO. But if the State mandates, how is it paid for?

Mr. FLORIAN. That is an excellent question. Typically, today, when the State expands a road it is paying for it from its various sources.

Mr. DEFAZIO. Right.

Mr. FLORIAN. So in the contract, if the State mandates something, the State has to pay. However, we put in a provision where, if the concessionaire benefits from that State-mandated expansion or change to the road, that the concessionaire has to compensate the State for the economic benefit it receives.

Mr. DEFAZIO. So we would get an extended kind of negotiation here. If the State said we have got to add a lane, we are going to pay for it, then we will end up squabbling a little bit over rate of return and how it benefits you, but it is possible they could add the lane.

Mr. FLORIAN. And the concessionaire, ultimately, if there is more traffic or other benefits to compensate the State back for that portion of the economic benefit they gain.

Mr. DEFAZIO. Okay. Thank you.

Mr. Chairman, do you want to take a round, then we will have a second round?

Mr. PETRI. Sure, I will take a try at it.

This isn't going on in North Dakota. It is clearly a phenomenon where there are certain not bottlenecks, but conditions in the transportation network where people can extract additional—you can put it however you want to, provide additional management benefits and extract additional rent from the overall system. We had the same system in our State years ago. People argued a lot about they called them tax islands for nuclear power plants, which were a great benefit to the local community, they didn't have to pay any real estate tax and they got really good schools and everything else. We got rid of those and the State assumed the revenue from the high capital power plants and no one wanted a power plant in their backyard. So the other side of it was we didn't get any more nuclear power plans. So it is not a free transaction. But people didn't like the idea that all the benefits of this facility that was providing, in this case electricity to a broader region, accrued in a very narrow area.

We have somewhat the same phenomenon. You can privatize bits and pieces of the system, you are not going to privatize the whole system, and people will be able to extract some rent or benefit for a pension fund or something else from it. Does this make sense overall? Is this making our transportation system better? Is there some way of channeling this phenomenon to take care of choke points and to return money back into the system in terms of greater transportation efficiency? I guess, Mr. Foote, professor, that is

what your role in studying all this is in part. If you care to comment.

Mr. FOOTE. Well, I think this goes to the first test I put forward, that and Governor Daniels also reiterated. His belief is that if you are recapitalizing a transportation asset, the realized dollars should be reinvested in the transportation network. In the case of the State of Indiana those dollars will be captured within the State and reinvested, and, again, I think that is one of the primary reasons why the Indiana Toll Road is probably in the public interest.

Now, you are thinking somewhat more broadly, that those dollar will stay within the State of Indiana, but will not benefit residents of the State of North Dakota. And certainly it is not Governor Daniels' job to—you know, he is not accountable to those residents. So there probably are some inequities that are built into this State-by-State system of financing our transportation infrastructure, and presumably it is this Committee in the Federal Government that actually redistributes some of those dollar in places where it can be better used but is not available.

Mr. PETRI. If I were in the investment business, I would go to Delaware, for example. They are already collecting high tolls, but they have got a small hold on the whole east coast, and they can probably extract additional revenue by privatizing it and saying that it is this pension fund that is raising all the tolls, but they are getting their share out of it.

Is there any role in—there is something that is raised by some of this which is in the area of moral hazard, and that is you who are elected for a short term are making long-term commitments which may or may not be of long-term benefit to the community they are served. And I guess we never can really totally deal with that, but that does raise that issue, and it is sort of systemic. Is there anything we can do at the Federal level to reduce that risk?

Ms. HEDLUND. I am not sure what we can do at the Federal level, but I think it should be noted that there are contractual techniques that are available to the public sector to protect the public over the long term. Everyone recognizes that we don't really know what is going to happen in the future. Some of these projects may be financial failures, and so what happens if the road comes back to the public sector. They may make so much money that they become an embarrassment to the public sector. What happens if the traffic gets very heavy? How are you going to incentivize the private parties going forward? And there are a number of techniques.

One that the Commonwealth of Virginia is going to use in connection with the assignment of the Pocahontas Parkway to a private entity is to have revenue sharing. Once the returns on that road—which are not very robust at the moment, but they might be in the future—once they reach a certain level, then the Commonwealth of Virginia is going to share in the returns that that road generates.

In terms of what do you do if the road becomes congested, another technique—and this has been used in California, also in Virginia—to the extent that these roads benefit from non-compete provisions, if the road becomes congested and the owner of the road refuses to make the investment in additional lanes, they will sim-

ply lose the benefit of the non-compete, and the public sector can go and do whatever it wants.

A third technique—and this is one that is used very commonly in Europe and is being studied here—one device that the private companies use for taking their profits out of these projects early on is refinancing. In Europe it is typical that 50 percent of all refinancing profits go back to the public sector.

So there are ways, financial devices used for keeping the public sort of in the game over the long haul.

Mr. PETRI. Any other responses to that?

Mr. GROTE. Mr. Chairman, I think those are good ideas, and in some ways the decision of a concession financing reminds me of decisions of debt financing, except we are talking about a longer term, and maybe, larger consequences at the end of the day. But over the years, State and local governments have gotten some of them, anyway, have gotten—pretty comfortable with using debt and there are, as you may know, certain debt issuing policies and decisions about when it is appropriate to leverage an asset. Maybe some of our private investors think that those restrictions, while appropriate for municipal debt, might be a little too restrictive or conservative for a long-term asset lease.

But in some ways the decision-making is kind of the same. You have decided that there is a compelling enough public need, an investment backlog, a choke point, whatever, that you are actually going to leverage something over 50 or 99 years through taxable debt and equity. But, you are still making that first key decision, that the benefits of accelerating whatever you are trying to do are worth losing the flexibility over 50 or 99 years of leveraging an asset that generates revenues.

Mr. PETRI. Just one—excuse me, yes.

Mr. GRIBBIN. Just one thing very quickly. I do think contractual mechanisms—and we have thought through a lot of these in a lot of detail to try to balance putting together a business transaction with public policy. I think contractual mechanisms are very, very important, as Karen mentions.

The one thing that has slowed down some of this type of activity where the Federal Government could be quite helpful is just the environmental process. And it is obviously incredibly important to protect the environment. At the same time, the length and the challenges of going through the environmental process has slowed some of this interest and some of this investment in transportation in this Country.

Mr. PETRI. One last question. Several observers in the transportation construction industry indicated that when these deals were done, the price that was realized ended up being two or three times more than what they anticipated was likely. Are there some assumptions that the investors are making? How do you explain that? Someone clearly is trying to figure out how these deals really are going to pay off, and there seems to be—Indiana has one set of assumptions and the people who bid on it have a little different set of assumptions, evidently. Is there any way of making that understanding why people are willing to pay so much for these assets up front or what they are assuming how they are going to extract—

I mean, there is no free lunch, they are going to have to—they are assuming they are going to come out okay on this.

Mr. FLORIAN. They are definitely taking that risk in terms of the future revenues of the road. For the City of Chicago, for example, we did an analysis that said if we raise the tolls on exactly the same schedule that we anticipate we will let the concessionaire raise the tolls, how much debt could the City of Chicago put on the road if it held the road itself and how much funding would that provide the city for whatever purpose. And the number that we came up with is we thought that the city could put perhaps \$800 million, \$900 million of debt on the road, and that is the amount it could front-load to reinvest. And, as you know, the city ended up getting \$1.8 billion. So the tax-exempt municipal bond market doesn't allow an entity like the City of Chicago to fully garner the value of the road.

The other thing that is actually quite striking is that if you look at the projections that the City of Chicago had for the volume growth, the traffic growth on the road, they were conservative, maybe 1 percent growth over a long, long period of time. The concessionaires in this case took a much more aggressive view. They think that the traffic growth might be 3 percent, 4 percent, 5 percent over a long period of time, and they are taking risk on that. Well, if you look at the difference between a 1 percent, 3 percent or a 5 percent growth, there is a tremendous amount of value created. That is really what the City of Chicago did, it captured more aggressive assumption in terms of what the growth would be over time and shifted the risk of that projection to a private operator.

Mr. PETRI. Very well.

Mr. DeFazio.

Mr. DEFAZIO. Thank you, but that sort of begs the question what if the City of Chicago had engaged the same traffic engineers to make the more aggressive projections than the 900 million number would have gone up in terms of initial capitalization, because you would have been assuming a larger revenue stream sooner.

Ms. Hedlund, I just want to be sure I got this. So at what point in the lease does the State start to share in the revenues?

Ms. HEDLUND. It is a negotiated percentage, and I don't recall exactly what the number is in Virginia, but there is a minimum percentage that is essentially guaranteed to the contractor; above that the State shares in 50 percent of it; and then there is a final number above which they actually take 80 or 90 percent of it.

Mr. DEFAZIO. Okay, so it is graduated..

Ms. HEDLUND. It is graduated.

Mr. DEFAZIO. Okay. But the Indiana and Chicago agreements do not have any clause like that.

Ms. HEDLUND. That is right.

Mr. DEFAZIO. Right. Okay. And then the other one about the conversion of the I guess was it the equity, if the equity is converted to debt, then—

Ms. HEDLUND. If there are certain types of refinancings, where the owners are getting—essentially accelerating the benefits of the transaction, that a portion of those refinancing profits can go back to the public sector. And that is something that is—

Mr. DEFAZIO. Standard in Europe?

Ms. HEDLUND.—is standard in Europe.

Mr. DEFAZIO. So in the case of Chicago, where there already has been some conversion of equity to debt, there already would have been an additional return to the City of Chicago for some of the value of that.

Ms. HEDLUND. These refinancings are typically defined as ones that are not contemplated in the original plan. Now, I was not involved in Chicago, but my understanding is that the refinancing that was done within the first year was something that was contemplated.

Mr. DEFAZIO. Oh, okay, so it wouldn't have fallen into that.

Okay, Mr. Garrett, I hope you—since I know that we have engaged Macquarie, who I think is a very reputable but also tough negotiator, I hope you have been listening to Ms. Hedlund here. And I am wondering, given some of what you have heard today, how would you balance the interests here in looking at these projects in Oregon?

Mr. GARRETT. I think, Congressman, what we would do is we would try to get Ms. Hedlund on our side of the table to help inform us.

Mr. DEFAZIO. All right.

Mr. GARRETT. Congressman, I think we are in a fortunate position to watch these conversations evolve, and obviously there are lessons learned. And, indeed, this conversation has evolved since we were engaged in it. So our discussions, again, if we reach that point—we are early in the stage; we are just seeing if indeed the projects we have identified are feasible to pursue this pathway, but if indeed they are, I think we are well positioned to learn from some of our brethren throughout the States, better inform our negotiations, and we will make sure we have the appropriate people on our side.

Mr. DEFAZIO. Well, at this point we just have a consulting negotiation and sort of a developing proposal,—

Mr. GARRETT. That is correct.

Mr. DEFAZIO.—so we have ample time to benefit.

Mr. GARRETT. You bet.

Mr. DEFAZIO. Good.

Ms. Hedlund, you alluded to one thing, and, again, I don't know if this is common, and I will ask the others. But you said if there was a failure and a reversion. Now, would there always be—I mean, there isn't necessarily—do all these contracts have to revert, or could there be a failure and then you would be in bankruptcy, and then it becomes an available—

Ms. HEDLUND. What the contracts contemplate if there is a financial problem and the owners of the road can no longer pay their debt—that is the thing that you are concerned about—

Mr. DEFAZIO. Right.

Ms. HEDLUND.—is an opportunity to the debtholders to step in and remedy the problem, and at that point the concern is going to be that perhaps operation and maintenance has not been kept up to the standards required under the contract. You give the debtholders an opportunity to come in and fix it, but if they don't fix it, the owners and the debtholders lose the benefit of the franchise.

So there is a very serious downside and the debtholders are pretty strongly motivated to come in and make things right at that point.

Mr. DEFAZIO. Is that true of the agreements for Indiana and Chicago?

Mr. FLORIAN. It is, sir. You know, basically, there are these operating standards that are quite detailed, and those operating standards have to be met. If they are not, for some period of time, a secure period, the concessionaire has a right to fix it, but if they don't, they lose the road and all the investment and all the money they put into it.

Mr. DEFAZIO. Just to respond to a concern you raised and then I know, Mr. Chairman, we have another member who has questions, but we did include—and they are not yet fully actualized—very significant changes and environmental streamlining in SAFETEA-LU, and I don't know whether DOT has finished writing the implementing regs yet or not, but the point is we have heard that and we are—I think you will find that there have been changes made to very carefully balance between protecting the environment and the public interest and expediting some of these projects. And I would assume that Macquarie is either familiar with or will become very familiar with those sorts of things if it is looking at new projects, as it potentially is in Oregon.

Thank you, Mr. Chairman.

Mr. PETRI. Thank you.

Ms. Schmidt.

Ms. SCHMIDT. Thank you, Mr. Chairman.

And I apologize if this has already been addressed, because I came in late, but I would like to address my questions to probably Mr. Gribbin and Mr. Florian.

I came from a local government background and a State government background, and in both cases we talked about public-private partnerships, and we didn't really see the savings for us at the local level or at the State level, and we were confused as to how a private partnership, private developer could actually make money. I mean, I understand that you don't have the constraints that local governments and State governments have in building roads, bridges, and other configurations, but even toward that end the savings were minuscule in comparison to what we thought we would lose in the prospect. So, you know, I apologize if you have already addressed this, but could you kind of like walk me through how you are going to make money off of this and how the respective States that you have these joint ventures in are also going to make money in this, and how this really is a win-win?

Mr. GRIBBIN. Sure, I will take a first stab at that, and Mark can follow on and fill in some gaps.

The benefit of a concession model is you get your savings up front, so in Chicago they got a \$1.83 billion check; Indiana will get \$3.8 billion. So you take all of the guesswork out of will this public-private partnership actually result in savings to the State, because that is front-loaded. The way that the private sector is able to value this higher is, first of all, we are able to do some financial engineering and get more debt out of the facility than the public sector can. Secondly, as Mark mentioned earlier, we will have what we believe is more accurate traffic forecasts, which in these cases

tend to be more aggressive, or higher traffic forecasts, so we see more value in the facility than the public entity does. And, finally, there are operational efficiencies.

Now, Congressman DeFazio was correct in saying that we did not value those heavily as part of our model for the value of Indiana, but ultimately there will be some upgrading efficiencies as we introduce electronic tolling and as we streamline some of the operation systems there. But, again, from the public standpoint, there is no guesswork over whether there are savings or not. Whether there are savings or not is actually all of our risk, because we have made this up-front payment. So then the obligation and the onus is on us to come up with those savings.

Ms. SCHWARTZ. May I follow up? I guess my concern is, again, coming from my background and also from my personal background in land holdings and dealings, when I have been confronted with an opportunity, whether from a private sector in a private role or in a public sector with a private person coming in and offering me money up front for a deal, when I have amortized it out over the long run, I would make more money if I did it on my own. Now, I understand you would put in tolling capabilities that will allow you to capture more of the dollars and those kind of things, but can't a State do that as well?

Mr. GRIBBIN. That is an excellent question. That is sort of a reoccurring question and it is a question that the States and localities should ask themselves, you know, can we capture the same value ourselves. In the case of Indiana,—I am not aware if Chicago did something similar, but the State actually took the auditor of the toll road, the company that was auditing the toll road, and gave them that question; go out there, take these assumptions, and come back and tell us what value we could capture out of this asset. And the answer was \$1.8 billion. The ultimate lease transaction amount will be \$3.8 billion. So in this case they did that study and they found out that the public sector, from our standpoint of view, kind of undervalued it. You know, time will tell, maybe we overvalued it on the private side.

Mr. FLORIAN. I would just add that I don't believe any of these transactions should occur unless there is a benchmark in terms of what the public governmental body believes the value of that asset is to them and holding on to that asset. And once you have that as a benchmark, you can go through a process, see if you can get value that is greater, significantly greater, and if you can't, you don't do the transaction. Mayor Daley, as well as Governor Daniels, basically said to the marketplace and to their voters we are going to do an experiment here, we are going to see if we can get incremental value. If we don't get it, we are not moving forward with the transaction. They both did create benchmarks for what they thought the value of the concession was if they held on to it, and in both cases that was exceeded significantly by the private sector because of these assumptions.

Ms. SCHWARTZ. I just have one quick comment. \$3.8 billion sounds like a lot of money, but when it is put in the hands of government, sometimes it is not as wisely reinvested into the community, and I think that is the greater risk, is capturing those dollars up front and then that is incumbent upon the States or the local

governments to reinvest those dollars wisely for those citizens. That is not your responsibility, but that is theirs.

Mr. PETRI. Maybe you could—you have been very patient, but we are going to be voting in a few minutes. We might as well, if you are willing to answer a few more questions.

Why is it that Chicago can't hire the same people that the bidders do in terms of making traffic projections? I mean, I would assume that that is really not Chicago's decision, it is the bondholder's. I mean, if you are going to finance Chicago Skyway through the city, you are going to look at the traffic projections as part of your package for investors and do your due diligence, and you must employ independent people who do that. Why should the projections be any different when they are made by a public entity as opposed to a private investor?

Mr. FLORIAN. I think, at the end of the day, you have two different entities that are thinking about the value of the road, and you can hire feasibility consultants, the same feasibility consultants. But really what we are saying here is the private sector is willing to put a bigger price on these assets than the governmental bodies typically believe these assets are worth. If you own an asset that is worth \$1 and somebody else thinks it is worth \$2, are you willing to sell it for \$2? Likely, you will.

Mr. PETRI. But it is not really Chicago I mean, Chicagoans say they are going to have 10 percent a year growth, and they can go to Goldman, Sachs and say sell us some bonds based on those projections, and you say we are not going to do it, we will only submit on 1 percent growth because you hire someone who looks at it or you have statistics on which you base it. So why does that analysis differ when Chicago goes in as opposed to the people that they are selling this to?

Mr. FLORIAN. I think there is a difference—

Mr. PETRI. Is there less confidence in a public owner for the next 75 years than a private owner? Is that it? They think the people won't drive over the roads if they are owned by Chicago as opposed to being owned by this—I don't think people care when they are driving in their cars.

Mr. FLORIAN. You bring up a great question. I think it is just the difference between an owner in the public sector and how they view these types of assets and wanting to be conservative with regard to those assets, and then investors, public pension funds and other entities, they are investing as an equity owner and they are looking for growth. They take a different view.

Mr. PETRI. But I am an investor.

Mr. FLORIAN. Yes.

Mr. PETRI. I can buy Chicago bonds.

Mr. FLORIAN. Yes, you can.

Mr. PETRI. And maybe I can even negotiate a bond with—I know if you do this, municipal bonds, where there is some revenue kicker or whatever. Or I can lend my money to the private buyer. So it shouldn't make that much difference.

Mr. FLORIAN. I understand what you are saying. They are different pools of capital, frankly. There are municipal bond investors that are quite conservative in the way they view the world, so they historically have really not allowed people to finance aggressively

against anticipation of future growth. These are pension funds and others from around the world that take a much different view and a much more aggressive view.

So you are right, you can make either decision, but they are actually two different pools of capital. This new pool of capital that is more aggressive and really wants to invest in infrastructure as an equity player is, frankly, relatively new, just in the last three to five years.

Mr. PETRI. So couldn't we advise Chicago or Indiana or others to structure their bonds to appeal to this new pool rather than selling the assets?

Mr. FLORIAN. Well, one of the alternatives that we have talked to these clients about, as well as others, is do you sell a piece of the road or a minority share to somebody who would be willing to take an aggressive view, and garner value that way but still maintain a substantial ownership stake. That may be one way of splitting the baby, so to speak.

Mr. GRIBBIN. Well, one of the things that Mark touched on I think deserves underscoring, and that is even in the private sector it is not unusual to have two people view the same business and value that business differently, and that happens quite frequently.

Mr. PETRI. That is why they do business with each other, because they each think they are winning.

Mr. GRIBBIN. Exactly.

Mr. PETRI. And you won't find out for a few years who is right.

Mr. GRIBBIN. Exactly.

Mr. PETRI. Let us see, any other questions? Do any of the panelists have an additional comment you would like to make? Not at this time?

In that case, we thank you very much. You have been very responsive. I suspect this will not be the last word on this subject, but it has been an interesting first word for this Subcommittee. Thank you very much.

The hearing is adjourned.

[Whereupon, at 1:40 p.m., the subcommittee was adjourned.]



**OPENING STATEMENT OF
THE HONORABLE RUSS CARNAHAN (MO-03)
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
SUBCOMMITTEE ON HIGHWAYS, TRANSIT & PIPELINES
U.S. HOUSE OF REPRESENTATIVES**

**Hearing on Understanding Contemporary Public Private Highway Transactions:
The Future of Infrastructure Finance?**

**Wednesday, May 24, 2006
9:30am-11:30am
2167 Rayburn House Office Building**

Mr. Chairman and Mr. Ranking Member, thank you for holding this important and interesting hearing.

With continued constraints on federal and state highway funding as well as an increasing need for more efficient surface transportation systems, public private partnerships can offer significant resources for agencies on all levels.

Much needed improvements on overcrowded highways in St. Louis and Jefferson County are often delayed because of state budget crunches. In my district and others, innovative private sector participation may have the potential to make road projects more affordable for our communities while simultaneously improving the quality of work involved.

I am pleased to explore the benefits that the broad range of public private ventures may provide in the delivery of public transportation projects.

Governor Daniels, Governor Kaine and other distinguished guests, welcome to our subcommittee. I look forward to hearing your testimony. Thank you for taking the time out of your busy schedules to be with us today.

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Statement by Congressman Jerry F. Costello
Committee on Transportation and Infrastructure
Subcommittee on Highways, Transit, and Pipelines
Hearing on Understanding Contemporary Public Private Highway
Transactions: The Future of Infrastructure Finance?
May 24, 2006

Thank you, Mr. Chairman, for calling today's hearing on contemporary public private highway transactions. I'd like to welcome today's witnesses.

This hearing today is extremely important, given that every state has infrastructure needs and limited dollars and resources. We are currently grappling with public private partnership issues in my congressional district and I am left with more questions than answers.

For example -- how will costs be controlled? Will revenues be used for infrastructure improvements or other projects? Will private investment properly maintain roads and infrastructure in the long-term or will it fall back on the government? What is the proper role of government to provide and maintain our

infrastructure? These unanswered questions are significant and I believe should be addressed before going further down the public private partnership debate.

