Redefining the Urban Partnership: Public-Private Toll Financing Provisions of ISTEA

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THE INTERMODAL SURFACE TRANSPORTATION Efficiency Act of 1991 (ISTEA) and automatic vehicle identification technology will share responsibility for the growth of toll facilities during the next decade. Discussed here are some of the toll-related provisions of ISTEA that could greatly influence the way state and local governments build and finance those facilities and how they repair and expand roads, bridges, and tunnels.

The following are the basics aspects of the ISTEA provisions. First, Section 1012 of ISTEA allows for state departments of transportation to use Federal-aid highway funds for up to 50 percent of the cost of a new toll road and up to 80 percent of the cost of a new bridge. Second, the road or bridge can be publicly and privately owned, as long as there is a contract between the agency receiving the Federal-aid funds and the private toll-road developer. The developer's capital counts as the state's matching funds. The tolls must be used for maintenance, recovering the cost of the facility, debt service, and a reasonable return on the developer's investment. The tolls can stay on the facility after it is paid off if the road is properly maintained and the excess revenue is used for Title 23 projects. Third, existing free roads and bridges that are in need of

significant rehabilitation and expansion can be converted to toll facilities to pay for repairs. For those projects, Federal-aid funds can also be used for up to 80 percent of the cost of rehabilitation. Finally, the state may either grant the federal funds to the project or loan the funds to the project, regardless of whether the project is publicly or privately owned.

The following are several important points about the loan program:

- The borrowers may take up to 30 years to repay the loan.
- The loan must be subordinate to all other project debt (which means other creditors are paid first if the borrower defaults).
- The interest rate may be no higher than the state's earnings on its pooled funds.
- The first payments on the loan may be delayed for up to 5 years after the reopening of the project.
- The repayments may be used for any Title 23 project in the state. Most important, the money becomes state money. No federal requirements apply for the second round of projects.

Notice three things about these new provisions:

- The law strongly encourages the creation of new toll facilities and the conversion of free roads and bridges to tollways, especially since it allows states to keep the excess cash.
- This is the strongest federal law by far ever passed in support of public-private partnerships.
- The loan provisions are a good deal for everybody—the state, private toll-road developers, and public toll authorities—especially since the money loses its federal requirements as it is recycled and, if the Federal Highway Administration (FHWA) agrees, the loan repayments can be used as a "soft match" (Section 1044) for other free highway projects even as they are being reloaned to new toll projects. If this practice is allowed, the normal state matching funds would be freed for use in other projects. Although not stated explicitly in the law, it is clear that members of Congress were thinking about states setting up permanent revolving loan funds with the