In the short-term, public private partnerships look like a great deal. Local communities and states get cash and resources fast to make the necessary infrastructure and transportation improvements, reduce congestion, and at limited taxpayer expense. However, it is the long-term that worries me. Are we saddling our future generations, our children and grandchildren, with bad investments and debt, primarily because government does not want to make the tough choices?

No one denies that infrastructure financing is a problem and getting worse. But is moving further away from traditionally cost-free roads toward for-profit, privately-run roads and bridges a smart decision?

In the late 1990s, New Mexico wanted to expand N.M. 44 to a four lane road. Funding was tight in the state and as such, New Mexico entered into a public private partnership agreement to design, manage, and build a road with a 20 year pavement performance guarantee. The warranty deal is quite questionable and may be costing taxpayers more money. When New Mexico entered into this agreement, it thought it would be changing the way states handle highway construction and maintenance. However, fewer states have gone that direction, but instead, have chosen concession agreements.

The City of Chicago, Virginia, and Indiana all entered into concession agreements recently and I am interested to hear from the Governors of Virginia and Indiana to get their assessment of the projects and the way forward for their respective states.

Again, I remain skeptical about the way forward using public private partnerships so I look forward to the testimony of today's witnesses and this series of hearings from the subcommittee.



Transportation for Illinois Coalition
April 25, 2006

**PUBLIC/PRIVATE PARTNERSHIPS
POLICY ISSUES**

Overview

Financing future transportation improvements in Illinois poses ever greater challenges. For that reason, the public/private partnership concept should be carefully reviewed to determine if such arrangements are feasible. The TFIC Issue Paper identifies an initial series of issues that must be addressed by the legislative and executive branches of Illinois State government, as well as by the public at large, as part of this review process.

Legislation has been proposed that would allow the Illinois Department of Transportation (IDOT), the Illinois State Toll Highway Authority (ISTHA), the Regional Transportation Authority (RTA) and its service boards (CTA, Metra and Pace) to enter into public/private partnerships, including partnerships for the construction of new infrastructure projects and for the lease of new and existing infrastructure assets. In the case of Illinois highways, two types of partnerships are frequently mentioned: (1) the leasing of all or part of the existing toll road system; and (2) the construction and leasing of new toll road extensions, such as the O'Hare Western Bypass.

Under the first scenario, in exchange for payments from a private partner, ISTHA would enter into a long-term concession or lease arrangement giving the private entity the right to operate a toll road, raise and collect the tolls, and keep any profits from the operation. This is what the city of Chicago did with the Chicago Skyway. Under the second scenario, IDOT and ISTHA would partner with a private entity, which would finance and construct a new toll road. In exchange for this financial commitment, the private partner would enter into a long-term lease giving it the right to operate the road, to raise and collect tolls on it, and to keep the profits from the new road.

While such partnerships have the potential for benefiting the transportation system by providing up-front cash for transportation improvements and/or enabling quicker construction of needed toll road extensions, the partnerships are complex arrangements that have long-term policy implications. TFIC has identified fifteen specific public policy issues that we believe should be considered. Each of these issues is discussed below. It should be noted that the decisions on these issues would impact the amount of money that private partners are willing to invest.

The Transportation for Illinois Coalition is recognized as the authority on and unifying voice for transportation needs in Illinois. Given this leadership role on transportation issues, TFIC is a necessary part of any serious discussion of this issue and stands ready to fully participate in the public discussion of the concerns identified. Until the issues outlined below have been fully and openly addressed in authorizing legislation, TFIC is unable to take a position on public/private partnership legislation in the Illinois General Assembly.

PUBLIC/PRIVATE PARTNERSHIPS POLICY ISSUES

Policy Issues**1. Continued ability to finance new additions to the expressway system in the future.**

One of the traditional virtues of Illinois tollway system is the ability to use the success of completed segments to help build new segments. Originally the Tri-State had to pay for itself. All extensions after that were financed using the system as a whole since no new extension could cover its initial construction or operating costs. First the Northwest was financed using the base system, then the East-West, then the North-South in DuPage and now I-355 in Will County. Carving off a piece of the system for a private partner could make this option much more difficult to use in the future. Leasing the entire system to a private partner would likely eliminate the ability for cross-subsidizing new segments. Potential needed future expressways that could be hindered over the next few years include the Ill 53 extension in Lake County, the Elgin-OiHare/OiHare Bypass and extension of the Prairie Parkway north of I-88. How can this flexibility be preserved with a private partner?

2. Use of revenues generated by public/private partnerships.

Public/private partnerships have the potential to generate significant sums of \$1.8 billion in the case of the Skyway and \$3.8 billion in the case of the Indiana Toll Road. In Indiana these moneys are to be used for highway purposes, while in Chicago they are not. Illinois toll roads were paid for by the users and it seems appropriate that any funds generated for the public sector through a privatization arrangement should be used for the benefit of the highway users. Should this principle be reflected in the proposed legislation?

A related question deals with whether the public is best served by a onetime payment of benefits or by payments stretched over many years. With a onetime payment to the public sector, funding can be quickly put to work and improvements realized, but the partnership provides no ability to generate funds for future needs. When payments to the public sector are stretched out over the life of the agreement, future needs can also benefit. How can/should funding for future needs be included in public/private arrangements?

3. Requirement for future subsidies from IDOT's highway program rather than using the toll highway system to finance new private partner roads.

There are few if any roads to be built in Illinois that can completely pay for themselves through tolls. A public/private partnership to construct toll road extensions will require a public subsidy. But, ISTHA is prohibited by its bond covenants from providing money to uses other than maintenance, operation and expansion of the ISTHA system. Therefore, IDOT would probably have to provide the subsidy, which in the past had come from toll increases on the existing toll system. This could be a major future drain on state highway programs.

The case study on the Elgin-OiHare/OiHare Bypass, prepared by Business Leaders for Transportation, indicates that private financing could generate \$905 million towards construction of this project, and that another \$300 million in public subsidy would be required (over and above the \$140 million in federal funding authorized last summer). The study assumes that \$139 million of the \$300 million would come

PUBLIC/PRIVATE PARTNERSHIPS POLICY ISSUES

from ISTHA. But, as noted above, ISTHA would be unable to provide any funding because it would not benefit ISTHA's system. The source for the full \$300 million in public subsidy would likely be IDOT's state highway program. Using IDOT's current estimate of 10% annual construction cost increases over the next two years, the state highway program subsidy for this project could easily be more than \$600 million if assuming that \$905 million is possible to be raised by a private partner from facility tolls.

The public policy question here is whether subsidies for future toll road extensions in northeastern Illinois should continue to be financed by system wide toll increases or from the state highway program.

4. Ability to manage the transportation network as a system.

It is difficult enough today with IDOT and the Tollway managing the interstate system; CTA, Metra and Pace operating the public transportation system; and six counties and hundreds of municipalities managing the local road system. How can a private partner be integrated into the system?

A private operator will manage the system to maximize returns to shareholders/investors, not to maximize the public interest. A good example of this is the Skyway repair that is being done at the same time as the Dan Ryan reconstruction. There is no incentive for a private owner to want to schedule work so there is an alternate route available during construction. That would only cause the private owner to lose profits. How can good system traffic management for future construction be included?

5. Potential higher costs to the highway user.

There are several factors that could result in higher costs to the highway user:

- One of the biggest risks for a new toll facility is the potential for delay in starting up and reaching full traffic volume. With no existing revenues to support financing during this time, the investors and bondholders will likely require a risk premium and additional reserves to pay debt service during start-up. This adds costs compared to a financing using bonds secured by a system, which has a long track record.
- Private facilities must generate a return on equity to investors that the Tollway does not, which can increase tolls for the user.
- A private partner will find it difficult to operate a single segment at less cost than a public agency. First of all, it is not as cost efficient to independently maintain one segment of road as it is to add that segment to a much larger system. Additionally, the legislation requires the private operator to abide by many requirements that can increase costs.

In order to protect the public, partnership agreements generally will index future toll increases to an index like the CPI. For example, the Skyway agreement allows 7.9% average annual toll increases through 2017 and toll increases after that at the greater of 2% per year, inflation, or nominal gross domestic product per capita. The Indiana Toll Road agreement provides an initial 72% increase in tolls for cars and a four-year phased increase of 120% for trucks, with additional annual increase for all vehicles beginning in 2010.

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Public agencies, on the other hand, only raise tolls when it is necessary to meet increased costs or expansion needs that have to be justified and presented to the public before approval. Typically public owner toll increases do not pace the CPI.

In summary, what are the costs to the highway user for private as opposed to public financing and operation? Should the public have any input into future toll increase commitments? If so, how can that be accomplished within the framework of a public/private partnership?

6. Maintaining current Tollway financial strength.

The OiHare Western Bypass is one of the region's most needed facilities because it will reduce congestion at the current entrance to OiHare by providing access to a new western entrance and allowing traffic on the Tri-State and Northwest Tollways alternate methods not only to get to OiHare but for through traffic to get around OiHare. If operated by an entity other than ISTHA, the Bypass will divert existing traffic (and revenues) from the ISTHA system, thereby reducing the Tollway's ability to repair and expand its system both now and in the future. However, it is unclear whether traffic growth on the Tri-State would offset traffic diverted by the Bypass. Also, this revenue diversion could be avoided by the Tollway tolling the entrance/exit ramps to the Bypass, but that would lessen the usefulness of the facility and make it less attractive to the private sector. How can ISTHA be protected from future revenue stream losses?

7. Maintaining flexibility to raise additional transportation resources.

Illinois has a strong record of support for periodic transportation funding increases. (See Attachment for history of funding increases and listing of major projects completed or funded in past 25 years.) However, promises of additional money without raising public user fees could make future support for raising fees more difficult. Legislators who might be nervous about fee increases can point to private partnerships as a reason that public initiatives are unnecessary. Taking the pressure off of officials to increase funding to implement a headline project makes it more difficult to put a package together that meets all of the state's transportation needs such as rural widening/resurfacing and bridges, public transportation, and interstate reconstruction. To pass initiatives in the General Assembly, all parts of the state must benefit from the program. Cherry picking key projects by the private sector could hurt IDOT and ISTHA in future efforts to raise user fees to make improvements system wide and to keep the existing system in good condition.

How can private partnerships be structured to enhance future public initiatives or to be part of an overall transportation funding strategy?

8. Potential inconsistency between privately controlled design-build and the public interest.

Use of design-build on urban expressways could have potential negative impacts on urban neighborhoods. Ability to implement context sensitive designs may clash with maximizing profit to private partners. The private sector's goal will be to make the facility as attractive as possible to the motorist at the lowest possible cost to the private investor. There is no incentive for the private sector to protect adjacent residents and businesses or mitigate their concerns. How can the public be assured that its concerns will be considered and mitigated in the design process?

PUBLIC/PRIVATE PARTNERSHIPS POLICY ISSUES

9. Consideration of public financing options which could offer the ability for additional improvements while protecting the public interest.

Currently the Tollway enjoys a fairly high bond rating which reflects a high ratio of revenues to debt. Private owners are willing to accept much lower debt ratings to maximize the amount of construction. If ISTHA were willing to accept a lower bond rating, it could significantly increase its construction at current toll levels. Higher debt levels and leverage (and lower bond ratings) can be consistent with good management, optimal operation and accomplishing important public projects. How do these public options compare to private options?

10. Flexibility to modify or terminate agreement.

Privatization concepts look at very long lease times (75 to 99 years). Unforeseen circumstances can arise during that time which may necessitate the modification or termination of the agreement.

For example, if the Illinois Tollway were leased, the partnership agreement would likely include provisions for annual toll increases, to be imposed by the private partner, in order for the private sector to make a profit. Most of the tolls are paid by Suburban Cook and Collar County residents. If the proceeds from the lease were used to benefit downstate and/or Chicago and the tolls increases were perceived as too high, it might be politically necessary to modify or terminate the agreement. In fact, controversies did arise, fairly early in the lease period, concerning public/private toll roads in Toronto and in Orange County, California. In Toronto's case, the matter has been in court for several years, with the courts ruling in favor of the private concessionaire. In California, Orange County was able to terminate its agreement, but at a cost of more than \$200 million paid to the private partner.

How can the legislation minimize this risk and address the need for flexibility to respond to changing political considerations?

Additionally, flexibility is needed to respond to changing transportation circumstances during the life of the lease. Today we cannot foresee what needs our transportation systems will have 30 or 40 years from now - let alone 70 or 80 years away. How can the flexibility be maintained to address unforeseen future transportation needs?

11. The right of the public to know what is being placed in contracts with private partners.

While public agencies are supposed to be transparent, private businesses strive to be opaque to protect proprietary information and maintain competitive advantages. The public/private partnership legislation under consideration in Missouri requires contract details to be a closed record until after the agreement between the state and private operator is executed. Illinois has a history of public involvement in transportation planning and funding. How can the legislation provide the proper mix of sunshine to protect the public and secrecy to protect the private partner's proprietary and competitive interests?

PUBLIC/PRIVATE PARTNERSHIPS POLICY ISSUES

12. Impact of non-compete provisions.

Inclusion of non-compete provisions will increase the amount a private partner will be willing to pay for a long-term lease since their risk is reduced by removing the possibility of future transportation improvements being constructed in or near the corridor. While the Skyway agreement does not include a non-compete clause, the Indiana Toll Road agreement has a limited non-compete clause.

If included in a contract with the private partner, a non-compete provision could prohibit state, local and transit agencies from making future improvements in or near the corridor. Should the legislation restrict the use of such provisions?

13. Conversion of free roads to toll roads.

The current proposed legislation permits turning existing freeways into toll roads. Should this power be granted?

14. Extent of administrative discretion.

It is important to consider how much administrative discretion should be given to transportation agencies to negotiate and commit to public/private partnerships. The Chicago City Council had to approve the Skyway agreement. The Indiana state legislature had to approve the Indiana Toll Road agreement. Should there be some oversight or approval process required for public/private partnership commitments? How much administrative discretions should be granted?

15. Compliance with state statutes regarding labor provisions, environmental impacts, work force diversity, and competitive bidding procedures

Public agencies are required to adhere to state statutes and regulations with respect to numerous areas that are designed to protect the broad general public interest. These range from ensuring minority participation in public works projects to provisions that ensure community participation in the design of a transportation facility. Some of the statutory and regulatory requirements include the following:

- * Disadvantaged Business Enterprise Law
- * Prevailing wage law
- * State procurement code requirements, including competitive bidding for construction
- * Qualification-based Selection Act for hiring engineering and design firms
- * Context sensitive design requirements

How would a private entity ensure that some or all of these public policy goals are met?

PUBLIC/PRIVATE PARTNERSHIPS POLICY ISSUES

Attachment: Transportation Funding Increases

Governor Thompson raised the gas tax and license fees in 1983, initiated the Build Illinois Program in 1985, raised tolls to construct the North-South Tollway in DuPage in the mid-eighties, and raised the gas tax again in 1989. Governor Ryan raised license fees in 1999 to fund the Illinois First Program, increasing resources for state and local roads by more than \$4 billion. Governor Blagojevich raised tolls in 2005 to fund the \$5 billion Open Road Tolling program and numerous expansions to the Tollway including the North-South extension in Will County. Only during the eight Edgar years were there no increases in state funding for transportation and this was due to Illinois receiving the largest increase in the nation (50%+ increase) in federal highway funds with ISTEA in 1992. Major infusion of public infrastructure funding has occurred every four or five years for the past 25 years.

Many new expressways or expressway expansions have been either completed in the last 25 years, are now under construction, or are funded in current multi-year programs with traditional public financing. Here are 20 examples:

Elgin O'Hare expressway west of I-290 (*Completed*)
 North-South Tollway in DuPage County (*Completed*)
 I-355 from I-55 to I-80 (*Under construction*)
 Tri-State add lanes to the entire length (*Portions under construction, completed and funded*)
 Northwest Tollway add lanes from the Kennedy to west of Elgin (*Funded*)
 Add lanes to Reagan Tollway from I-290 to Ill 59 (*Portions completed, under construction and funded*)
 I-290/Ill 53 add lanes in Western Cook County (*Completed*)
 I-39 from Rockford to Bloomington (*Completed*)
 I-80 add lanes from the Tri-State to Indiana (*Under construction*)
 I-155 from Lincoln to Peoria (*Completed*)
 I-72 from Springfield to Quincy (*Completed*)
 Ill 29 from Springfield to Taylorville (*Portions completed and under construction*)
 US 51 south of Decatur (*Portions completed and under construction*)
 US 67 in Morgan County (*Portions completed and under construction*)
 I-270 in St. Clair County (*Completed*)
 Alton Bypass (*Under construction*)
 Ill 13 in Saline County (*Completed*)
 US 45 in Saline County (*Under construction*)
 US 34 in Henderson County (*Portions completed and funded*)
 Ill 336 from Quincy to Macomb (*Portions completed and under construction*)

Submitted for the Record



COMMITTEE ON TRANSPORTATION & INFRASTRUCTURE
Subcommittee on Highways, Transit, and Pipelines

**“Understanding Contemporary Public-Private Highway Transactions:
The Future of Infrastructure Finance?”**

May 24, 2006
9:30 a.m.
2167 Rayburn House Office Building

Opening Statement of Congressman Elijah E. Cummings

Mr. Chairman:

Thank you for calling today’s hearing to enable us to examine the growing role of public-private partnerships in the development of transportation infrastructure in this nation.

Public-private partnerships have been created in our nation’s transportation sector since our country was founded. However, after a period of relatively limited

use over the past few decades, they are enjoying something of a resurgence in the transportation sector in large part because public sources of funding – including both federal and state sources – are falling increasingly short of our nation’s need for new infrastructure.

I believe that public-private partnerships are important mechanisms for supporting the development of transportation infrastructure and should be available options whenever they effectively and efficiently advance a project.

According to the Federal Highway Administration, as of February 2004, 23 states have passed legislation that provides some level of legal authority for private

participation in the development of public infrastructure.

In many of these states – as in my state of Maryland – this authority is vested with the state toll road authority and allows the authority to include the private sector in the development of a toll road.

However, though they offer significant new flexibility in the development of transportation infrastructure, innovative financing mechanisms – including public-private partnerships – must not become substitutes for a strong and vibrant federal infrastructure program.

While the Administration and the Congressional Budget Office have different estimates of when the Highway Trust Fund will attain a negative balance, both entities

are in agreement that a negative balance will be reached near the end of the SAFETEA-LU period – and this has very serious implications about our ability to maintain a meaningful federal program.

Mr. Chairman, this year marks the 50th anniversary of the Federal-Aid Highway Act that created the U.S. Interstate Highway System.

The construction of the Interstate System was a remarkable achievement made possible in large part through the creation in 1956 of a new federal financing system for transportation. This system remains centered on the Highway Trust Fund, to which the federal gas tax and related transportation taxes are directed.

Unfortunately, as the funding generated through the federal gas tax – and concomitant state taxes – has begun to fall short of need in recent years, states have focused their increasingly limited resources – rightfully so – on maintaining existing infrastructure and new construction has slowed.

According to the Federal Highway Administration, 30% of all state expenditures on roadways made in 1981 were made on new construction. By 2001, expenditures on new construction had fallen to just 13% of total expenditures.

I believe that the federal government should lead the development – as it did 50 years ago – of a truly

national transportation system that is increasingly intermodal and that can carry our economy forward. To continue to play this role, however, federal leaders must be willing to develop the financing mechanisms that will be needed to support a strong federal transportation program.

Public-private partnerships are likely to be significant parts of the transportation financing system of our nation's future – but the role that they play should be decided as part of decisive and comprehensive decisions about the future shape and funding of our federal transportation system.

I look forward to discussing these critical issues with today's panelists and I yield back the balance of my time.

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TESTIMONY

GOVERNOR MITCHELL DANIELS

GOVERNOR OF THE STATE OF INDIANA

HOUSE HIGHWAYS, TRANSIT AND PIPELINES SUBCOMMITTEE

HOUSE TRANSPORTATION AND INFRASTRUCTURE COMMITTEE

WEDNESDAY, MAY 24, 2006

**“UNDERSTANDING CONTEMPORARY PUBLIC PRIVATE HIGHWAY
TRANSACTIONS: THE FUTURE OF INFRASTRUCTURE FINANCE?”**

Chairman Petri, Ranking Member DeFazio, and members of the Subcommittee, I am pleased to appear before you today to discuss "Major Moves," Indiana's steps to address our growing infrastructure needs through public-private partnerships.

Indiana's Major Moves is one example of the spreading trend of innovative alternatives to address the nation's growing infrastructure problems. As Transportation Secretary Mineta recently commented, "A big part of the answer is to involve the private sector more fully – not just as a contractor or vender, not merely as a financier, but as a partner in the funding, management, and expansion of our transportation infrastructure. The United States will see a transportation investment boom that could forever change the way Americans travel, when state governments adopt policies that allow the private sector a greater role in building, expanding and maintaining transportation systems."

The Committee knows well the enormity of the national gap between infrastructure needs and available dollars. Indiana's part of this shortfall is at least \$3 billion, or ten years of new construction spending at the current rate. For a centrally-located state that accurately labels itself "The Crossroads of America," one with great promise as a logistics and distribution capital, the cost of inaction would be especially enormous. A huge part of Indiana's future depends on its transportation capabilities. We must make significant enhancements to the state's physical and "intangible" infrastructures in order to ensure that they are able to support the future requirements of a growing and evolving Indiana economy.

All across our state, hundreds of road and bridge projects have been promised for years, in some cases decades, with no source of funding and no hope of becoming reality unless bold new steps are taken. Upon taking office, I asked for an immediate review of all of the projects on the drawing board, and a prioritization of projects based on traffic congestion, safety and especially economic development opportunities. We sought input from the public at open meetings throughout the state. Finally, we produced a ranking of over 200 projects with realistic cost estimates attached. In the end, it was clear that our new administration inherited a transportation infrastructure gap of at least \$3 billion over the next 10 years.

We looked at every option to address this funding shortfall, from raising the state gas tax (currently 18 cents), indexing the gas tax, transferring state sales taxes on gasoline to transportation, issuing more debt, increasing heavy truck fees, and increasing vehicle registration fees, to name just a few. It was clear that very few of these 200 plus projects would become reality on a business as usual basis. Without new approaches that stretch dollars and access new funding sources, only a fraction of our transportation needs would be met. Many projects would never be built.

The only real alternative was to bring to bear that handiest of revenue sources, Other People's Money. The use of public-private partnerships can enable us to accomplish two important things: 1) generate significant funds for infrastructure projects across the state from leveraging an existing asset, the Indiana Toll Road, and 2) build otherwise unaffordable projects, including I-69 from Evansville to Indianapolis.

Public-private partnerships are hardly a novel idea. In much of the world, but only recently in the United States, private capital already plays a large role, most often in partnerships (called "P3s") with

public authorities. The Reason Foundation estimates \$25 billion of private investments are proposed or committed for new and existing roads in six states. If it were merely a matter of getting hands on money today that would otherwise come in over the years, such partnerships would make little sense. The goal is to capture far more value than an asset would be worth in public hands, and that is often not difficult to achieve.

The Indiana Toll Road has operated at a loss during five of the last seven years, and has been inadequately maintained. For years, the road postponed needed expansions and repairs and failed to install the electronic technology that now makes tollways elsewhere faster, more convenient, and more efficiently operated, all because there was no way to pay for these necessary improvements. A principal reason was its antique pricing; tolls had been completely unchanged since 1985, and were far below comparable American tollways. We had tolls as low as 15 cents. I once asked how much it costs to collect a 15-cent toll, and the answer came back 34 cents. My response was that we'd be better off on the honor system.

Just as many business units are more valuable if separated from their conglomerate parent, an asset like a highway can be worth vastly more under different management. When we offered our road for long-term lease, we received a high bid of \$3.8 billion. The highest estimate of the road's net present value in state hands, assuming future toll increases far beyond past history, was less than half that amount. A more realistic estimate was \$1.1 billion. Indiana will soon cash a check that closes the infrastructure gap most had believed insoluble. To bring in \$3.8 billion through higher fuel taxes, Indiana would have had to more than double its existing gas tax. If we had attempted to close the gap through additional bonding, we would only have been able to borrow about one third of this figure before colliding with marketplace limits.

The ultimate success of this policy depends on the wisdom with which we use the new funds. As in business, it is a mistake or even a misdeed to take value from a capital asset and use it for short-term operating purposes. Central to our proposal was the insistence that the value liberated from our road be redeployed swiftly into new, long-term public assets that will strengthen our economic backbone and leave a more prosperous state to our children.

The authorizing legislation passed both chambers this past March, and we soon expect to sign the largest P3 infrastructure deal thus far in the United States. The preliminary lease agreement was executed on April 12 and is scheduled to close on June 30 with Statewide Mobility Partners, a partnership of Macquarie and Cintra. Macquarie is an Australian company who is serving primarily as the banker in this arrangement and Cintra, a Spanish company, will serve as the operator. These two firms are the most experienced companies worldwide in P3s today, but I believe it is only a matter of time before there will be serious US competition in this emerging market.

The agreement provides for \$3.8 billion cash in exchange for a 75 year lease of the Indiana toll road. It is important to note that the \$3.8 billion is a cash payment to the state. While other states are raising gas taxes and paying interest on borrowed funds, Indiana will have cash in the bank and will be collecting more than a half million dollars per day in interest to reinvest in our future.

In addition to the \$3.8 billion, Statewide Mobility Partners agreed to commit to significant improvements to the road totaling over \$400 million. The total interest on the initial \$3.8 billion is estimated at \$700-\$900 million – making the minimum total benefit to Indiana at \$4.5 billion.

A few significant highlights of the legislation include:

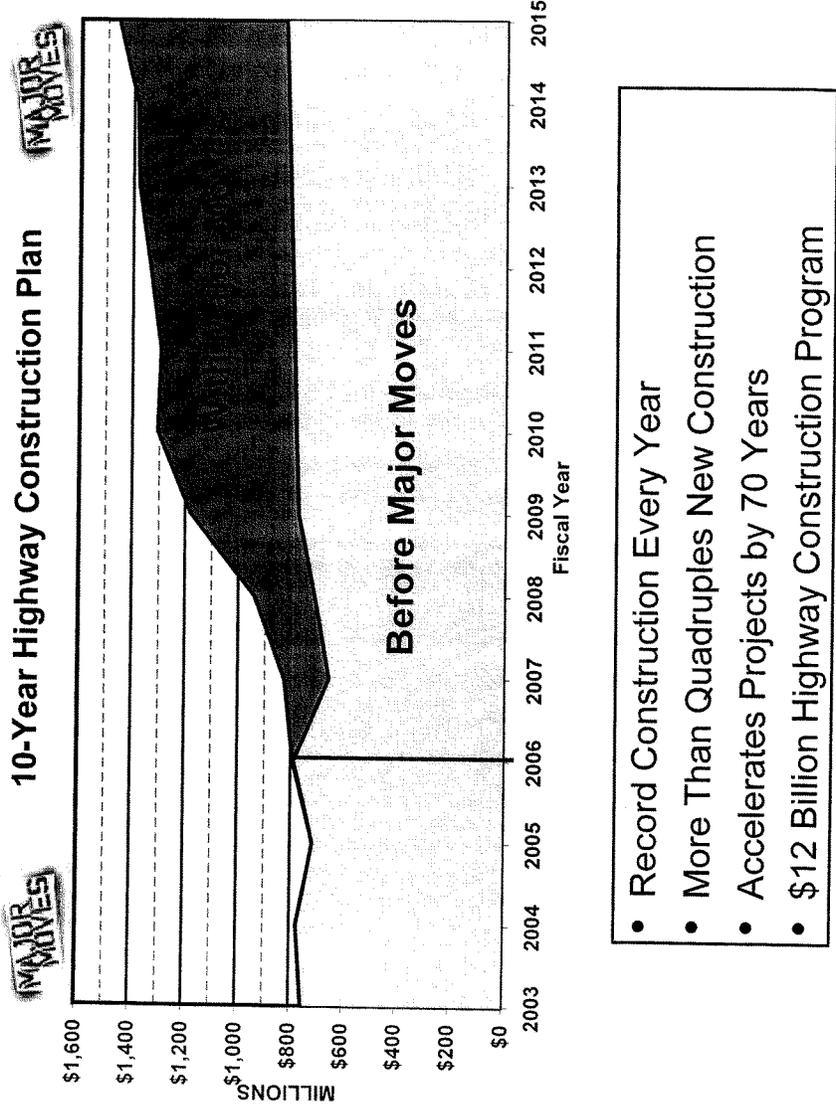
- 1) Indiana can enter into a lease agreement for the Indiana toll road and can enter into a public-private partnership(s) to build the Evansville to Indianapolis portion of I-69.
- 2) Revenues from the toll road agreement go into three funds: 1) The Toll Road Fund which will be used to retire outstanding Indiana Toll Road bonds of \$200 million and transaction costs associated with the lease financing; 2) \$500 million to a Next Generation Trust Fund, a reserve fund from which the state can draw down interest only at 5 year intervals, for road and bridge projects; 3) the remaining funds go to the new Major Moves Construction Fund.
- 3) Thirty-four percent of the Major Moves Construction Fund, representing the total value of all Indiana motorists' tolls, (the remaining 66% are paid by out of state or commercial traffic) will be reserved for the seven northern toll road counties. An additional \$150 million will go to local government in all 92 counties for local road projects over the next two years. The remainder of the fund will be used to help fund the hundreds of new construction road and bridge projects that the state will undertake over the next decade.
- 4) Eligible projects from the funds are limited to highway and bridge projects.

The lease agreement is an extensive legal document, with very specific provisions regarding all aspects from maintenance, improvements, and installation of electronic tolling facilities, even to time requirements for the removal of snow. Acting administratively, we had already begun to increase tolls on the toll road before knowing whether an acceptable bid would be received. Under the agreement, future tolls are capped at the greater of 2% per year or the increase in inflation or GDP.

Within a few years, Indiana will be home to some \$5 billion of new public assets that otherwise would not have existed, including US 31, the Hoosier Heartland Corridor, I-69, and two new Ohio River Bridges. It will result in the biggest infrastructure building program in state history, quadrupling new construction, and advancing project timelines by more than 70 years, all without raising the state gas tax. This program will generate directly an estimated 130,000 jobs in Indiana, and we believe it will trigger a wave of business development opportunities in the future.

I consider Indiana's recent actions nothing more than a practical approach to a problem most in our State thought intractable. We have found a way to close our infrastructure gap and invest in hard, permanent public assets for our future without a penny of gas tax increase or a penny of debt.

We look forward to working with this Committee to understand the benefits of these transactions and to examine innovative solutions addressing the transportation infrastructure gap.



Statement of Mr. Mark Florian, Managing Director, Goldman, Sachs & Co.

Testimony before the Subcommittee on Highways, Transit and Pipelines of the
House Transportation and Infrastructure Committee

May 24, 2006

Mr. Chairman and Members of the Subcommittee:

My name is Mark Florian and I am the COO of the Municipal Finance and Infrastructure Group for Goldman, Sachs & Co. and I also manage our North American Infrastructure Investment Banking business. I appreciate the opportunity to testify before the Subcommittee today on "Understanding Contemporary Public Private Highway Transactions: The Future of Infrastructure Finance".

I. EXECUTIVE SUMMARY

Municipal budgets continue to be constrained as the infrastructure demands of municipal governments grow dramatically. As a result, state and local governments have begun to access non-traditional forms of financing for capital and operating needs. One strategy that is used globally, but is relatively new in the United States, is the public-private partnership (PPP). Under PPP agreements, state and local governments receive compensation (either in the form of a substantial up-front payment or as an ongoing annuity) to contract with a private operator who provides operating, maintenance and/or construction expertise for large-scale infrastructure projects.

Fueled by the investment of pension funds and insurance companies searching for steady, predictable cash flows, the PPP market is a particularly effective financing tool for toll roads, which are able to monetize future volume and toll increases while offloading future operating and capital expenditure risk. Specifically, in many European, Asian and Australian markets, PPP has become the primary source of infrastructure funding for government transportation agencies. The structure and accordingly the benefits that may be derived from a PPP concession may take various forms from one time up-front payments to on-going revenue sharing structures, while initial construction and/or expansion programs can be combined with either of the two. With the recent success of two major U.S. PPP transactions in Chicago and Indiana, an investor class with a strong interest in infrastructure assets and a growing acceptance of the PPP concept in states and local governments, we believe that public-private partnerships are a key part of the new frontier of infrastructure finance.

II. MARKET OVERVIEW

The United States is at a crossroads in its transportation infrastructure lifecycle. Large capital investments have been identified across the nation, which are critical to sustaining the U.S.'s economic growth and quality of life. Traditional funding sources have not kept pace with these needs, thereby requiring local governments to search for alternative and innovative financing approaches to deliver these projects. Given the magnitude of the major capital needs on the horizon, states and local governments have begun to consider alternative forms of financing, including the significant financial resources that can be provided by the global infrastructure PPP market.

While it has been customary for the local municipalities to finance the improvement and maintenance of their infrastructure, they are capacity constrained and limited in the ways they can finance their assets. Many of these states, cities and authorities have millions, if not billions, of dollars of debt associated with each of their assets. In addition, the tax-exempt market, where these assets are traditionally financed, imposes strict limitations on the amounts of leverage that can be layered onto each asset as well as restrictive coverage requirements and additional bonds tests.

There are a number of ways through the traditional tax-exempt markets that municipalities fund transportation projects. Highway projects are most typically (and conservatively) financed through a securitization of motor

fuel taxes. This revenue stream is not nearly enough to cover the outstanding maintenance and capital improvement costs associated with many of these assets. These funds can be supplemented through the various transportation funding programs implemented by the federal government. Specifically, many states leverage their receipts under SAFETEA-LU through Grant Anticipation Revenue Vehicles (GARVEE bonds). GARVEE financings can offer states and local governments additional sources of funds for their infrastructure projects but can be subject to conservative assumptions and a haircut of value due to the inherent risk of reimbursement. Additionally, many capital constrained projects can apply for a Transportation Infrastructure Finance and Innovation Act (TIFIA) loan, which is specifically designed to aid progressive transportation projects. A TIFIA loan can provide low cost funds that offer immense flexibility for new and complex projects, but can also be quite restrictive.

Ultimately, these financing mechanisms, though extremely effective on a project-by-project basis, do not provide enough proceeds to renew and expand our nation's infrastructure. More and more, municipalities are turning to the private sector to finance and own their infrastructure projects. Public private partnerships can provide municipalities with the capital injection that is necessary for the continuation of a healthy transportation system. In addition, PPPs offer the municipalities a way to monetize certain assets and provide funds to accelerate desperately needed projects.

III. PUBLIC-PRIVATE PARTNERSHIP OVERVIEW

Public-Private Partnership Trends in the US

Many municipal governments are considering public-private partnerships to achieve funding goals in the wake of large capital needs and restrictive budgets. For example, the State of Indiana recently found itself faced with a \$2.8 billion deficit in its 10-year transportation plan. After determining that the maximum potential tax-exempt proceeds would be insufficient to fund its plan, the State retained Goldman Sachs to execute a PPP concession process, which concluded with the acceptance of a \$3.85 billion bid in exchange for a 75-year lease of the Indiana Toll Road. The proceeds from the lease will be used to fully fund the transportation plan, accelerate several other projects that will upgrade and enhance Indiana's infrastructure, generate significant new construction and manufacturing jobs, and lower the State's future debt issuance and interest costs. In addition to this up-front payment, the private operator expects to spend \$4.4 billion (2006 dollars) to maintain and expand the Indiana Toll Road over the life of the lease.

Similarly, Goldman Sachs also advised the City of Chicago on the \$1.83 billion concession lease of the Chicago Skyway, which was announced in 2005. In Chicago, the City used the proceeds to pay down existing debt, establish a \$500 mm "Rainy Day" fund, allocate \$375 mm to the annual operating budget, and fund several social service programs. In addition, the City received an upgrade from S&P from A to A+.

In light of these transactions, many governments are recognizing that the steady annual cash flow that toll transactions produce are of immense value to private operators. One of the key drivers of value in both the Indiana Toll Road and Skyway leases was the ability of the buyer to pay for the future cash flows that the road would produce. The debt markets, which have historically supported public toll roads, rely primarily on historical growth to determine the borrowing levels for a toll road. Equity investors in PPP projects, however, are willing to pay for the expected value of future cash flows from steady revenue-producing assets such as a toll road, and they are often comfortable taking a more optimistic view on the future performance of established assets.

Currently, several other states have begun to contemplate and employ similar models to gain alternative funding for infrastructure expansion. Specifically, the State of Texas is currently assessing the financing alternatives for seven new toll roads, including a private concession model. However, Texas is also evaluating the applicability of Private Activity Bonds and TIFIA loans for its projects. It may be the case that the State of Texas is able to utilize these federal funding techniques in combination with a PPP. The State of Utah is also engaged in determining the appropriate funding technique for a new toll road project. In conjunction with this process, the State of Utah recently passed PPP legislation to enable PPP as a viable financing alternative, which it is seriously pursuing for the project. Also, Harris County Toll Road Authority, owner and operator of the vast toll road network around Houston, has procured a team to study the various alternatives in the PPP market.

Benefits of Public Private Partnerships for States and Local Governments

The benefits of Public Private Partnerships include:

- **Flexibility with Use of Proceeds:** The municipality could utilize the up-front proceeds to accelerate needed transportation or other projects. The true value of the ability to utilize the proceeds of a PPP for any use determined by the municipality is enhanced by the strict limitations of tax regulations for the use of any proceeds from a tax exempt bond deal. Through a PPP, the municipality is able to utilize the proceeds for a variety of uses that could range from accelerating planned transportation projects to funding social service programs. The City of Chicago retained a portion of the proceeds from the lease of the Skyway for a "rainy-day" fund that ultimately aided in the ratings upgrade of the City – and that will lower future financing costs.
- **Greater Up-front Proceeds:** A public private partnership allows the municipality to capture greater upfront value than a municipal bond transaction, given that the municipality is paid based upon the growth of future cash flows of its infrastructure assets, as compared to focusing on historical cash flow in the debt market.
- **Strict Operating Standards:** The municipality can carefully craft the terms of the concession agreement to achieve strict operating standards that meet the municipality's public policy goals. If the concessionaire does not comply with the standards, ultimately the municipality can take the road back by canceling the concession. Both the Indiana Toll Road and the Skyway transactions have 300-page operating standards that address, in great detail, the manner in which the roads will be operated and maintained.

Considerations of Public Private Partnerships

The principal points of consideration in determining whether to pursue a public private partnership vs. other strategies are as follows:

- 1) **What are the public policy implications of retaining ownership but transferring operations to another entity for a predefined period of time in accordance with a concession agreement?** Clearly, the public policy concerns associated with a private entity leasing or owning a public asset are a major factor in a PPP and must be contemplated very carefully. Again, recent experience demonstrates that PPP financing can work to satisfy both public policy needs and the interests of investors. It is also important to consider the future of the municipal employees as a result of a concession. It is possible for concession contracts to be written so a concessionaire must use municipal employees for all or a portion of toll collection, maintenance, administration, etc.
- 2) **What control issues is the municipality relinquishing under this model?** Since the municipality remains the owner, this inherently enables them to retain a greater degree of oversight of the ongoing maintenance and operations. In addition, the municipality determines a detailed list of operating standards that the concessionaire is required to follow. The municipality has the right to terminate the lease upon failure to meet any of these standards, which also allows the municipality further control under a PPP.
- 3) **The length of the potential concession agreement will be important in determining potential proceeds.** The term of the concession must be sufficient to provide the concessionaire the benefit from depreciation. This creates flexibility to depreciate the asset in the most attractive manner. The length of the concession agreement is also an important public policy decision. The State of Indiana ultimately decided to scale back to a 75-year lease from a 99-year lease after preliminary indications showed that value would not be severely affected.

Process Overview

The public-private partnership process is complex but is most likely able to be completed within 9–12 months. For example, the Indiana Toll Road process is anticipated to close in June, which is 9 months from the launch of the RFP process and 5 months from the receipt of bids. The key items to implement in a PPP are:

- Legislative approval
- Prepare feasibility study/projections
- Obtain any Federal Highway Administration or other federal approvals
- Draft concession agreement and operating standards

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- Solicit bidders and select top quality firms/consortia
 - Due diligence/negotiation of key agreements

The implementation of a successful public private partnership is dependent on many factors. A strong foundation of preliminary groundwork may contribute heavily to the later success of a municipality's PPP efforts. An overview of a typical PPP process is outlined below:

- 1) Organizational Phase
- 2) Internal Due Diligence Phase
- 3) Pre-Marketing Phase
- 4) Marketing Phase
- 5) Close Transaction Phase

IV. WHY THE SUDDEN EMERGENCE OF THE PPP MARKET?

Seemingly overnight, large amounts of money are being pooled into a variety of funds to solely invest in infrastructure. Goldman Sachs is raising an infrastructure fund more than of \$3 billion, the Carlyle Group is targeting a \$1 billion fund and numerous other firms are contemplating funds of similar magnitudes. These funds are driven by the significant demand for the infrastructure asset class from a long list of toll road companies, pension funds, insurance companies, construction/engineering firms, private equity funds, as well as potential public entities. These investors seek steady long-term returns from infrastructure assets. Additionally, the infrastructure asset class provides these investors with an additional method of diversification for their investment portfolios.

The inherent value that can be realized by a private investor above and beyond what can be realized by the municipality in the tax-exempt market is the main value driver of the PPP market. Private investors are able to realize more value from these assets than a municipality. In addition, the private investor most often bids in conjunction with an experienced operator that will manage the operations of the asset upon sale. Ultimately, a private operator is more likely to be able to hold down expenses and manage the asset more efficiently simply due to economies of scale and experience.

V. CONCLUSION – ARE PPPS THE FUTURE OF INFRASTRUCTURE FINANCE?

The need for alternative funding to repair and replenish the nation's infrastructure has given rise to the increased prevalence of public private partnerships in the United States today. There are pools of private capital that are available for this very purpose. Public private partnerships are truly mutually beneficial – municipalities are able to monetize assets for up-front cash payments to fund future projects or inject additional capital in others while private owners, operators and investors are able to access the steady stream of cash flows produced by infrastructure assets. The marriage of private operating efficiencies and incentives with essential public assets can only enhance our nation's transportation infrastructure.

As budgets become increasingly constrained and funding sources harder and harder to come by, it is likely that PPPs will become a prominent fixture in the infrastructure finance landscape. The growth in the PPP market in the past year has been exceptionally strong and there is every reason to believe that it will continue in the future. Public private partnerships are a very real and practical solution to many of our local municipalities' transportation funding crises. Although a PPP may not be appropriate for every project or municipality, it provides a valuable alternative to the current financing options that are available.

APPENDIX. CASE STUDIES



\$3.85 BILLION CONCESSION LEASE OF THE INDIANA TOLL ROAD

Goldman Sachs recently served as the public private partnership advisor to the State of Indiana on the \$3.85 billion 75-year concession lease of the 157 mile Indiana Toll Road (the "Toll Road"). The transaction is currently scheduled to close in June 2006.

The Indiana Toll Road PPP process began in July 2005 after the State determined it needed to consider alternative sources of capital to fund the \$2.8 billion deficit in its 10-year comprehensive transportation plan. The plan, entitled "Major Moves" represented the Governor's vision to create jobs and drive economic growth by transforming Indiana into a transportation logistics hub via the construction of several key road projects.

The State spent several months analyzing the pros and cons of pursuing a public private partnership, including a review of the standalone bonding capacity of the Toll Road, a strategic analysis of the potential valuations that a bidder would be willing to pay, and an assessment of the level of interest of the bidding community. In the end, the State decided to proceed with an accelerated concession process in which binding offers would be received within 120 days. The primary reason for the tight time frame was a need to deliver bids to the legislature for approval prior to adjourning in early March.

Given the accelerated pace, Goldman Sachs moved quickly to utilize its global network to contact over 70 potential buyers around the world. Leveraging the relationships and expertise that we have gained as the advisor to the City of Chicago in the Skyway concession sale and to several international toll road projects (including the recent sale of the remaining public interest in the French Toll Road system), we were able to dramatically increase the overall level of interest in the Toll Road beyond what was witnessed in the Skyway process.

During the process, Goldman Sachs provided the State with risk pricing for the important policy decisions they needed to make in the Concession Agreement. For example, they were able to make the decision to shorten the concession from 99 years to 75.

In January 2006, we received binding offers from four of the final bidders. The winning bid, \$3.85 billion, was submitted by Cintra-Macquarie, the same team that won the auction to own and operate the Chicago Skyway. The State legislature authorized the transaction in March 2006, and financial close is expected to occur in June 2006.



\$1.83 BILLION CONCESSION LEASE OF THE CHICAGO SKYWAY

Goldman Sachs advised the City of Chicago on the privatization of the Chicago Skyway that generated a winning bid of \$1.83 billion. The City solicited Requests For Qualifications in the spring of 2004 resulting in ten international consortia submitting preliminary proposals to purchase the concession. Five consortia were deemed qualified by the City and were invited into an intensive due diligence process. The 99-year concession transaction closed on January 24, 2005 and the \$1.83 billion was delivered to the City on that day. Annual engineering inspections and monitoring of operations will be conducted over the life of the agreement per the 300 page operating standards manual. In addition, the concessionaire is mandated to complete several specific capital improvements to the Skyway.

The Chicago Skyway is the first toll road privatization of an existing road in the United States. The Chicago Skyway is a 7.8 mile divided elevated toll road and toll bridge and has 3 lanes in each direction. It connects to the Indiana East-West Toll Road to the Dan Ryan Expressway. Recent traffic flows have been affected by major restrictions due to the capital works program which began in 2002. Tolls, which had not changed since 1993, were \$2 per car, \$1.20 per truck axle. Prior to the concession, all of the tolls had been collected manually and the concessionaire is encouraged to enable electronic tolling.

The Skyway's key strengths include a lack of competing direct routes, minimal impact of toll increases on traffic demand, strong cash flow margins and revenue growth rate; limited future capital expenditures;

modernization potential, and a beneficial economic environment.

Summary Financial/Operating Information				
(\$000)	2000	2001	2002(a)	2003(a)
Revenues (\$) ^(b)	39,214	44,004	43,232	39,770
Operating Expenses (\$) ^(b)	7,896	9,106	10,050	11,417
Cash Flow (\$)	31,318	34,898	33,182	28,352
Total Vehicles (000)	16,516	18,717	18,711	17,422

(a) Lane closures due to CIP impacted traffic and revenues, completion of CIP is expected by December 2004.
(b) Source: Audited financial statements.

Goldman Sachs led a 2-year process to privatize the Chicago Skyway. The bidding process was designed to create maximum bidder tension to potentially enhance value in a tight competition for this asset. In the end, the Cintra-Macquarie Consortium submitted the winning bid.

Cintra-Macquarie is widely respected as a premier international toll road operator with 35 years of demonstrated experience. It operates more than 30 toll road concessions spanning over 1,000 miles including the Highway 407 toll road in Toronto (99-year concession for a 60-mile toll road) and is involved in the last three private U.S. toll road financings. Furthermore, it has raised over \$10 billion in both debt and equity for the financing of toll roads.

The City explored this concession sale for several reasons. The City believes that a private operator will provide high customer service and traffic flow. It was a favorable time for a sale because the City had invested \$300 million in improvements, tolls have not been increased since 1993, and there is continued economic development in region. The sale also gave the City the opportunity to maximize City tax-payer benefit with monetization of toll increases. Finally, net proceeds were used to defease/cancel \$400 million in existing Skyway net debt, and to establish a reserve fund to finance City public-service initiatives.



UDOT - MOUNTAIN VIEW CORRIDOR

Goldman Sachs is currently serving as the State of Utah Financial Advisor for the Mountain View Corridor (MVC), a 40-mile new highway project connecting I-80 west of the Sale Lake City Airport and running south along the western portion of the Sale Lake Valley into Utah County. UDOT is well under way on its EIS process, having spent the last 18 months developing alternative configurations for the \$1.5 to \$2.5 billion project. The EIS is expected to be completed in mid-2007, with a Record of Decision expected by late 2007.

UDOT management and staff have been focused on studying all possible alternatives for the new road, knowing that the State's available financial resources for transportation projects are very limited. The average annual funding for all transportation in the State is less than ten percent of the cost of the new project. Tolls are being studied as an alternative that may provide the necessary funding. As to the capitalization of such potential tolls, the newer concession approach is being modeled with the inherent Greenfield projects risks in mind and is being compared and contrasted to the traditional tax-exempt tolling authority model.

While UDOT has significant experience with design-build processes, having procured one of the largest design-build contracts in US history for the \$1.6 billion I-15 project, UDOT has not previously utilized the concession model and a public-private partnership to procure new road projects.

Earlier this year, and together with UDOT staff, Goldman Sachs prepared and presented multiple briefings to both the Utah Transportation Commission and for the leadership of the Utah State Legislature regarding the options of public-private partnerships in general and procurement via concession specifically.

Over a three month legislative session, Goldman Sachs' personnel testified at various legislative hearings and briefed all levels of the State's executive branch on the Chicago Skyway process and success as well as the then-pending Indiana Toll Road process. GS also suggested numerous specific points for the proposed legislation. The Legislature responded by passing PPP legislation giving UDOT a PPP option it has not had previously.

Greenfield projects carry a completely different level of risk above that of the Brownfield projects. Goldman

Sachs surveyed various members of the international bidding community, rating agencies, monoline insurers and toll road operators on the specific process variations that could create similar success in Greenfield procurements using the concession model. Goldman Sachs understands how Greenfield project risks may impact the size of the field of possible bidders and the ultimate levels of valuation in the concession of a Greenfield project. Changing as many unknowns to knowns is key to this process. We have brought our experience on Brownfield projects and our knowledge of specific characteristics of Greenfield projects to UDOT's process, helping the team to evaluate the alternatives with a greater level of confidence in this cutting-edge alternative procurement possibility.

For the past two months, we have been modeling the MVC in all of its configurations, taking inputs from all other consulting team members. Traffic studies, preliminary engineering, and funding possibilities combine in these models to test the leveraging capabilities of the various debt and equity mixes.

We will continue to serve as UDOT's financial advisor, helping the State through the toll/no toll decision, and through the choice of a preferred procurement. Results from our modeling and testing process will help UDOT staff and the State's policy makers make proper determinations and decisions in order to deliver the MVC at the lowest possible cost to the State and to the ultimate users of the MVC. Goldman Sachs is committed to helping the State of Utah and UDOT find maximum financial leverage in order to minimize the annual funding required to service this exciting new Corridor for the fastest growing sectors of Salt Lake and Utah Counties.



TEXAS DEPARTMENT OF TRANSPORTATION

Goldman Sachs was hired in October 2005 by the Texas Department of Transportation to serve as concession advisor on their Comprehensive Development Agreement (CDA) program. Goldman Sachs works closely with TxDOT staff and outside advisors (including Nossaman, Guthner, Knox & Elliott LLP) to analyze and deliver the most efficient financing solution from the following options:

- Pay-as-You-Go
- Highway Revenue Bonds
- Toll Revenue Bonds
- Concession
- Asset Sale

This analysis has resulted in a more refined process for determining project eligibility for typical pay-as-you-go or tax-exempt bond road financing, or utilizing a concession approach. Furthermore, we are helping TxDOT develop a programmatic approach to technical provisions, determining the role of other organizations in CDAs, developing a master schedule, managing resources and balancing stakeholder requirements. Provided below are several current road procurements we are advising:

- SH 121 – This segment runs through both Collin and Denton counties. There are four proponent bidders short-listed.
- IH 635 – Four proponent bidders are short-listed for this procurement. This project creates a partial loop around the City of Dallas.
- Loop 1604 – This project will provide a critical road capacity for the San Antonio area. Two proponent bidders have been short-listed.
- IH 820 – This Dallas project is undergoing programmatic re-evaluation for inclusion in the CDA process.
- SH 130 Segments 5&6 – We are evaluating the merits of a negotiated concession approach on these segments including assumption and financial analysis verification.
- TTC 69 and SH 161 – These high priority projects are undergoing programmatic evaluation for inclusion in the CDA Program.

Our engagement with TxDOT is projected to last multiple years as these projects are in varying stages of development and there is potential for even further CDA projects beyond those mentioned above.

Testimony by

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to the

Highways, Transit and Pipelines Subcommittee
of the
House Transportation and Infrastructure Committee

Subject: Understanding Contemporary Public Private Highway
Transactions—The Future of Infrastructure Finance

May 24, 2006

Good morning Mr. Chairman and members of the Subcommittee, and thank you for the opportunity to testify about the sale of the concession rights for existing publicly-owned highways to private investors. There have been two such transactions in the last year, the Chicago Skyway and the Indiana Tollroad, and both have generated a great deal of interest from the press, the financial community and, most importantly, state and local governments across the country. Public officials are looking at these concessions as a way to raise significant amounts of money without raising taxes or issuing bonds. In fact, the *New York Times* in an article in January titled “Turning Asphalt to Gold” (a) predicted that the sale of public assets might become the next big thing in this country.

Over the last year, as a senior fellow at the Kennedy School of Government and after fifteen years as an executive in a company serving the toll road industry, I have been looking at these transactions through a public policy lens. In keeping with this, my role today is not to explain how these deals work or to recap the financial benefits that may accrue to the various parties. Instead it is to lay out a framework to examine the public policy aspects of these sales. In other words, to answer the question, are these concession sales in the public interest?

At this point everyone in this room is familiar with the first of these concession sales—the Chicago Skyway. The winners in this deal are:

- The taxpayers of the City of Chicago who received a windfall equal to about one-third of the total size of the City’s annual operating budget;
- The Mayor and City Council who were able to solve an immediate budget crisis without resorting to tax increases; and
- The private investors who have what they hope will be an attractive investment.

It is also supposed that the people who use the Skyway are winners because the private owner will provide better service than the City, such as the introduction of electronic toll collection. While it is true that the long-awaited electronic tolling was implemented by the private owner, this service enhancement could have been implemented by the City as has been the case with dozens of publicly-owned toll roads in the United States. There are many examples of public toll roads being operated efficiently and with an eye to service. Better service is not a good reason, in most cases, to privatize our highways.

While there are winners, there are also losers. In the case of the Skyway, the losers are the Skyway users who will be paying significantly higher tolls than they would have paid under City ownership. The other loser is the region.

First, the Skyway users: Under private ownership and with the agreement of the City, tolls on the Skyway will more than double in the next twelve years and continue to increase through the term of the concession. The increased revenues resulting from these

toll increases will be used by the private owner to service the debt and equity that financed the \$1.8 billion purchase price. In effect, the future tolls collected on the Skyway have been monetized to fund the operating budget of the City of Chicago.

Further, the toll proposition is based on the users' willingness to pay a toll in return for receiving a service. In this case, users will see ever increasing tolls and ever increasing revenues being banked by the private investor, with, at best, only modest improvements in service. Interestingly, the City has required the private investor to file annual financial reports for Skyway—we can only conjecture about public's reaction in ten years when the sale proceeds have been spent but the earnings of the private investor continue to increase in step with higher tolls.

The other loser is the region. First, not one dollar of the sale proceeds realized by the Chicago was earmarked for investment in transportation projects, despite the fact that Chicago is one the country's most congested urban areas.

The City also has abdicated the control of a major transportation artery and along with it the ability to manage the regional transportation network in a coordinated fashion. To see how this might adversely impact the public interest, it is important to recognize that the private investor's sole motive is profit maximization. That is not a bad thing, but it does color how the toll road will be managed. Let me cite two illustrations of this point: Under the concession agreement, the private owner has the ability to use time of day pricing to discourage trucks from using the Skyway during day time hours. One possible consequence of this is to force trucks onto neighboring roads, generating externalities—traffic, congestion and pollution—for which the private owner is not accountable and does not have to concern itself.

Second, the alternative routes for drivers who do not want to use the Skyway are non-tolled limited access roads that are operating currently at or near capacity, thus allowing Skyway to operate, in effect, as a monopoly. Even if it was believed that lower tolls on the Skyway would lessen congestion on the alternative routes, the private investor, again, is motivated only by maximizing revenues on its road.

And what happens if the decision is made in the next several years to toll these alternative free roads in order to manage congestion? To do this effectively requires a coherent and coordinated regional toll policy. With Skyway out of the public's control, this is no longer possible. Further the imposition of tolls on these free roads will likely increase the revenues to be realized by the private owner with no subsidiary benefit to the region.

I have not tried to mask my opinion that the Chicago Skyway sale scores poorly in terms of the public interest. This low score is not because the Skyway is now in private hands, but because of the particular motivation for the sale and the intrinsic nature of the Skyway. In contrast with the Skyway, the Indiana Tollroad situation has significantly different characteristics that, in my view, change the balance. First, all of the sale proceeds will be reinvested by the State to improve its transportation infrastructure. True, these new roads will be paid for, in effect, by the people who use the Indiana Tollroad,

but these users as well as the taxpayers of Indiana should benefit from an enhanced statewide transportation system.

Second, given where the Tollroad is situated and its relationship with other roads, it is my opinion that there is not much opportunity for the private owner's actions to impose costs on the surrounding communities. Eighty percent of the trucks that currently use the Indiana Tollroad are traveling inter-state and are not likely to use local roads to avoid tolls. Also, unlike the Skyway, the Indiana Tollroad is not part of a network of roads that would benefit from being managed in a coordinated fashion. For all of these reasons, the Indiana Tollroad concession tilts in favor of the public interest.

The last point I want to make is that it is important for all of us to understand why investors are willing to pay large sums for these concessions. The reason is simply that these investors have been granted a franchise to increase tolls—an action that state and local governments are reluctant to take. The last toll increase on the Skyway was in 1993 and on the Indiana Tollroad in 1986. In both cases, the new owners, pursuant to agreements with the City and the State, will increase tolls immediately upon signing the concession agreements and every year thereafter for the term of the concessions. These increases are not be subject to voter approval, and are the consequence of what has been tagged, the outsourcing of political will.

I am not arguing against the involvement of the private sector in the provision of public services such as transportation. The sale of existing roads should meet, however, three tests:

- First, a significant portion of the proceeds of the sale should be reinvested in improving and enlarging the particular region's transportation infrastructure;
- Second, the private owner should be held accountable for the externalities—the non-cash costs—of operating the road; and finally
- If the road is part of a regional network, the toll regulation needs to accommodate regional solutions.

Applying these tests may reduce the amount of money that can be raised by state and local governments through these sales, but maximizing the dollars should not be the sole objective. Improving the mobility of our citizens should be the overriding goal.

Source:

(a) *New York Times*, "Turning Asphalt to Gold", January 20, 2006.



Oregon
Theodore R. Kulongoski, Governor

**Oregon Department of
Transportation**
Matthew Garrett, Director

**Matthew L. Garrett
Director
Oregon Department of Transportation**

**Testimony
Before the Subcommittee on Highways, Transit, and Pipelines
Of the Transportation and Infrastructure Committee
United States House of Representatives**

**Hearing on Public Private Partnerships
May 24, 2006**

Chairman Petri, Congressman DeFazio, and members of the Subcommittee, my name is Matthew Garrett, and I serve as the Director of the Oregon Department of Transportation (ODOT). I want to thank you for the opportunity to testify before you about Oregon's innovative approach to funding transportation projects through public-private partnerships.

The Context: Large Needs and Inadequate Revenue

Oregon has turned to public-private partnerships out of necessity. In Oregon, as in so many other states around the nation, there is a massive gap between the needs of the transportation system and our ability to meet these needs with our existing resources.

Oregon is growing rapidly, with a population that has swelled by nearly 40% in the last two decades. As more and more people have moved into places like the Portland metropolitan area, formerly free-flowing highways have become clogged with significant congestion. As the suburbs have continued their continuous outward march, turning quiet towns into cities, new routes and additional capacity on existing highways are needed to bring people from where they live to where they work and to move goods quickly and efficiently. The Portland metropolitan area will add another million people in the next 25 years, and the movement of freight by truck in Oregon is expected to double over the same period. Both of these factors will further increase congestion and impose significant additional costs on businesses that face difficulty getting goods to their destination in a timely manner.

Unfortunately, current revenues are not even close to sufficient to meet these needs. Oregon needs \$1.3 billion in additional revenue each year in order to properly maintain and expand the state's transportation system. Oregon's gas tax has remained flat since 1993—the same year the federal gas tax was raised—and over time inflation has taken a significant bite out of both of these revenue sources. The significant additional funding provided to Oregon and other states under SAFETEA-LU because of your leadership is greatly appreciated and will help us make improvements to our transportation system, but it isn't enough to sustain the investments we need over the long-term.

Over the last several years the Oregon Legislature has provided ODOT several funding packages by raising fees on drivers and vehicle owners and bonding these revenue streams for years to come. However, even these significant investments—most of which were focused on preserving or rebuilding aging infrastructure rather than adding capacity—have left many needs unmet. What's more, Oregon has used bonding extensively to pay for transportation improvements, and while further bonding would address current needs, it would leave a large hole in future years that would sacrifice our long-term ability to improve our transportation system.

Looking into the future, as vehicles become more fuel efficient, gas tax revenue will increase less rapidly than vehicle miles traveled, reducing the ability of the gas tax to sustain adequate financing of transportation. And rapidly rising construction costs and the effects of inflation over time mean that even modest increases in transportation funding will buy less.

Oregon Innovative Partnerships Program

This large gap between transportation system improvement needs and our ability to pay for them has led Oregon to look at innovative financing sources as a way to fund highway construction.

As they say, necessity is the mother of invention, and in our state of need we are being quite inventive. Oregon was the first state to enact a gas tax, and with our Road User Fee Pilot Program getting underway this year we are the first to take a serious look at moving toward a per-mile tax, which would help keep revenues from falling off as cars become more fuel efficient.

We are also in the early stages of exploring the possibility of financing transportation improvements through public-private partnerships and tolling. In 2003 our Legislature enacted the Oregon Innovative Partnerships Program to allow new, cutting edge approaches to funding and financing transportation projects. This law directs ODOT to focus on innovation, speed and partnerships with private sector firms and other units of government; another goal—leveraging private sources of capital—was also at the front of the Legislature’s agenda. In a separate piece of legislation, the 1999 Oregon Legislature directed ODOT to examine tolling as a way to help finance new capacity on highways.

Oregon’s Innovative Partnerships Program allows ODOT to enter into partnerships with private-sector businesses and government agencies to study, design, finance, construct, operate, and maintain critically needed transportation projects. The involvement of private sector partners in early planning stages allows for the identification of design, construction, and funding innovations that help the state deliver transportation projects quickly and more efficiently. Oregon’s efforts are unique in bringing the private sector into this process so early and so deeply.

Our Innovative Partnerships Program encourages our partners to consider flexible financing options for infrastructure projects, including private-sector funding, lease-back tolling operations, special improvement districts, and federal and state bonds. Although tolling is by no means a foregone conclusion, it is emerging as the most likely way to finance the large projects under consideration. In one scenario, ODOT might negotiate a contract with a private firm under which they will build and operate a highway under a long-term private concession that will allow them to collect tolls on the facility.

Oregon’s public-private partnership efforts are focused on using tolls or other financing mechanisms to expand highway capacity. Unlike some other states, we have not proposed leasing existing routes to generate revenue for other projects. However, our private sector partners are considering options for tolling existing routes in addition to tolling new capacity. This might be done because drivers may not use a toll road if a free alternative exists. This approach may help raise enough revenue to cover project costs, while tolling only a new route might leave a significant funding gap. We are sensitive to concerns about this idea, however, and are looking at ways to minimize the impact. This could involve tolling only through traffic and trips leaving the area, without charging purely local travel. Significant discounts could also be offered for local residents.

Turning to the private sector has numerous benefits. Working with the private sector can streamline the study, design, funding and construction of transportation projects and achieve cost and time savings by engaging the innovations, efficiencies and technologies unique to the private sector. During the project development phase the private sector is able to allocate human and financial resources as necessary to move a project forward and can quickly bring tremendous

resources to bear to solve problems; due to budget constraints the public sector is less flexible in its allocation of resources.

In addition, the private sector brings the ability to access a tremendous amount of private capital more effectively than the public sector can. Access to private equity capital is important to be able to make toll road projects work in Oregon. While both the public and private sectors can do debt financing by issuing bonds, only the private sector can secure equity financing by selling stock. Bonding for tolling projects, whether secured by a public entity or private sector firm, is likely to be subject to a significant discount due to uncertainty about tolling revenue. Such a financing discount may yield too little capital for the project to be built by bonding alone. By adding private equity capital to the financing, the private sector may be able to bridge the gap and yield enough financing for the project to be constructed.

However, even in turning to the private sector we are not giving up the government's role as guardian of the public interest. Under this program, ODOT will retain control over the ultimate direction of the project. ODOT will make all final decisions and will conform to strict environmental and land-use regulations and be sensitive to the needs of the communities the projects serve. What's more, the cost efficiencies of these projects won't come on the backs of laborers. Even though the private sector will be doing the bulk of work on these projects, prevailing wage and overtime requirements for construction workers will remain in place.

Projects Under Consideration

The Oregon Innovative Partnerships Program identified three significant transportation projects as possible public-private partnership projects: the Newberg-Dundee Bypass, the Sunrise Corridor and the I-205 South Corridor Improvements. The three projects were selected because they have the potential to significantly relieve traffic congestion in the communities where they would be built, and because there is currently no way to fund their construction, which would cost well over \$1 billion.

Newberg-Dundee Bypass

The 11-mile Newberg-Dundee Bypass is located on the south side of the towns of Newberg and Dundee. The Bypass will provide relief from rapidly increasing truck and commuter congestion on Highway 99 that plagues the hearts of these communities and negatively impacts freight mobility. Traffic on this route is expected to increase from approximately 35,000 vehicle trips a day to as many as 56,000 over the next 20 years as these communities that lie just outside the Portland metropolitan area see significant growth.

Sunrise Corridor

The Sunrise Corridor is a proposed new highway corridor that would serve an area that was recently absorbed into the Portland metro area and provide a direct connection between I-205 and US Highway 26, two important routes. Two separate sections of the proposed corridor have been discussed over the years and are currently in different phases of planning. A new six-lane, limited access highway stretching five miles along the OR 212/224 Corridor east of I-205 would address the traffic congestion and safety problems in the Corridor. The Corridor currently carries more than 60,000 vehicles per day, and trucks generate more than 12% of this traffic. The Sunrise Project is currently the subject of a Supplemental Draft Environmental Impact Statement

(SDEIS) that will be completed in late 2007. Development of a new four-lane, limited-access parkway stretching eight miles further east along the Highway 212 Corridor would extend the Sunrise Project to serve the newly incorporated City of Damascus and surrounding areas and provide an improved connection between I-205 and Highway 26. This area was recently brought into the metro region's Urban Growth Boundary and is expected to absorb several hundred thousand new residents of the Portland area in the next few decades.

I-205 South Corridor

The I-205 Corridor is a 25.5-mile-long, north-south freight and commuter route in the Portland metropolitan region. Development over the past decade, particularly in the south metropolitan area, has increased traffic volumes significantly. The transition from six lanes to four lanes at the Willamette River crossing in the south portion of the Corridor contributes to significant traffic congestion. A study is underway to identify needs and potential innovative solutions in the I-205 Corridor, including additional lanes in each direction and improved interchanges.

ODOT issued a Request for Proposals (RFP) for these three projects last spring. The RFP sought private sector interest in a two-phase contracting process. The first contract is for "pre-development" services to bring the project to the point it can secure private sector financing. By satisfactorily completing and delivering the work tasks under the contract so that the projects are demonstrated to be technically and financially feasible and acceptable to the public, the private partner would earn the exclusive right to enter into negotiations with ODOT on the "implementation contract" to actually build and perhaps operate and maintain the new facilities.

ODOT received proposals from two firms on Newberg-Dundee and one each on South I-205 and Sunrise. ODOT began an extensive evaluation process that involved internal and external experts and consultation with local government representatives. The proposals were evaluated on the qualifications and experience of the proposers; their approach and understanding of the project; their plans for gaining public support for the project; and the proposed compensation arrangements.

Oregon Transportation Improvement Group

The ODOT evaluation team unanimously invited the Oregon Transportation Improvement Group (OTIG) to interview, as the top ranked proposer on all three projects. OTIG is a consortium of companies with extensive experience and long histories of success in the financing, design, engineering and operation of state-of-the-art transportation facilities. OTIG is led by Macquarie Infrastructure Group (MIG), based in Sydney, Australia. Macquarie is one of the largest public infrastructure companies in the world and is traded on the New York Stock Exchange. Macquarie's technical advisor is Hatch Mott MacDonald, an engineering consulting firm with 33 offices across North America and staff resources of 12,000 worldwide.

The group was chosen because of its significant U.S. and international experience financing, developing and operating high-quality transportation facilities; its ability to fund the projects up front; its willingness to assume the financial risk for the timely construction and successful operation of the three projects; and for a proposed 30% reduction in costs if awarded all three projects.

ODOT is currently working with OTIG in a pre-development phase to evaluate the financial and technical feasibility of various options for building the projects through a public-private partnership. Activities undertaken during this phase will allow OTIG to make informed decisions regarding whether to go forward into the implementation phase. During the next year, OTIG will work side by side with ODOT and local communities as they investigate the feasibility of the projects. Coordination with local agencies will also address the need to study the projects in the local and regional contexts. No decisions have yet been made about when, or even whether, they might be built.

OTIG has agreed to bear the cost of conducting the pre-development studies, but ODOT will be required to reimburse these costs if ODOT or OTIG decide not to proceed with a project; none of OTIG's pre-development costs will be reimbursed if the projects move successfully into implementation. The total pre-development costs for the three individual projects are estimated at over \$26.5 million, but ODOT's potential reimbursement is capped at \$20 million. The recently approved contract includes several escape clauses that either party can use if predevelopment work shows the projects to be financially or technically infeasible.

If the pre-development work demonstrates that the projects are technically and financially viable, OTIG will have exclusive rights to enter into negotiations with ODOT to implement the projects. OTIG has proposed to finance, construct and operate these new facilities as toll facilities for a period of years that has yet to be negotiated. For a number of the early years, these projects are projected to operate at a loss. OTIG would operate the new facilities in exchange for the right to receive a return on its investment in the later years of its lease term.

An implementation contract would offer OTIG a long-term concession of a negotiated length, during which time OTIG could collect the tolling revenue. This contract would specify exactly how the private sector would build, operate, and maintain the facility. For example, the contract could specify certain arrangements to ensure safety and security; could set appropriate toll levels; and would set standards for operation and maintenance of the facility to ensure that OTIG would operate a quality highway and turn it back to the state in a good condition.

Although OTIG will have the first shot at securing the implementation agreement, ODOT will have leverage in these negotiations because the state is not absolutely locked into contracting with OTIG to build these highways. ODOT is required to conduct good faith negotiations, but if we are not able to secure an acceptable agreement, we have the right to walk away and sign a contract with a different firm after a one-year waiting period has passed.

If the projects move forward, OTIG has agreed to conduct a competition for design and construction, ensuring that Oregon will receive the highest value on its investment. OTIG will function as a developer of any projects that are built, but it is not a construction company. OTIG would request proposals for design and construction of any projects that might be built under the program, thereby opening up millions of dollars in projects for construction companies along with hundreds of well-paying construction jobs.

Newberg-Dundee Bypass Feasibility Review

The Newberg-Dundee Bypass is the farthest along in this process, making the project the test case for whether a public-private partnership can move forward and succeed. ODOT has already selected a corridor for this project and received a record of decision on a location Environmental Impact Statement (EIS) from the Federal Highway Administration; the two other projects under consideration have not reached this point in the environmental review process.

OTIG recently released a Summary Feasibility Review for the Newberg-Dundee project that indicates that highway tolling would be the most financially viable source of funding the Bypass. There are a number of tolling options available and a number of traffic and revenue variables that require further study before any firm conclusions can be reached. A more detailed study of these variables will be conducted over the next three to four months.

OTIG will be exploring two general tolling options: tolling only the Bypass and access tolling. Access tolling would toll all traffic passing a point on the corridor regardless of the route it takes. OTIG's preliminary analysis indicates that tolling only the Bypass may not generate enough revenue to pay for the project, leaving a large funding gap that the public would have to bridge using unidentified resources. Moreover, leaving the existing route untolled would encourage people to use the existing route to escape the toll, reducing the congestion relief provided by constructing the Bypass.

Under access tolling, cars taking either route would be tolled as they pass a point on the existing highway on the north end of the corridor prior to the Bypass. This option would toll all through traffic using either route as well as local residents leaving or entering the region on the corridor. However, the option OTIG is exploring will likely leave purely local traffic that stays within the region free—even if it uses the Bypass—and it would likely provide a discount for local residents who take the corridor to and from Portland. OTIG's early analysis indicates that this option might provide adequate funding for building the Bypass without requiring significant investment of additional public resources. Allowing cars to use either route for the same fee would also maximize congestion relief.

It is important to note that this is an early assessment of the project's feasibility and is not a formal proposal. OTIG will continue its research over the next several months and will likely release its final review by the end of this summer. At that point we will know under what conditions, if any, a public-private partnership will be feasible for this project.

Conclusion

While this pre-development phase is designed to determine the technical and financial feasibility of these projects, one of the most important outcomes of the process will be determining public support for tolling, which is not common in Oregon. ODOT and OTIG cannot and will not move forward with projects that do not have public support. If the public indicates that it will not support the construction of a toll highway, we will not proceed with a public-private partnership. Unfortunately, given the challenges of financing these projects, that decision could mean that the projects will be faced with many years of uncertainty as to when financing might be made available.

Although we are still in the relatively early stages of exploring the use of public-private partnerships on these three projects, we are moving ahead quickly to determine whether this new approach could be put to use. With funding levels inadequate to pay for the major expansion of our transportation system that is needed to meet current and future challenges, we must look to new and innovative ways of doing business that hold promise for delivering important projects. We do not expect that public private partnerships will become the only or even the primary means of paying for projects that increase highway capacity, but if our experiment proves successful they could add another tool to our highway funding toolbox and help us deliver important projects that otherwise might not materialize.

Macquarie



TESTIMONY OF:

D.J. GRIBBIN
DIVISION DIRECTOR
MACQUARIE HOLDINGS (USA) INC.

BEFORE THE

HOUSE TRANSPORTATION AND INFRASTRUCTURE
COMMITTEE SUBCOMMITTEE ON HIGHWAYS, TRANSIT, AND
PIPELINES

"UNDERSTANDING CONTEMPORARY PUBLIC-PRIVATE
HIGHWAY TRANSACTIONS: THE FUTURE OF
INFRASTRUCTURE FINANCE"

MAY 24, 2006

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1. INTRODUCTION

Good morning, Mr. Chairman and members of the Committee. My name is D.J. Gribbin, and I am a Division Director for Macquarie Holdings (USA), Inc. Thank you for giving me the opportunity to join this panel discussion exploring the future of infrastructure finance.

For those who may not be familiar with Macquarie, we are a diversified global financial services organization. In particular, Macquarie is recognized as a leader in the ownership, management and development of important infrastructure assets around the world, including a growing number in the United States. Macquarie has operations in 24 countries, including a significant presence in North America. Over 500 of its 8,200 worldwide employees and approximately one quarter of Macquarie's 800 infrastructure professionals are located in North America. Macquarie has 16 offices in the United States.

Macquarie recognized as early as 1990 the potential of infrastructure as an emerging asset class that offers attractive long-term investment characteristics and benefits from a long-term active management philosophy. Macquarie is a committed, long-term investor in infrastructure. Our aim is to manage responsibly and profitably the assets in which we have investments. We take a partnership approach, adding value through specialist strategic, commercial, operational and financial expertise with proven ability to enhance the performance of assets over the long term.

The Infrastructure and Specialized Funds (ISF) division of Macquarie manages a US\$24 billion global investment portfolio, which includes investments in over 90 assets in more than 20 countries. Major infrastructure sectors that Macquarie specializes in include toll roads, airports and airport-related assets, telecommunications, water, rail, port, energy generation, transmission and distribution assets as well as water & wastewater and, social infrastructure.

In my time here today, I will briefly outline some of what Macquarie has done here in the U.S. and how the private sector can play a role, and potentially a significant role, in helping overcome the lack of funding for highway infrastructure. As this Committee has explored in great detail, the financing gap for highway infrastructure is staggering. The Federal Highway Administration's Conditions and Performance Report estimates that this nation will need to invest an additional \$118.9 billion to meet the needs for surface transportation.

Before I begin, however, let me thank this committee for the work it has done to encourage increased private sector involvement. The tools you provided under TEA-21 and SAFETEA-LU are helpful. Provisions expanding tolling opportunities, allowing private activity bonds, streamlining the environmental process, and reforming the design-build rules will facilitate private participation in funding transportation infrastructure. And as a result, the creative energy and finances of the private sector will have an opportunity to more fully influence this market.

2. CONCESSION AGREEMENTS – FINANCIAL BENEFITS

In a 2004 speech before the American Road and Transportation Builders Association, the former Chairman of this Committee and my former boss, Transportation Secretary Norman Y. Mineta noted, "the smart course for transportation's future requires a turn in the direction of public-private partnerships. . . Within the world of public-

private partnerships, ventures can be structured to provide better incentives for innovation, cost reduction, faster project delivery, and improved management of new – and existing – facilities.” Secretary Mineta was prescient. Less than two months after this speech, Indiana Governor Mitch Daniels announced Indiana was seeking financial investors interested in leasing the Indiana Toll Road. When completed, this one transaction will close Indiana’s transportation funding gap and allow for construction of the State’s 10-year transportation plan. As Governor Daniels noted earlier, few projects in this plan would be constructed had Indiana continued to rely on traditional funding mechanisms.

Allow me to use my time here today to focus on the public policy implications of this transaction and concession transactions in general. Macquarie has been involved in transportation concession transactions in eight countries around the world, including four agreements here in the United States.

Long-term leases of highway infrastructure have raised a number of questions. Notwithstanding the fact that this new model of highway financing liberates billions of dollars of investment, it has come under some criticism, which I will address later in this testimony.

Hernando de Soto, in his book *The Mystery of Capital*, explained how dead capital has contributed significantly to poverty in the developing world. Dead capital is comprised of investments made within a legal structure that prohibits those investments from being used as capital. For example, poor workers who build a home on land without clear title have created dead capital. They cannot borrow against their investment, and it is very difficult for them to sell their investment. The home has value, but that value is captive. Inadequate legal structures in developing countries have locked up \$9.3 trillion in investments of this type, investments that could be used to develop businesses, create jobs, and lift people out of poverty. Instead, the legal structure surrounding these investments prevents them from being utilized as capital. Highway infrastructure here in the United States is analogous. Inadequate markets and legal systems in this country have locked up billions of taxpayer dollars in our transportation infrastructure, billions of dollars that could be used to create jobs and fuel economic growth. Fortunately, two recent transactions, the long-term leases of the Chicago Skyway and the Indiana Toll Road, have demonstrated that the captive capital invested in these assets can be freed.

The most notable aspect of the Indiana Toll Road concession is that this relatively simple transaction freed \$2 billion in captive capital. As Governor Daniels noted, the State did a study of what the highway would have been worth had the State raised tolls and operated it according to the provisions of the concession agreement. The study found that it would be worth approximately \$1.8 billion. Yet, Statewide Mobility Partners, a Macquarie-Cintra partnership, has signed a concession agreement offering \$3.8 billion. So how did this transaction liberate \$2 billion in captive capital, \$2 billion that can now be spent for the benefit of Indiana citizens?

Simply put, the liberated \$2 billion resulted from placing the Indiana Toll Road in a market environment. The Indiana Legislature created a legal construct under which the State of Indiana was able to transfer legal property rights to whatever entity in the world placed the highest value on the Indiana Toll Road, in this case a partnership of Macquarie and Cintra, Statewide Mobility Partners. This new legal construct liberated the captive capital allowing Statewide Mobility Partners to pay more than twice the value the State placed on the asset. The partnership was able to find additional value in this asset for two reasons:

1. A debt-equity financing model allowed the Partnership to pay more for the asset than a traditional bond financing approach; and
2. A private sector owner will be able to achieve more efficient operations through innovations and timely investment in operations and maintenance.

The debt-equity model used to finance the long-term lease of the Indiana Toll Road was quite innovative. Given the limited time I have, let me just briefly touch on why this approach to financing the Toll Road was able to liberate so much captive capital.

The traditional bond financing approach has layers of conservatism built into valuing the asset, and that conservatism tends to under-value the asset. In addition, bond covenants require a debt coverage ratio, i.e. that the revenues of the asset exceed debt payments by a defined percentage. This debt coverage ratio provides a cushion for investors, but it prevents that cushion from being used to help finance the asset. By contrast, a debt-equity model is able to use the equity investment as the cushion or assurance that those holding the debt will be repaid. As a result, the debt-equity financiers are able to free up more capital than those using traditional bond financing, producing a greater payment to the owner of the asset.

Policy makers have asked whether an up-front payment is in the public interest. Some states have pursued a revenue sharing agreement instead of a lump sum payment up front. Which is a better deal? Like many public policy questions the answer is – it depends. In the case of highway concessions, the answer hinges on the financial needs of the state. In the case of Indiana, the Governor declared that proceeds from the Turnpike sale will be used for additional highway construction. When one considers the cost of construction cost inflation (from 8 to 19% last year depending on material) and the safety and economic benefits of having a facility built earlier, it was more cost effective to have a lump sum payment. For states in need of a steady revenue stream over years, a revenue sharing agreement may better meet their needs. Whatever the financial needs of the state, the concession model allows governments to unlock value trapped in assets.

3. CONCESSION AGREEMENTS – OTHER BENEFITS

In addition to liberating the capital locked in infrastructure assets, concession agreements provide a number of other benefits, including:

- Revenue risk transfer. Whenever government funds the construction of highway infrastructure through public debt, taxpayers are exposed to the risk that toll revenues may not be sufficient to cover the bonds issued. This is particularly true of new, greenfield projects. Funding via private investment shifts this revenue risk to the concessionaire.
- Operations and maintenance cost risk transfer. Operation costs and the liability for future maintenance are the responsibility of the concessionaire. For example, the concession agreement for the Chicago Skyway requires the Skyway Concession Company LLC, (SCC) to make improvements to the roadway and pay all operating costs. A similar provision was included in the Indiana Toll Road Concession agreement.

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- Accelerated project delivery. Concession agreements can help accelerate project delivery in three ways: (1) concessionaires have incentives to complete projects on time or ahead of schedule, accelerating design and construction timetables; (2) concession agreements on existing facilities or new facilities with a great deal of traffic can provide an infusion of cash to accelerate the construction of other transportation projects by providing the funding they lack; and (3) concession agreements can help projects short of funding bridge the financing gap, and with the concession model, non-viable projects can become financially viable.
 - Funding security for expansion and maintenance. Public authorities responsible for maintaining and improving facilities are subject to fluctuations in tax revenues and to uncertainty that comes with legislative appropriations. As a result, lack of funding or other priorities may prevent those responsible for maintaining the road from addressing the needs of the facility in a timely manner. Delayed routine maintenance can lead to more serious and costly maintenance problems, further exacerbating the funding shortage. Concessionaires, on the other hand, have the resources and incentives to provide maintenance when needed because that is when it is most cost-effective. Fundamentally, private operators provide a service to which there is a free alternative and are therefore incentivized to provide value for money in the form of a well-maintained facility.
 - Economic development. By advancing projects not otherwise feasible or by generating cash payments, concession agreements can significantly further economic development. The United States Department of Transportation estimates that \$1 billion in spending on road construction generates 47,500 new jobs. This Committee has estimated that \$1 invested in highways delivers \$4 in economic benefits and estimated that between 1980 and 1991, highway investments gave rise to almost one-fifth of the increase in productivity in the U.S. economy.
 - Fiscal Solvency. A cash infusion from an upfront payment presents an opportunity to maintain or restore fiscal solvency. For example, in the fiscal year ending December 31, 2002 the Chicago Skyway generated revenues of \$43.2 million and expenses of \$34.8 million, for a profit of \$8.4 million. According to Chicago's chief financial officer, the concession arrangement has increased the city's credit ratings, lowered its debts, and allowed the city to create three funds to meet various needs: a \$500 million long-term, interest-generating reserve; a \$375 million medium-term reserve to be drawn down over eight years in order to provide budgetary relief and reduce the need to raise taxes; and a \$100 million neighborhood, human, and business infrastructure fund supplementing 20 city programs. Remaining funds paid off Skyway and other debts.
 - Rational Pricing. Inflation forces all toll operators to increase tolls. Concessionaires, however, are free from the political pressures that government operators face. As a result, they can keep toll prices more stable. Prices under a concession agreement increase in a more gradual, less disruptive fashion than under government management where political pressure keeps tolls frozen until operational demands force sharp, sudden price increases.
 - Investment opportunities. Currently, there are limited opportunities for those interested in investing in our nation's infrastructure. Under a concession model, pension funds and others interested in investing in infrastructure will be allowed to do so. Hundreds of billions of dollars are moving around world markets

looking for long-term investments. For U.S. pension funds, especially those of labor unions, a concession agreement provides them with a great opportunity to invest in American infrastructure.

4. CONCESSION AGREEMENTS – POLICY CONCERNS

Notwithstanding the numerous benefits of a concession approach to financing and operating transportation infrastructure, a number of concerns have been raised about the ability of the private sector to meet public policy objectives under a concession model. These concerns include the following:

- Toll Increases. As mentioned above, all toll facilities have to increase tolls to cover the cost of inflation and the costs associated with expansion. The tolls in concession agreements are set by the public owner of the facility in the concession agreement, not the concessionaire. So whether a toll road is publicly owned or managed by a concessionaire, tolls are established by a public authority.
- Length of concession agreements. Concession agreements have spanned up to 99 years. The long-term nature of these agreements has caused some to express concern about the ability to adequately protect the public's interest over such a long term. The length of a concession agreement is driven by the need to mitigate revenue risk and the importance of giving the concessionaire enough property rights in the asset that the concessionaire views itself as a owner and not a renter. However, the length of the concession agreement will ultimately depend on the needs of the community in which the facility is located.
- Safety and security. Some have expressed concerns that a concessionaire will try to maximize revenue by skimping on maintenance and allowing unsafe road conditions to exist. Under a concession approach, these concerns are mitigated two ways. First, the concession agreement is a legally binding contract with clear performance standards and severe penalties for non-compliance. The Chicago Skyway agreement, for example, requires the concessionaire to: operate, maintain, repair, and toll the Skyway in material compliance with defined operating standards and all applicable laws; make defined capital improvements to the Skyway; and make periodic reports to the City on traffic, environmental issues, accidents, and finances. Violating the concession agreement can lead to forfeiture of the concession payment and the operating rights to the facility. Notwithstanding the concession agreement and its penalties, the concessionaire has a strong incentive to provide a safe facility for its customers. Drivers in this country always have a non-tolled alternative. Concessionaires understand that they have to keep their facility in a condition that will encourage drivers to pay for premium service. Privately operated toll roads are consistently seen as among the most safe roads for drivers to use, given their high standard of maintenance, design, and free-flowing nature.
- Operating characteristics. Concerns have been raised over how concessionaires will respond to a number of operating challenges, including issues as varied as landscaping, emergency vehicle operations, and free access for public transportation vehicles. Again, the concession agreement governs all these issues, and it is often in the private operator's interest to provide considerable amenities to maintain community support. For example, on the South Bay Expressway, Macquarie built trails, sports fields, camping grounds, and engineering berms, as well as doing extensive landscaping, all of which were of great interest to the community.

- Loss of toll revenue. The fact that future toll proceeds go to the concessionaire instead of a public toll entity has caused some to express concerns about how the facility will pay for future maintenance costs and the potential need for additional capacity. However, under the concession agreement, liabilities for operations and maintenance, in addition to future capacity needs, are the responsibility of the concessionaire. Thus, the loss of toll revenues does not inhibit the state's ability to maintain or expand the facility because those duties are the responsibility of the concessionaire.

As several of the points above indicate, the key to mitigating many of the concerns about a concession approach is the concession agreement itself. Reviews of the concession agreements for the Chicago Skyway and the Indiana Toll Road may be found at www.fhwa.dot.gov/ppp/agr_chic_skyway.htm and www.tollroadsnews.com/cgi-bin/a.cgi/0lh_8pf8EdqcEIJ61nsxlA. A copy of the Indiana Toll Road Concession Agreements and its amendments may be found at <http://www.in.gov/ifa/tollroad.html>.

5. PUBLIC-PRIVATE PARTNERSHIPS

Concessions, however, are just one form of public-private partnership (PPP). In addition to bringing much-needed capital to transportation infrastructure projects, PPP contracting methods have been shown to save substantial amounts of time and money. For example, a Battelle report found that performance-based contracting can result in savings of 6 to 40 percent and increase on-time delivery by up to 50 percent. The State of Florida has found that non-traditional methods were more timely and cost-efficient than traditional low-bid contracting. In 2004, the United States Department of Transportation sent a report to Congress detailing many of the benefits that have been realized under PPP procurement approaches. A copy of that report may be found at www.fhwa.dot.gov/reports/pppdec2004/index.htm.

6. PRE-DEVELOPMENT AGREEMENTS

While several states and quite a few countries have found significant value in the use of concessions and PPPs, many state DOTs do not have the staff resources to fully explore this new procurement approach. For this reason, the Oregon Department of Transportation (ODOT) has teamed up with Macquarie under a procurement agreement similar to that used by Texas on their Trans-Texas program.

Under the Oregon Innovative Partnerships Program agreement, the Oregon Transportation Improvement Group (OTIG), led by Macquarie Infrastructure Group, is partnered with ODOT to determine the feasibility of developing three PPP projects in Oregon. The predevelopment agreements (PDAs) between the ODOT and OTIG allow either party to halt the development process if the projects are not financially, technically or politically feasible. Should this occur, the financial arrangements between the parties are clearly defined, and Macquarie will receive a discounted fee for its investment. If the project moves forward, all costs will carry forward and be rolled into the final project financing.

Under this procurement approach, ODOT will only be required to reimburse OTIG for costs incurred if projects do not reach implementation—no funds will be paid from ODOT to OTIG if the projects move successfully into

implementation. The pre-development costs for the three projects are estimated at over \$26.5 million. If the projects do not proceed, ODOT's contribution to costs is capped at \$20 million.

The total estimated cost to develop, design, and construct these three projects is more than \$1 billion. Procurement costs will be controlled through competitive bidding. Both design and construction work will be selected through a competitive bidding process to ensure taxpayers get the best price for this project. Over the last seven years, ODOT has secured less than \$100 million for two of the projects, and sufficient public funding is not expected to be available for a considerable period into the future. If this experimental process is successful and the projects reach implementation, OTIG will provide the funding necessary to develop the projects.

The PDA structure encourages a strong commercial focus on developing successful projects. The early involvement of the private sector limits the risk of pursuing technically feasible but commercially unviable project alternatives. In addition, this process allows ODOT to harness the creative energy of the private sector to seek out innovative ways to construct a project, or series of projects, that stand virtually no chance of being built under the traditional procurement model.

7. THE ADMINISTRATION, CONGRESS AND THE FUTURE OF PPP'S

Secretary Mineta deserves to be commended for his willingness to aggressively challenge traditional approaches to congestion relief. His 6-point National Strategy to Reduce Congestion on America's Transportation Network is well reasoned and founded on a premise that bears repeating – "Congestion is not a fact of life." In too many communities across America, policy leaders have given up trying to reduce congestion and are just focusing on trying to manage it. In his plan, the Secretary declares his intention to educate policy leaders around the nation on the options available to them to reduce congestion. Hearings, similar to the one this Committee is holding today, are an excellent first step in that education process.

Even with the Administration's National Strategy to Reduce Congestion on America's Transportation Network and the successful passage of SAFETEA-LU, there is a considerable amount of assistance this Committee and the Administration can lend states interested in pursuing PPPs. Listed below are a few ideas we would suggest to encourage those states interested in pursuing alternative procurement methods, methods which can provide drivers in their states with higher quality transportation infrastructure, quicker delivery times, and lower costs.

- Encourage the continued use of the SEP-15 program. Governments are excellent at reaching a public consensus, but they can be slow to change and innovate. Innovations involving procurement of transportation infrastructure can be particularly challenging because local, state, and federal rules can all come into play. SEP-15 is a program created by the FHWA to address this reality. SEP-15 allows states to be creative in their procurement processes and move forward with procurements that may not fall within the FHWA's traditional guidelines. Yet, SEP-15 allows the FHWA to protect the federal interest in projects by requiring increased federal oversight of the project and by allowing flexibility only on a case-by-case basis. Some of the experiments being performed under SEP-15 could result in new rules shaving years and millions of dollars off the development of highway projects.

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- Streamline TIFIA Program reviews and awards. TIFIA can play a crucial role in project financing for projects seeking non-traditional financing options. Yet the length and complexity of the TIFIA process has dampened its use. Providing TIFIA with more flexibility to support innovative projects would be helpful.
 - Streamline environmental permitting. As this committee is aware, the environmental permitting process takes far longer than is necessary to protect the environment and build community consensus around a project. This committee provided strong leadership in this area during the debate and drafting of SAFETEA-LU. Continuing efforts along these lines will help communities provide much needed transportation infrastructure in a more timely manner.
 - Consider the federal interest in a project. Traditional highway procurement has a federal funding component of 80 to 100 percent. As such, it makes a great deal of policy sense for federal procurement rules to apply to protect the federal interest. With a slackening of federal revenue and increased funding from state, local and private sources, this Committee should consider whether one dollar of federal revenue should still federalize a project or whether a de minimis federal contribution would be allowed without all federal rules attaching.
 - Encourage states to experiment with private sector investment. One of the larger barriers to increased private sector financing is the lack of authority under state law to allow such participation. Congress could help breach this barrier by providing greater incentives for states to be less reliant on federal funding by using private capital. For example, the administration has previously proposed requiring that for any federal-aid project estimated to cost \$50 million or more, the state would have to study the feasibility of a toll road and the financial advisability of privatizing its construction, maintenance, and operation. This is similar to an approach taken by Texas and would provide much-needed impetus to States that currently do not authorize private participation in highway construction or operations.

8. CONCLUSION

Mr. Chairman and Members of the Committee, thank you again for holding this hearing today and affording me the opportunity to speak on this important topic. Concession agreements have the potential of unlocking capital trapped in assets and making non-viable projects viable. Utilizing improved financing and asset management techniques, the private sector can help bridge the highway infrastructure gap. As Secretary Mineta has stated, "...we don't have to put our lives on hold any longer. We have the tools, the technology, and the plan to make today's congestion a thing of the past." We need only make modest changes to our legal structure to unlock tens of billions of dollars in captive capital.

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Testimony by

Bryan Grote
Principal, Mercator Advisors LLC

To

Highways, Transit and Pipelines Subcommittee
Committee on Transportation and Infrastructure
U. S. House of Representatives

On

**“Understanding Contemporary Public-Private Highway Transactions:
The Future of Infrastructure Finance?”**

May 24, 2006

Mr. Chairman and Members of the Committee, thank you for inviting me to testify today on a topic of great interest to the transportation community. As you are aware, policy makers and project sponsors in many parts of the country are seeking to better understand “public-private partnerships” (PPPs) – especially their potential to supplement existing sources of investment capital. Recent and proposed long-term concession financings of toll facilities have generated particular interest.

My name is Bryan Grote, and I am a Principal of Mercator Advisors LLC. My company helps sponsors of major projects develop financial plans and assemble investment capital. We also work with government agencies to design, implement and evaluate financial assistance programs. Over the past 15 years, as both public policy analyst and project financial advisor, I have observed the evolution of innovative financing techniques and public-private partnerships. In response to growing investment needs and constrained public funds, state and local project sponsors have increasingly experimented with alternative approaches. In my testimony today, I will briefly summarize the nature and extent of public-private highway transactions. And I hope to put PPPs in a useful context for examining their potential to generate capital and help address the nation’s funding gap for highway and other transportation investment.

Facing the Growing Challenge of Infrastructure Investment

It has often been said that transportation infrastructure is to the economy what the circulatory system is to the body. And that supporting economic growth and promoting social welfare require both adequately maintaining the existing system and strategically investing in new capacity. Yet most analyses indicate that our nation faces a substantial gap in meeting its highway and transit system needs. This “investment gap” at the national level has been estimated at somewhere between \$500 billion (to merely maintain the system at current conditions and performance) and \$1.1 trillion (to make cost-beneficial improvements that expand economic growth) over the next 10 years.¹

Complicating the investment challenge is the urgent need to address numerous “mega projects” in many parts of the country. These major corridors and urban connectors may cost hundreds of millions – or even billions – of dollars each and cannot be readily accommodated within existing capital programs.

This Subcommittee has been at the forefront of efforts to bolster Federal assistance. In addition to increasing Federal funds by a third over the previous authorization period, SAFETEA-LU authorizes or extends several so-called “innovative financing” provisions to help advance transportation investment. Examples include:

- More flexibility to charge tolls on Interstate and other Federally assisted highways, through the Express Lanes Demonstration Program, the Interstate System Construction Toll Pilot Program, and the Value Pricing Pilot Program;

¹ *Future Highway and Public Transportation Financing*, National Chamber Foundation, November 2005.

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- Potentially greater access to Federal loans and guarantees, under the Transportation Infrastructure Finance and Innovation Act (TIFIA) and Railroad Rehabilitation and Improvement Financing (RRIF) credit assistance programs; and
- Reduced debt financing cost for certain public-private highway projects and rail-truck transfer facilities, through the new \$15 billion private activity bond program.

But even with more Federal grant funds and innovative finance tools, the current program structures and funding sources are insufficient. It seems increasingly obvious that state and local governments must become more pro-active in addressing their infrastructure needs. Federal assistance – particularly outside the health and social security “mandatory” entitlements and defense and homeland security “discretionary” priorities – will continue to face mounting budget pressures. For various political and technical reasons, the existing broad-based excise taxes that currently support most public transportation assistance will continue to fall well short of infrastructure needs.

Assessing the Nature and Potential of Public-Private Partnerships

Certainly there is a strong tradition of public funding of public works in the United States. The unique ability of state and local governments to access tax-exempt financing through the U.S. capital markets, coupled with the 50-year grant reimbursement funding strategy afforded by the Federal Highway Trust Fund, firmly established the public orientation towards highway investment in this country.

But some states, regions and localities are recognizing that relying on “more of the same” in order to manage the existing infrastructure and make even minimal capacity enhancements for the future will not be a successful strategy. Public officials are beginning to turn to the private sector to share management responsibility and supplement governmental resources. Business concepts such as market pricing, customer orientation and operations outsourcing are being applied to the development and management of transportation assets. Many transportation agencies around the country are beginning to experiment with PPPs to develop, operate, maintain and, in some cases, even finance transportation infrastructure.

A significant challenge before policy makers and program managers at all levels of government is to move beyond the PPP rhetoric and examine both the nature and potential of transportation PPPs:

- What types of PPPs are being employed and why?
- How much “private investment” can be generated by PPPs?
- Why might a concession (long-term franchise) approach make sense for some projects?

My brief testimony today cannot exhaustively cover the many aspects of transportation PPPs. Rather, my objective is to give a broad overview of some fundamental issues and questions concerning PPP approaches to transportation investment. Hopefully, this will provide a useful analytical framework for considering the potential benefits, as well as limitations, of partnering with the private sector to help address the nation’s critical transportation investment needs.

Basic Types of Public-Private Partnerships

PPPs appear to be best-suited for large, complex projects with acknowledged need and strong governmental support. Private sector involvement can provide substantial benefits in terms of accelerating project development and construction, transferring construction and performance risk, providing more efficient operation and superior service, introducing new technologies, and even attracting net new investment capital.

The generic term “public-private partnership” encompasses a wide range of contractual arrangements by which public (federal, state, local or special) authorities and private entities collaborate in the development, operation, ownership and/or financing of a transportation infrastructure project or program. The precise form of these arrangements is a function of the legal, political and financial features of the relevant state or local project sponsor.

Different PPP arrangements can be thought of as extending along a spectrum, from governmental (traditional) sponsorship at one end to essentially private provision of transportation infrastructure at the other. **Exhibit I** displays these arrangements in five basic categories:

1. Traditional governmental delivery model (conventional design-bid-build with public funding);
2. Design-build approach with conventional public funding;
3. Design-build approach with innovative public financing and/or private operation;
4. User-backed project financing with governmental control; and
5. User-backed project financing with private sector control (private concession).

Although not every PPP arrangement and corresponding project will fit neatly into this simplified template, it is a useful way to analyze the service the PPP is providing. The ultimate source of revenue support for the project is a key factor in determining whether a PPP can directly induce new investment. User charges such as tolls and fares secure “project financing,” whereas general and dedicated taxes are associated with “public financing.” Under this definition, a bond issue sold to private investors but *payable from tax sources* would be considered “public financing,” whereas a bond issue sold to the same private investors but *payable from direct user charges* would be classified “project financing.”

This basic PPP template helps identify the specific “value-added” by the private sector participation: Is it absorbing construction risk, expediting completion, assuming operational responsibility, bringing management expertise to bear, or all of the above? Many PPP benefits derive from risk transfer, project acceleration, operating and maintenance efficiencies, and enhanced project management. These benefits are real and can be significant, but they do not necessarily generate additional investment capital needed to pay for the project.

Some PPP arrangements, however, can directly induce new investment capital. To the extent that a PPP project generates user fees, it can help attract new debt and equity capital by

monetizing the economic value of the project. For example, in Exhibit I, the “Governmental Tax-Exempt Project Financing” approach and the “Private Concession Project Financing” approach both involve user charges rather than governmental resources (tax support). In contrast, the “D-B with Public Funding” approach and the “D-B with Innovative Financing or Operation” approach both require a governmental payment stream that ultimately relies on public revenues like taxes – moneys that otherwise would be spent on other projects. So it is arguable whether these last two PPP models are truly bringing new resources to bear.

Private Investment through User Charges

Those PPP arrangements involving projects capable of generating their own revenues, whether through direct user charges (like tolls) and/or indirect beneficiary fees (“value capture” like development impact fees or special district assessments), are of particular interest to project sponsors and policy makers. Such PPPs have the potential to generate “private” (user-backed) revenues that represent net new resources for capital investment. Essentially, the private investment attributed to PPPs derives from their ability to produce *new* user fees or achieve greater leveraging of *existing* user fees. The state of Texas, for example, recently entered into an agreement with a consortium led by a Spanish toll road company to develop \$7 billion of new highway projects along one of the statewide “Trans Texas Corridors,” without public subsidy. The developers have committed to invest a total of \$1 billion of private equity in the project, and raise the balance through toll-backed bond issues.

Overview of U.S. Highway Investment

Despite the visibility of several large, high-profile, toll-backed project financings in recent years, highway capital investment in the U.S. is still dominated by traditional public funding. As shown in **Exhibit II**, about 94 percent of the nearly \$750 billion invested in highway capital improvements nationwide during 1993-2005 has come in the form of either public grant funding (\$575 billion) or tax-supported debt capital (\$119 billion). Only about six percent (\$49 billion) has been in the form of private investment – toll-funded grants, tax-exempt toll revenue bonds, or (in a handful of cases) taxable debt and equity capital through concession financings.

This picture very likely will begin to change more quickly in future years, as state and local governments struggle to cope with deteriorating conditions and worsening congestion. But even aggressive assumptions about the public’s future willingness to pay tolls and other user or beneficiary fees nudge up the private share of *nationwide* highway capital investment only gradually. The complex nature of many vital unfunded projects and the sheer magnitude of the investment shortfall preclude any “quick fix.”

Recent History of Major Highway PPP Projects

Another snapshot of highway investment in recent years reveals the growing importance of PPPs in generating private investment. While the ability of PPPs to significantly address funding shortfalls *on a nationwide scale* may be limited, their usefulness in advancing *particular projects* (such as major corridors and urban connectors) is considerable and growing. Nationwide, some

\$21 billion of investment in 43 major highway facilities has been accomplished using various public-private templates over the last dozen years. The states of California, Florida, Texas and Virginia are leaders in this field, having accounted for 50 percent of the total dollar volume (\$10.6 billion) through 18 major highway PPP projects. Nationwide, PPPs have accounted for over a quarter of the total user-backed private investment in U.S. highways (nearly \$13 billion of the total \$49 billion). **Exhibit III** summarizes PPP activity since 1993 for major highway projects (those costing in excess of \$25 million each).²

While much of the PPP focus is on the potential for private capital and new resources, it is important to keep in mind the other – perhaps less obvious – benefits. Many PPP arrangements do not access new user-backed revenue streams and therefore address the investment gap only indirectly, at best. There may still be compelling reasons to involve the private sector in developing, constructing, financing, operating and maintaining transportation projects. And for certain projects the accelerated benefits and reduced costs of such PPP investment may be significant. Over the long run the cumulative savings achieved through value engineering, accelerated schedules and other innovative PPP approaches may be significant even on a program-wide basis.

For example, it may be possible to reduce governmental operating costs through partnering with the private sector. Several states have outsourced maintenance responsibilities for portions of their Interstate systems. In terms of transit, overseas experience with “private finance initiatives” has shown that substantial cost savings and service improvements may be possible through private operations. Private sector participation does not make transit self-supporting, but it can reduce the required level of government subsidy. In essence, policy makers are finding that there can be value in separating the *public funding* of transportation services from the *public provision* of them.

Financing Highways through Long-Term Concessions

Of particular interest to industry observers are those projects that have been financed or leased through private concession-type PPPs:

- The Dulles Greenway (VA, 1993);
- The SR-91 Express Lanes (CA, 1993);
- The Camino Columbia Bypass (TX, 1999);
- The SR-125 South Toll Road (CA, 2003);
- The Chicago Skyway (IL, 2005); and
- The Indiana Toll Road (IN, 2006)

There is considerable speculation about the future role of highway and other transportation concessions in the U.S. In many countries without the relatively easy access to tax-supported

² Public Works Financing, U.S. Transportation Projects Scorecard (through 2005).

capital, long-term private concessions have been used successfully to develop and operate a significant share of the transport infrastructure. We are beginning to see versions of that financing approach emerge as a realistic alternative for large user-backed facilities in this country.

Rationale for the Concession Model

In simple terms, the rationale for using concession-type approaches lies with the revenue / risk profiles of the projects being financed. Large, start-up toll projects tend to face significant construction and revenue ramp-up risks. But in the long-run, these projects generally are able to generate net revenues (in excess of operating and maintenance requirements). The more flexible and patient capital provided through private concessions may better match these project financing profiles than conventional municipal debt capital.

Concession financing typically combines private equity investment and interim debt financing (in the form of bank loans and/or revenue bonds) to carry the project through construction and revenue ramp-up. During this initial period of uncertainty, the debt holders receive interest-only payments to minimize the financing burden on the cash flows. Once project performance has stabilized, permanent financing can be arranged more easily. This “regearing” not only takes out the interim loans but also provides a return to equity investors. Increasingly, financial intermediaries are assembling mutual funds as the preferred vehicle to raise investment capital. In this way, participating mutual fund investors pool their risk based on the performance of a portfolio of projects. This contrasts with the municipal bond model, where investors face individual project risk in terms of full and timely debt service payments throughout the project financing period.

It is true that private equity and taxable debt under a concession approach require higher nominal returns than does tax-exempt debt. Yet private sponsorship can bring advantages in the form of development expertise and greater flexibility in structuring the plan of finance to accommodate the project’s revenue profile. For example, as we have recently seen with the Chicago Skyway and the Indiana Toll Road, a capital structure involving private equity and taxable debt may be able to monetize a larger sum from a given revenue stream than a 100 percent municipal bond approach. Municipal bonds (unlike bank debt) generally require an investment grade rating and therefore are more volume-constrained by the debt service coverage levels the project must demonstrate.

Limitations of the Municipal Model

The traditional U.S. municipal bond model works well for financing established systems. But this may not be the most efficient method for financing large start-up, user-backed projects. Municipal bond investors typically require full and timely payments on long-term, fixed-rate obligations. In order to mitigate construction completion and revenue ramp-up risk and achieve minimal investment grade ratings (necessary for wide market access), the standard municipal bond model often must accommodate a back-loaded debt structure, extra large cash reserves and external credit enhancement. Furthermore, municipal bonds typically have fixed amortization

schedules, which lack flexibility in dealing with the revenue ramp-up risk exhibited by many project financings.

These various requirements tie up extra capital, require negative amortization of principal (compounding of outstanding debt), or otherwise result in additional expenses that can significantly dilute the cost savings of the tax exemption. Finally, with several large toll projects financed under this model having experienced difficulty because of lower-than-anticipated traffic levels, there may be greater resistance among municipal bond investors to purchasing long-term debt that subjects them to “equity-type” risks but pays them only “fixed-income-type” returns.

The bottom line result depends on the underlying project economics and the willingness of future users to pay for use of the facility. It may not always be the case that a public/tax-exempt financing approach is optimal for a particular project.

Conclusion: Considering a Strategic Role for PPPs

Given the current fiscal and political realities, it is clear that state and local project sponsors will have to rely increasingly on new approaches to highway and other transportation infrastructure investment. PPPs can play an important role in expediting projects, bringing innovation and, under certain circumstances, even attracting capital. Yet the fundamental resource issue remains. PPPs may facilitate the use of innovative procurement, management and finance techniques, but they are not revenue sources per se. Their ability to address the investment gap depends on generating new, often project-related, revenue streams – in other words, charging fees that direct users or other beneficiaries are willing to pay for enhanced service levels.

The great reliance on broad-based, general government resources for most highway investments will remain. But the extent to which PPPs can be used to generate targeted, supplemental resources will be increasingly important in advancing certain large, complicated projects that are a key part of the investment backlog.

Figuring out better ways to partner with the private sector may not solve all – or even most – funding problems. But it can be a meaningful step towards a more effective and rational long-term investment strategy at the project level. While debating how to address the larger government funding and policy issues surrounding highway investment, some policy makers and project sponsors are in fact beginning to take this step without waiting for more ominous signs of the transportation system’s circulatory failure.

Exhibit I: Simplified PPP Template

Project Activity	Traditional Governmental Delivery	D-B with Public Funding	D-B with Innovative Financing or Operation	Governmental Tax-Exempt Project Financing	Private Concession Project Financing
Delivery	Public	Private	Private	Private	Private
Operation	Public	Public	Public or Private	Public or Private	Private
Financing	Public	Public	Public	Public or Private	Private
Ownership	Public	Public	Public	Public	Private
Examples		Utah I-15; Conway Bypass (SC)	Route 3 (MA); US 550 (NM)	TCA Toll Roads (CA); Denver E-470	Dulles Greenway (VA); Chicago Skyway

Exhibit II: Private Highway Investment in Context

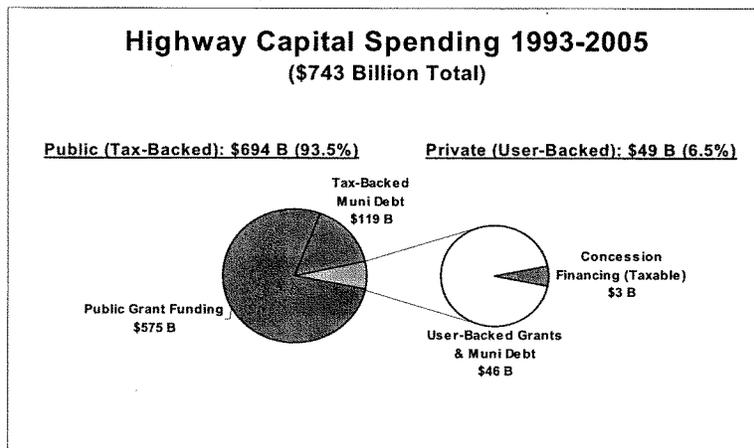
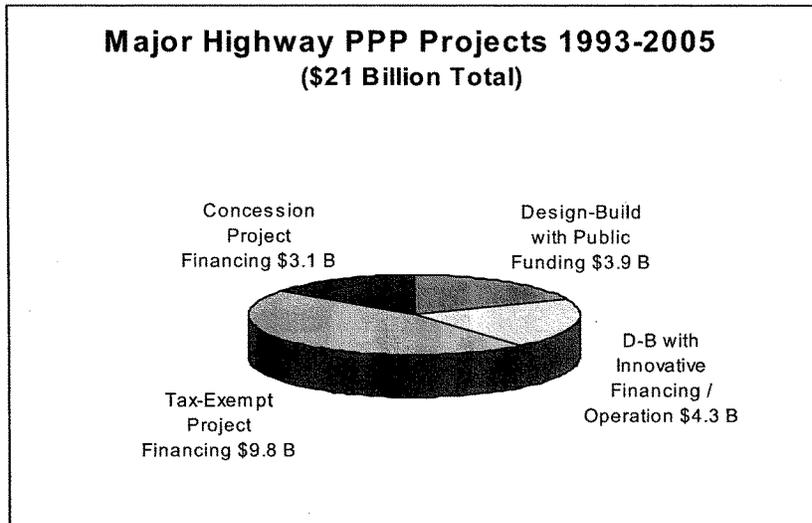


Exhibit III: Summary of Major Highway PPPs



Source: Public Works Financing

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**Statement of
Karen J. Hedlund
Partner, Nossaman, Guthner, Knox & Elliott, LLP**

**Before the
Subcommittee on Highways, Transit, and Pipelines
Committee on Transportation and Infrastructure
U.S. House of Representatives**

**Hearing on "Understanding Contemporary Public Private Highway Transactions: The
Future of Infrastructure Finance?"**

May 24, 2006

Good afternoon, Mr. Chairman, Ranking Member DeFazio and Members of the Committee. My name is Karen Hedlund and I am a partner of the law firm of Nossaman, Guthner, Knox & Elliott, LLP. It is my pleasure to speak to you today about how State Departments of Transportation (DOTs) and local transportation agencies are implementing their public-private partnership (PPP) programs. My firm has had the privilege of advising over a dozen States on PPP procurements, including Colorado, Delaware, Florida, Georgia, Indiana, Minnesota, North Carolina, Oregon, Texas, Utah, Virginia and Washington. This morning I will address how various States have crafted PPP legislation, how they go about procuring private investment in their transportation projects, some of the "lessons learned" from their endeavors and current trends. I will conclude with a note on the support and oversight provided to State and local agencies by the federal government.

Long-term tollway leases, such as the recent transaction for the Chicago Skyway and the Indiana Tollroad, have garnered most of the headlines. However, it should be recognized that most of the PPP activity in the States actually has revolved around the development of *new* transportation facilities. I will focus my remarks on these transactions.

Why are States Increasingly Embracing PPPs for Project Implementation?

The vast majority of transportation projects are still being funded from traditional sources, including State gas and vehicle taxes and federal highway trust fund appropriations. But today State and local transportation agencies are increasingly looking to supplement these sources with private investment. While PPPs are but one "tool in the tool box," their increased use is due to a number of factors: the growing gap between needs and traditional resources; the reluctance at both the State and federal levels to increase or index transportation taxes; the enactment of several important federal policy initiatives; and the completion of a number of landmark PPP

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transactions that have demonstrated the hearty appetite of the private capital markets for US transportation projects.

The modern use of public-private partnerships in the transportation arena originated over 15 years ago with California's enactment of AB 680 and adoption by the Commonwealth of Virginia of its Public-Private Transportation Act of 1995. Today over 21 States have adopted legislation authorizing the use of public-private agreements for the design, construction, financing and operation of transportation facilities. (See Exhibit A to this Statement).

The number of States with PPP legislation grows each year. Recent enactments include Indiana's new law authorizing a PPP approach to finance, build and operate the I-69 extension from Indianapolis to Evansville. Utah has adopted legislation authorizing public-private tollway development agreements. This month, the Alaska legislature passed a bill authorizing the use of a PPP to finance the long-sought Knik Arm Bridge near Anchorage. Last week, California's Legislature sent to the Governor a new statute permitting PPP development of 8 projects, including several directed to benefit goods movement.

In addition, PPP bills recently have been introduced or proposed in several other jurisdictions, including New York, Ohio, New Jersey and Missouri.

How do the States Procure Private Partners?

In 2005, the Nossaman firm was tasked by FHWA to survey State enabling laws relative to public private partnerships and analyze their key elements. A copy of this report can be found at <http://www.fhwa.dot.gov/ppp/legislation.htm>. Most of the authorizing statutes followed the model established by Virginia's 1995 PPTA law in providing guidance to the States' transportation agencies as to the procedures they should follow in procuring private partners and the criteria they should use in evaluating proposals and negotiating agreements.

Most States authorize the responsible public entity to solicit requests for PPP proposals for improvement of specific systems, corridors or routes. Many States may also accept unsolicited proposals, which enable the private sector to offer projects that the public entity might not otherwise have considered, provided that they satisfy the criteria outlined in the governing statutes and regulations, and are consistent with the State's overall transportation plans. Competition is incorporated in the unsolicited process by requirements for the public entity to invite competitive proposals within specified periods designed to permit adequate time for the preparation, submission and evaluation of competitive proposals.

Statutes generally afford the public entity considerable flexibility in the types of agreements they may enter into and the specific procurement process so that they may to more easily select the one that is most appropriate for a particular project. Contracts are awarded on the basis of "best value" taking into account both short and long-term benefits of the project proposal. Proposals to finance well-defined projects that have cleared the environmental process may be solicited on the basis of "hard money" bids. These can include the amount of franchise fees to be paid by the private party, the amount of required public investment, and/or limits on return on investment or

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future user fee levels. Private participation in projects that are still in the early development stage may be solicited based on the amount of funding the developer is willing to advance at its cost and risk for preliminary engineering, traffic and revenue studies and permitting activities, in return for the right of exclusive negotiation of the final terms for construction and operation. If such negotiations are ultimately unsuccessful, the agency retracts the right to re-bid the project. It should be noted, however, that the private sector is generally unwilling to accept the risk of NEPA approvals due to significant uncertainties about the time required to obtain such approvals and the ultimate outcome.

State laws or regulations typically require that proposers first demonstrate their qualifications to undertake a project based on relevant experience in development, design, construction, financing and/or operation of projects with attributes similar to the project being procured; the financial resources they bring to the undertaking and their legal structure. Short-listing of the most qualified proposers limits the number of final proposals that the agency must consider to those that are backed by qualified teams.

State law or regulations also outline what should be incorporated in a responsive proposal meriting review by the public entity, with flexibility given to the agency to add additional requirements relating to a specific project procurement. These typically include such items as a description of the proposer's technical approach, its financial plan, an estimate of its design and construction costs, the development timeline, the anticipated financial commitment of the parties, including equity, debt and other financing mechanisms, the monetary or other benefit to the public sector, assumptions about toll rates and other user fees, and proposed caps on rates of return and/or proposed revenue sharing with the public sector.

Authorizing statutes generally address who has user fee rate-setting authority and under what circumstances may they be changed or otherwise reviewed. States laws generally leave to contract negotiation when and by how much tolls can be modified by the private operator.

In our experience State and local transportation agencies take great care in managing the solicitation and review process, and in negotiating final agreements. These are time-intensive undertakings, and they assign their most senior and qualified public servants to the task. Months of effort are usually required to develop procurement documents and related agreements, including consideration of comments from the public and industry. Additional months are taken up in and in the detailed evaluation of final proposals and negotiation of implementation agreements. Outside engineering, planning, environmental and legal consultants are brought in to advise on the numerous technical issues that arise, and to give the agency the benefit of their experience on similar undertakings elsewhere in the country and around the world. Many States also establish review committees made up of representatives of various stakeholders outside the DOTs, as well as seeking the approval of the State's transportation commissions.

The States vary in the extent to which the State legislature is involved in project selection. Some enactments limit authority to engage in PPPs to specified projects, or limit the number or location of projects. Some laws require submission of projects or agreements to the State legislature's transportation committees for review, although few require legislative approval of

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final agreements. The latter is viewed as creating a “political risk” that would discourage proposers from expending the significant sums – not infrequently in the millions of dollars—in preparing proposals.

Other public policy issues sometimes addressed in legislative enactments include: whether tolls must be removed upon termination of the agreement; conversion of existing non-tolled highways to tolled projects; and maintenance of competitive routes or restriction on “non-compete” agreements. Most states leave the resolution of these issues to a case-by-case determination by the sponsoring agency.

What Projects are the States Procuring with PPPs?

Texas

Texas’ PPP program may be the largest in the United States, if not in the world. TxDOT plans to use PPPs as the primary method for delivering new highway projects throughout the state. No less than ten major projects are currently under PPP contract, in procurement or negotiations, or in preparation for competitive procurements.

They include the state’s Trans Texas Corridors 35 and 69, multi-billion dollar long-term projects to create new multi-modal transportation and utility corridors across the state. In early 2006 the state selected a joint venture of Spanish concessionaire Cintra and local contractor Zachry as its strategic business partner for the TTC-35 and is in active negotiation for the first PPP facility to be financed and built under it – SH 130 Segments 5&6. In March 2006 Cintra Zachry unveiled plans for a new 600-mile, grade-separated freight line in the TTC-35 corridor, running from Dallas-Fort Worth to the Mexican border. The plan relies primarily on private financing, with potential additional funding from the Texas Rail Relocation Fund.

I-635 Managed Lanes, the TTC-69, Loop 1604/US281 and SH121 are in active procurement. A procurement for the SH161 will commence this year. Procurement preparation recently began for the SH121/SH114 Connector known as the Funnel, and IH820/35W, with initial procurement documents scheduled to be issued in 2007.

At the local level, the Harris County Toll Road Authority, which built and operates 83 miles of toll roads in the Houston area, is undertaking comparative studies for retaining, selling or leasing them.

Other Active States

Several other states have active PPP programs, planning and procurements underway. The most active are Virginia, Oregon, Georgia, Florida and Indiana.

Virginia has one of the longest histories using PPPs, many of which have materialized from unsolicited proposals permitted under its law. VDOT is currently in negotiation of proposals to finance and construct the 56-mile I-95/395 HOT and HOV lanes project from the 14th Street

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Bridge to Massaponax as well as HOT lanes on the Capital Beltway (I-495) in Northern Virginia. In February 2006, VDOT issued a Solicitation for Proposals for the development and/or operation of the new U.S. Route 460 between Petersburg and Suffolk. Other current PPP projects include the reconstruction of the I-81 to add dedicated tolled truck (TOT) lanes and other improvements and the Dulles Corridor Metrorail Extension. Proposals submitted for a long-term lease for the Commonwealth's Dulles Toll Road have been suspended pending negotiation of a transfer of the toll road to the Metropolitan Washington Airports Authority (MWAA) to facilitate financing of the second leg of the Metrorail extension to Dulles Airport. The airport authority may continue to consider private proposals to operate the toll road.

In October 2005 Oregon DOT signed a pre-development agreement for three potential highway concession projects with a consortium headed by Macquarie Infrastructure Group. These projects are at various stages of environmental planning and feasibility analysis. Macquarie has committed to advance almost all the cost of the pre-development work in exchange for exclusive negotiating rights to implement those projects that prove to be feasible.

The Florida Department of Transportation is pursuing concession proposals for the Miami Port Tunnel connecting the Port of Miami's island facilities to the interstate highway system. In May 2006, FDOT short-listed three international teams for a procurement and contract award scheduled in early 2007. The Tampa-Hillsborough County Expressway Authority is procuring a concession for a new \$200M limited access alignment and interchange at I-275.

Georgia's Department of Transportation is currently proceeding with two major unsolicited proposals received in 2004. The first is a proposed concession for new improvements in the I-75/I-575 Northwest Corridor. The proposed improvements include two design concepts: HOT lanes with variable pricing which will also serve as the guideway for a bus rapid transit (BRT) system, and mandatory truck-only toll lanes. The second proposal is for a concession to develop and operate HOT lanes on GA 400 between Highway 20 and I-85 and on I-285 between I-75 and I-85. Last week Georgia received a new PPP proposal put truck-only toll lanes on portions of western I-285 between I-75 and I-20, and I-20.

The State of Washington is developing administrative rules under its new PPP legislation, modeled after Oregon's. Under its law, no tolls are permitted on a project except by specific approval of the legislature. Separately, the State Transportation Commission issued a tolling study in January 2006 that recommends a statewide tolling and pricing policy as a new funding source and congestion management tool.

What are the Important Trends in the Use of PPPs?

Leveraging public funds with private investment

California's AB 680 was premised on the notion that privately developed tollroads should not require any contribution of public funds. A corollary to this principal was that opportunities for private investment should only be offered for projects that were low on the State's priority list, reserving for traditional public financing the most urgently needed projects. Since that time

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States have come to understand that there are few new projects that can be financed solely on the basis of toll revenue. States are also recognizing that, given the overall inadequacy of public dollars, combining public and private investment dollars in highly congested corridors is the most effective tool to advance these urgent projects over the shortest time horizon.

Today, most State laws permit public contributions to PPP projects in the form of grants or loans, and authorize the State to cooperate with the private sponsors in obtaining needed TIFIA credit support or private activity bond allocations.

Infusion of long-term equity

Until recently, the majority of PPP projects in the United States did not involve long-term equity investment by the private sponsors. These teams, typically led by large US construction and engineering firms would risk substantial sums in developing proposals and bringing them to financial close, but they sought the return on their “sweat equity” primarily through developer fees paid at close of financing and through profit built into the associated design-build contracts. Long-term equity investments were also discouraged by tax laws that made such projects ineligible for lower-cost tax-exempt debt financing.

The last year has seen a resurgence in projects to be developed using the “concession” model, with project sponsor’s equity at risk to the long-term performance of the project. This change is in part a result of the provision in SAFETEA-LU authorizing \$15 billion in tax-exempt private activity bonds, and in part from entry into the US market of international players with experience in billions of dollars of projects financed under the private the concession model throughout the rest of the world. As noted above, the concession approach is currently being utilized in procurements for numerous new projects in Texas, Oregon and Florida.

Use of PPPs for non-tolled projects

Private equity investment presupposes a revenue stream from which the private investor can earn a return. The revenue stream, however, does not have to consist of an interest in tolls or other fees imposed directly on users of the project. Great Britain has used “shadow tolling” support their PFI program. Today, the Florida Department of Transportation, in the first procurement of its kind in the United States, is offering annual “availability payments” to prospective concessionaires willing to build, own and operate a new non-tolled tunnel to the Port of Miami. Payments will be made directly to the concessionaire by FDOT based on hours of lane availability of and such other factors as safety and compliance with operating and maintenance standards.

What is the Federal Role in State PPP Procurements?

PPPs are primarily a State undertaking, and procurements are governed in the first instance by State laws and regulations. Where federal funds are contributed to a project, FHWA oversight insures compliance with applicable federal requirements. The federal regulatory environment continues its evolution in support of transportation PPPs.

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Special Experimental Programs (SEP-14, SEP-15)

FHWA has long sought to remove barriers to the use innovative procurement processes through Special Experimental Programs, SEP-14 and SEP-15. SEP-15 established in 2004 allows use of experimental features on Federal-aid projects to test project delivery techniques that might otherwise be restricted by FHWA regulations or policy. Intended to encourage experimentation in the entire project development process, SEP-15 specifically aims at increasing private investment, project management flexibility, innovation and efficiency, and promoting timely project implementation and new revenue streams. SEP-15 cannot be used to modify the application of environmental laws.

Most recently the SEP-15 procedure has been accessed to permit the TIFIA office to put in place for a Texas project a conditional term sheet and draft credit agreement in advance of proposer selection in a competitive PPP solicitation.

TIFIA

The Transportation Infrastructure Finance and Innovation Act (TIFIA) authorized under TEA-21 enhances the feasibility of PPP financing by providing subordinated debt to projects on advantageous terms. SAFETEA-LU included amendments to TIFIA to improve its suitability to the PPP environment. It expands the types of eligible projects and expressly authorizes direct assistance to private operators. In addition, for existing eligible projects, it permits refinancing of project debt, provided a portion of the refinance proceeds is used to complete, expand or upgrade the project. The new private operator of Virginia's Pocahontas Parkway is expected to take advantage of the refinancing provision to extend the highway to the Richmond International Airport.

\$15 Billion Private Activity Bonds

SAFETEA-LU also made available to equity investors in highways and intermodal facilities tax-exempt financing that had long been a staple of private airport, transit, water and wastewater projects. Previously highway and projects were eligible for tax-exempt financing only if there was no significant revenue sharing, no private equity and no long term operating contracts. Thus federal income tax laws effectively precluded a project from combining tax-exempt financing and concession-type PPPs. The lower interest cost of the \$15 billion in private activity bonds to be allocated by the Secretary of Transportation will help make economically feasible Title 23 funded projects that would otherwise prove infeasible with higher cost taxable debt.

Interstate Tolling Programs

Finally, SAFETEA-LU expanded the authorization for tolling projects on the interstate highway system. Indiana and Texas are expected to access this authority for development of their portions of I-69, a new interstate extending from the Texas border to Canada. The Express Lanes program will facilitate capacity expansions of congested urban corridors through the use of time of day

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pricing and electronic tolling. And our overtaxed and deteriorated Interstates, such as I-81 in Virginia and I-70 in Missouri can be reconstructed and expanded using toll revenues to attract private investment where state and federal dollars are otherwise limited or unavailable.

Conclusion

PPPs are but one “tool in the tool box” of project delivery mechanisms. However, given that Federal and State fuel taxes continue their long decline in the dollar value of projects they can support, PPPs will play an increasingly important role in delivery our largest and most complex transportation projects. The combination of federal support and private sector interest have strengthened the hand of state and local government officials willing to embrace the PPP project delivery tool. The continued careful and prudent use of this tool by the States should provide great benefits to the public in the years to come.

**State Laws Authorizing Public-Private Partnerships for Transportation Projects
(Reflects legislative developments through May 2006)¹**

State	Statute	Comments
1. AK	AS § 19.75.111 (PENDING)	HB 471 was approved by both houses of the Alaska State Legislature and is expected to be signed into law by the governor. It would authorize the Knik Arm Bridge and Toll Authority to utilize a PPP to finance, design, construct, operate and maintain the Knik Arm bridge.
2. AL	ALA. CODE §§ 23-1-80 to 23-1-95 http://www.legislature.state.al.us/CodeofAlabama/1975/132328.html	Authorizes the Alabama DOT and county commissions to establish toll roads, toll bridges, ferries or causeways or allow for their operation by private parties. No express provision regarding the solicitation or acceptance of unsolicited proposals.
3. AZ	ARIZ. REV. STAT. §§ 28-7701 to 28-7758 http://www.azleg.state.az.us/ArizonaRevisedStatutes.asp?Title=28	Two pilot programs each allow up to two solicited and unsolicited proposals.
4. CA	CAL STR & HY CODE § 143(A) http://www.leginfo.ca.gov/cgi-bin/displaycode?section=stick&group=00001-01000&file=90-155.6	The legislation authorizing Caltrans to enter into PPPs (known as AB 680) was repealed in 2003; new legislation is pending pursuant to Governor Schwarzenegger's "GoCalifornia" transportation initiative (AB 1467).
	CAL GOV CODE § 5956 http://www.leginfo.ca.gov/cgi-bin/displaycode?section=gov&group=05001-06000&file=5956-5956.10	This legislation (also known as AB 2660) authorizes PPPs for a range of "fee-producing infrastructure projects," but explicitly excludes the use of toll roads on state highways.
5. CO	COLO. REV. STAT. §§ 43-1-1201 to 1209 COLO. REV. STAT. §§ 43-4-801 to 812 COLO. REV. STAT. §§ 43-3-201 to 43-3-416 http://98.187.128.12/colorado/next.dll/infobase/463f187?fr=document-frame.htm&f=templates	Allows solicited and unsolicited proposals for PPPs. Created a statewide tolling enterprise to finance, build, operate and maintain toll highways. Operated as a government-owned business within the Colorado DOT. Provides PPP authority to Colorado DOT for specific projects including tumpikes and HOT lanes.

¹ This survey should not be construed as legal advice regarding any particular project in any state. Please contact hbass@hossaman.com with any additions or corrections.

State	Statute	Comments
6. DE	<p>DEL. CODE ANN. tit. 2, part II, ch. 20, §§ 2001 to 2012 http://www.delcode.state.de.us/title2/c020/index.htm - TopOfPage</p>	<p>Authorizes solicited and unsolicited proposals for PPP projects, including highways and bridges.</p>
7. FL	<p>FLA. STAT. ANN. § 334.30 http://www.flsenate.gov/statutes/index.cfm?mode=-View%20Statutes&SubMenu=1&App_mode=D http://www.flsenate.gov/statutes/index.cfm?App_mode=Display_Statute&URL=CH0338/fri0338.htm&StatuteYear=2005&Title=%2D%3E2005%2D%3EChapter%20338</p>	<p>Allows Florida DOT to receive or solicit proposals for PPPs. 1953 statute that established the Florida Turnpike Enterprise, which is on an enterprise basis within the Florida DOT.</p>
8. GA	<p>GA. CODE ANN. §§ 32-2-78 to 32-2-80 http://www.legis.state.ga.us/legl-bin/gl_codes_detail.pl?code=32-2-1</p>	<p>In May of 2005, several significant amendments to this statute were enacted as S.B. 270. The statute now allows Georgia DOT to both receive and solicit proposals for PPPs. Potential competitors also have 135 days (instead of 90 days) to respond to an unsolicited proposal.</p>
9. IN	<p>IN CODE § 8-15.5</p>	<p>HB 1008 authorizes the Indiana Toll Road lease transaction. The legislation also establishes the process for entering into a public-private agreement on I-69 from Indianapolis to Evansville, and specifically prohibits the State from entering into such an agreement for any other road or project without further legislative approval. While similar in scope to the authorization for the Indiana Toll Road lease, there are a number of significant differences in the process for procuring an I-69 agreement. As an example, the I-69 PPA will be administered by INDOT, instead of the Indiana Finance Authority.</p>

State	Statute	Comments
10. LA	LA. REV. STAT. §§ 48:1251 to 1281 LA. REV. STAT. §§ 48:2020 to 2037 HTTP://WWW.LEGIS.STATE.LA.US/	Louisiana HB 1294, a bill to "authorize the Louisiana Transportation Authority to pursue public-private partnerships for the construction for certain transportation facilities", was passed by the House currently before the Senate.
11. MD	MD. TRANSPORTATION CODE ANN. § 8-204 http://198.187.128.12/maryland/text.dtl/infobase/57218/58756/58865/58876?fr=document	Maryland does not have a statute expressly authorizing highway PPPs. According to a 1996 Attorney General opinion referenced in the annotations to this statute, the Maryland Transportation Authority has authority to construct toll roads using certain forms of PPPs. 2
12. MN	MINN. STAT. ANN. §§ 160.84 – 160.93 http://www.revisor.leg.state.mn.us/stats/160/	Authorizes solicited and unsolicited PPPs for toll facilities. Authorizes HOT lanes.
13. MO	MO. REV. STAT. §§ 238:300 to 238:367 http://www.moga.state.mo.us/STATUTES/C238.HTM	Creates a special purpose non-profit corporation known as a Transportation Corporation as a vehicle for PPPs. No express provision regarding the solicitation or acceptance of unsolicited proposals.
14. NV	NEV. REV. STAT. §§ 338.161 to 168. http://www.leg.state.nv.us/NRS/NRS-338.html	Authorizes public bodies to accept unsolicited proposals to develop, construct, improve, maintain or operate transportation facilities. Toll bridge and toll road projects, however, are prohibited under this statute.
15. NC	N.C. GEN. STATE. §§ 136-89.180 to 136-89.197 http://www.ncleg.net/EnactedLegislation/Statutes/HTML/ByArticle/Chapter_136/Article_6H.html	North Carolina Turnpike Authority now authorized to develop, construct, operate and maintain up to nine toll facilities, including a toll bridge. Solicited process only.
16. OR	OR. REV. STAT. §§ 367.800 to 367.826. HTTP://WWW.LEG.STATE.OR.US/ORS/367.HTM OR. REV. STAT. §§ 383.001 to 383.019 http://www.leg.state.or.us/ors/383.html	Establishes the Oregon Innovative Partnerships Program with detailed guidelines at OAR 731-070-0005 to 731-070-0360. Allows Oregon DOT to solicit and accept unsolicited PPPs for tollway projects.
17. PR	9 LEYES P.R. AN. §§ 2001 to 2021	This statute establishes a toll transportation facility authority with broad powers to authorize private participation in public highway projects.

2 See MD 81 Op. Att'y Gen. (issued 2/2/96).

State	Statute	Comments
18. SC	S.C. CODE § 57-3-200 http://www.sstatehouse.net/code/57c003.htm S.C. CODE § 57-5-1310 et. al. http://www.sstatehouse.net/code/57e005.htm	Allows South Carolina DOT to enter into PPPs. Allows DOT to construct and operate turnpike facilities. § 57-5-1330(D) appears to permit SC DOT to use PPPs to develop these facilities. No express provision regarding the solicitation or acceptance of unsolicited proposals.
19. TX	TEX. TRANSP. CODE ANN. ch. 227, 361 and 370 http://www.capitol.state.tx.us/statutes/tm.toc.htm	Allows TxDOT, the Texas Turnpike Authority, and Regional Mobility Authorities to accept solicited and unsolicited proposals for PPPs.
20. UT	UT. CODE ANN. §§ 63-56-502.5 and 72-6-201	SB 80 authorizes the Utah DOT, with approval from the Transportation Commission, to accept solicited and unsolicited proposals for PPPs involving tollway facilities through the use of "tollway development agreements."
21. VA	VA. CODE ANN. §§ 56-556 to 56-575 http://leg1.state.va.us/cgi-bin/legp504.exe?000+cod+TOC56000000022000000000000	Virginia's Public-Private Transportation Act of 1995 authorizes PPPs and was modified during the 2005 legislative session. Allows solicited and unsolicited proposals. Contains detailed guidelines to assist VDOT and other public entities in implementing this program.
22. WA	WASH. REV. CODE §§ 47.46.010 to 47.46.900 http://www.leg.wa.gov/rcw/index.cfm?fuseaction=chapter&chapter=47.46&RequestTimeout=500	New PPP enabling legislation was passed in May of 2005 (as H.B. 1541). The exclusive source of financing for WashDOT projects is state treasurer-issued indebtedness; and no such indebtedness, or expenditures from it, may occur without prior legislative approval. Presently, solicited proposals only, but unsolicited proposals may be accepted after 1/1/07.

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TIMOTHY M. KAINE

**GOVERNOR
OF THE COMMONWEALTH OF VIRGINIA**

**BEFORE THE
COMMITTEE ON TRANSPORTATION AND
INFRASTRUCTURE**

**SUBCOMMITTEE ON HIGHWAYS,
TRANSIT & PIPELINES**

U. S. HOUSE OF REPRESENTATIVES

MAY 24, 2006

Introductory Remarks

Good morning Mr. Chairman and members of the Subcommittee. It is an honor to testify before the Committee today on an issue of such great importance to the Commonwealth of Virginia.

Virginia is a logical choice to testify on contemporary public-private highway transactions. We have nearly two decades of experience in private financing for highways and are widely regarded as a national leader in this area. Many of our sister states seek the advice of Virginia on how to create their own programs of private partnerships.

As Governor, I am responsible for the third largest highway system in the U.S. and have oversight responsibility for the fastest growing port on the east coast, some of the fastest growing airports in the country, and some of the largest and fastest growing transit and rail programs in the country. I previously served as the mayor of the City of Richmond, with local responsibility for highways, a port, and transit and rail services.

These responsibilities require a constant stream of very difficult decisions, all very much in the public eye, and all subject to review

by federal agencies, local governments, advocacy groups and the legislative branches of government.

If I can leave you with a single message today, it would be that no one size fits all. What works in Northern Virginia won't work in Southwest Virginia, much less Indiana or Illinois.

While my testimony today will focus on highway transactions, understand that some of our most exciting private partnerships exist in non-highway programs--a privately-financed port that opens next year in Portsmouth; private landowners stepping forward to pay 25% of the cost of the first Metrorail extension in the Dulles Airport Corridor; and private railroads meeting defined public benefit targets in exchange for capital cost sharing.

With this broader context as background, I would like to share some of our guiding policies and lessons, particularly as they relate to our innovative programs in highway finance.

First, true public-private partnerships are not free. Someone has to pay a toll or a special tax, share in the risk of a project, or dedicate private funds that might otherwise go to private sector profitability.

Second, the public sector has an obligation to ensure that a public-private partnership addresses a genuine public need. For example, we believe that public-private partnerships, primarily through tolling, could address up to twenty percent of our long-term highway needs. However, we cannot, and should not, ignore the remaining eighty percent of unmet needs.

Third, the benefits of a public-private partnership should accrue to the toll-payers or tax-payers or risk-takers, in proportion to their contributions. This requires a serious business model--not the customary method of making everyone a little bit happy, but real-life business decisions that are guided by hard arithmetic and an unwavering commitment to the public good.

Fourth, the decision to enter into a public-private partnership, as well as the implementation of that partnership, needs to be open to the public. Protection of bargaining rights and proprietary information can exist in a climate of transparency and accountability.

Finally, even within our highway programs, and public-private partnerships, there is room for innovation and multi-modal thinking.

- Our private partnership programs, along with our traditional highway programs, are beginning to ensure the integration of transportation and land use.
- The Pocahontas Parkway, our first highway concession (the third in the country) provides for access to the Richmond airport.
- Our HOT Lane projects on I-95, I-395, and I-495 in Northern Virginia will bring together and fund highway infrastructure, demand management programs, and bus rapid transit services. For those of you who have the pleasure of commuting in these corridors, this is one of our few opportunities for meaningful improvement in the foreseeable future.
- Our current solicitation for a public-private partnership on Rt. 460 in Southeastern Virginia will, hopefully, bring together and fund highway infrastructure, freight rail improvements, and intermodal services to serve the Port of Virginia, the Atlantic Fleet in Norfolk, and the metropolitan areas of Richmond and Hampton Roads.
- Our Dulles Corridor program brings together and funds connections among Metrorail, Dulles International Airport, and the Dulles Toll Road, a significant element in the

National Highway System. Several private partnerships, consistent with the above four principles, are embedded in our Dulles Corridor program.

Let me conclude my opening statement here by acknowledging Virginia's special role. Like all states, we are stewards of the federal highway and transit systems funded by the federal government. As home to the Atlantic fleet, the Pentagon, and a majority of the federal workforce in the Washington region, we have a special stewardship responsibility. We take that responsibility very seriously. Some of the very tools being discussed here today will help us meet that responsibility.

Thank you for your time. I will be happy to answer any questions you may have.

Detailed Statement of Governor Kaine

Funding Levels of Construction & Public-Private Programs

In the last 5 years, Virginia's publicly financed highway construction program has totaled \$7.3 billion. Of that \$7.3 billion, \$3.0 billion, or 41% was federal funding while \$4.3 billion was state funding, including bonds. In our proposed program for the upcoming six years, federal funding will be more than 75 percent. Our federal partners are critical to our traditional highway building program and our public-private partnerships as well.

As of May 1, 2006, Virginia has completed 3 highway construction projects under our public-private law. Another 4 are under agreement and 7 are under active negotiation or consideration. These projects, if all come to fruition, total more than \$17 billion in transportation investments – the equivalent of what it would take to complete all the projects in our current highway construction program.

Of that \$17 billion, about half has the potential to be private funding, repaid with tolls, special taxing districts, or other payment

structures. It has only been in the last two years that Virginia has seen risk capital “brought to the table” by the private sector.

The First Virginia Concession – Pocahontas Parkway

We have announced and will execute by June 1 our first concession agreement with Transurban, an Australian company, for the Pocahontas Parkway which links Richmond International Airport with areas south of our state capitol. This 99-year agreement is worth more than \$520 million to the Commonwealth.

The agreement is the first in the United States that includes revenue sharing between the public and private sectors and a “termination for convenience” clause in exchange for the right to operate and maintain a roadway. Toll rate caps have also been kept at a lower rate than other concessions. The Commonwealth will continue to assume some risk with environmental issues.

Virginia’s History of Public-Private Highway Finance Transactions

In addition to traditional tolling, the current options for highway financing have been building since the late 1980s. The Highway Corporation Act of 1988 authorized the construction of the Dulles

Greenway, a private road supervised by the State Corporation Commission (like a public utility).

The limitations of this Act led to Virginia's Public-Private Transportation Act of 1995 (PPTA). The PPTA, which underwent a significant revision in 2005, outlines the public policy goals of private financing. These goals are: more timely, more efficient, or less costly project delivery. In revising the law in 2005, we partnered with the private sector and used our 10 years of experience to improve our program.

During the 2006 General Assembly session, policy guidance for private concessions was incorporated into our state law. Two key components of this legislation were policy guidance on the use of any concession payment and tax liability. Concession payments must be used to provide a TRANSPORTATION benefit to the users of the facility. Our concession legislation, a bipartisan effort, dedicates any concession payment to a transportation purpose in the corridor and/or to benefit the payers of the tolls. Private entities are afforded the same property and local license tax exemptions as a public sector entity. These are important policy goals and business principles.

Virginia has always been one of the first states to take advantage of new federal authority and programs as it has been made available. These include State Infrastructure Bank (SIB) legislation, Transportation Infrastructure Finance and Innovation Act (TIFIA) authorizations, and Section 129 tolling agreements. In addition we have successfully applied for congestion pricing, value pricing, and pilot interstate tolling slots. Virginia also has an extensive network of high occupancy vehicle lanes and ITS-enabled facilities. In fact, the successful delivery of the Pentagon work force is highly dependent on the I-95 HOV lanes.

Observations about Public-Private Transactions

First – not every highway expansion project is a candidate for public private financing. One size does not fit all. Virginia has more than 70,000 miles of roadway. The majority of these are local roads which do not have sufficient volumes to support tolling. They are not candidates for private innovations other than design-build with public funds.

The fundamental premise of what public-private financing, including concession agreements, are based on is tolling a facility at a price that the market will bear. To toll and be successful, you

must have traffic volume. Last year, the U.S. Chamber of Commerce released its report, “Future Highway and Public Transportation Financing.” The report noted that, optimistically, private investment in today’s public infrastructure could finance at most twenty percent of the capacity that is needed.

Second – our laws and structures can be in conflict about the opportunities they provide to the private marketplace and end up impairing investment. In Virginia, we have worked to identify those impairments and address them with sound public policy.

SAFETEA-LU, the current transportation reauthorization, continues to move us in the right direction but implementation can take time. Virginia’s first concession agreement contemplates a partial refinancing of the Pocahontas Parkway so that an expansion of the facility can be constructed. We worked last year with this Committee and others to clarify that TIFIA loans could be used for refinancing. Timely rulemaking or regulatory innovation will be required to meet the demands of this project and this partnership.

The National Environmental Policy Act or NEPA is an important public protection law. We need to work together and figure out how to keep the public engaged but reduce how long the process

takes to complete. If, for example, congestion pricing is being implemented, economic forces must be considered. Our federal processes must balance these forces with the environmental and community protections that NEPA encompasses.

Third, funding for our core public infrastructure program must be stable and reliable. While private equity investors are willing to take financial risks, they are not as willing to step into an environment of uncertainty and long-term decline. I am concerned with the fiscal health of our federal highway trust fund as well as the sustainability of our highway construction program in Virginia with declining revenues.

In February, the Assistant Secretary for Budget and Programs testified to this Subcommittee on the fiscal health of the Highway Trust Fund. She reported the continuing downward trend in the cash balances in the Highway Trust Fund – expenditures are outstripping revenues. By the end of SAFETEA-LU in 2009, the Trust Fund is expected to have a negative cash balance of \$2.3 billion.

Virginia has its own highway trust fund whose structure hasn't changed or its funding sources in 20 years. Today, more than 50

percent of it must be used simply to maintain our current highway system. While private funding can help, it can't solve this fundamental public policy and fiscal issue. Our General Assembly continues in a special session to try to meet our long-term transportation funding problem.

The problem in part is from economic growth and vitality that our private partners want to leverage. In the last twenty years, 775,634 single-family housing permits have been issued in Virginia. Our transportation system faces the demands of a growing population – up by 24% in 20 years. The number of licensed drivers has grown 34%, registered vehicles 56% and vehicle miles of travel 71%.

Our transportation industry, including the Department of Transportation, is delivering more than 80% of our projects on time and on budget. The core issue is not performance or who delivers. The issue is funding, whether public or private.

Potential private investors are telling us that this uncertainty in traditional transportation funding is causing them to reconsider taking a risk in Virginia. They recognize, as each of us should, that we cannot turn our entire roadway system into a series of toll

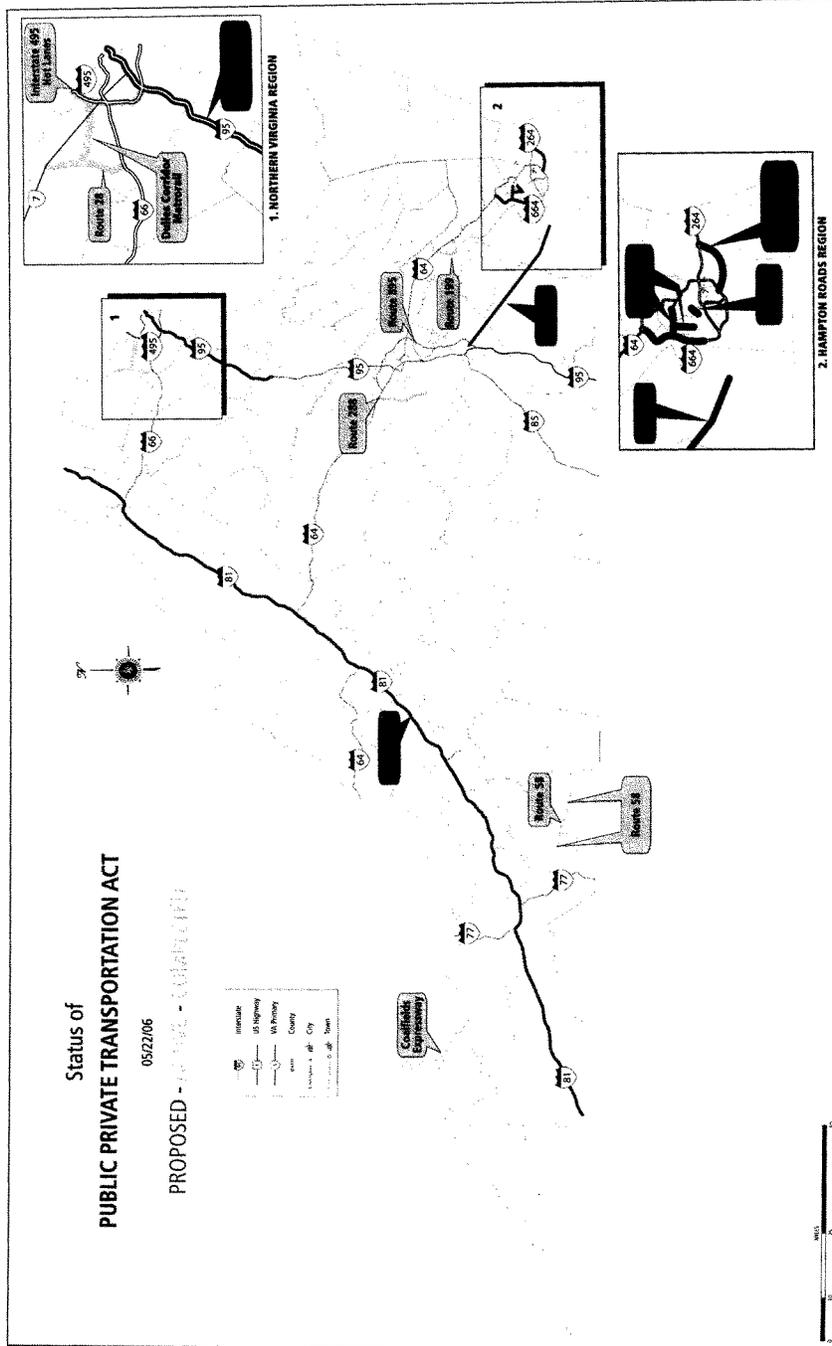
roads or special tax districts. The public sector must be a strong, fiscally sound business partner.

The last observation, Virginia has completed three major public-private projects in the last 3 years and has signed its first concession agreement and is negotiating two additional agreements. Each one has been unique and addressed different needs and issues.

The ink needs to dry so that perspective can be gained on these public-private transactions. If we all immediately turn to the private sector for financing, we run the risk of losing optimal pricing for our roads. We also run the risk of not negotiating the best business terms for the public good. Reasonable time is not an enemy of public-private partnerships, nor is learning from missteps along the way.

Virginia has leveraged private sector investments for almost 20 years in meeting our transportation challenges. While the private sector, in its purest form, looks at these investments for their return on investment, elected officials also have a responsibility to ensure that competition, transparency and accountability are a part of our actions.

As maintaining and operating our highways consumes larger shares of our funding, the private sector does provide part of the solution. For those projects that can be developed through a public-private partnership, investors want to be assured of a solid, sustainable public partner. That balance is what must be achieved.



Submitted for the record

**The Honorable Bill Pascrell, Jr.
Opening Statement
Highways, Transit and Pipelines Subcommittee
Understanding Contemporary Public Private
Highway Transactions on May 24 at 9:30 am**

- Good morning Chairman Petri, Ranking Member DeFazio, I thank you for holding this hearing and I would like to welcome Governor Daniels and Governor Kaine.
- Due to quickly diminishing transportation trust funds at the federal, state and local levels, an aging infrastructure system and increasing levels of congestion choking our highways, we are eager to explore alternative and innovative ways fund our transportation systems.
- Contrary to what members of this committee were led to believe, the Highway Trust Fund is scheduled to be \$2.3 billion in the red by FY2009. As currently structured, the gas tax will simply not be enough to fund our highway needs.
- On top of that states are facing severe budget constrains in their own transportation trust funds.

As states seek ways to build and maintain transportation infrastructure in the face of budget shortfalls, some have experimented with the notion of expanding public private partnerships involving state roads and highways.

Public Private investment in transportation projects seem to have resulted in some rewards for state and local governments—such as completing projects more quickly and receiving a large infusion of cash.

Conceivably these moneys could be used for other public priorities.

And while getting that lump sum to plug budget holes, instead of smaller but steady yearly revenue, is tempting I fear the potential loss of governmental revenues from foregone tax and toll revenue is a greater concern.

My home state of New Jersey, toll roads have been ubiquitous since the 1950s. The Turnpike and Garden State Parkway bring the state \$829 million from tolls annually. These “temporary

tolls” have become a staple for transportation financing throughout the state.

- Additionally, service areas on the roads already are leased to private firms and generate \$33 million for the state.
- The federal-state partnership has been a productive one for financing and planning our nation’s roads. Privatization of roadways may result in loss of control over management and operation of facilities – like toll rate setting or even the improvement of other roads in the geographical proximity.
- I am also concerned about the consequences to the state should the private-sector partner go under. Will states be liable for costs if private entities encounter financial difficulty?
- Would they be liable for some or all of the cost of operating and maintaining the toll road if a consortium went out of business?
- I look forward to an enlightening discussion today on the experiences to date on privatizing roadways. It will surely add to an already

exciting debate on the future of infrastructure financing.

STATEMENT of Rep. JON PORTER (R-NV)
House Transportation and Infrastructure Committee
Subcommittee on Highways, Transit, and Pipelines
May 24, 2006

Mr. Chairman, I thank you for holding this hearing today on understanding contemporary public private highway transactions: the future of infrastructure finance.

Southern Nevada is one of the fastest growing regions in the country with 5,000 new residents a month and over 45 million visitors a year. In addition, over 20 new high-rise condominiums and resorts are planned for completion in the next five years. This rapid growth has a major impact on how Nevada plans and implements its transportation infrastructure projects.

Public private transactions serve several functions in that they can accelerate the implementation of a project, encourage the use of new technology, encourage entrepreneurial development, and limit the size and scope of the public agencies involved.

The Nevada Department of Transportation's Blue Ribbon Taskforce has considered and encouraged the use of public private partnerships in a number of highway projects throughout the state.

Public private partnerships also foster a positive working relationship with private industry in the community. As we seek to address the increased demand on our highway infrastructure in Nevada, public private partnerships will play an important role.

I am extremely interested in hearing the comments from my fellow subcommittee members as well as the testimony from the witnesses. I yield back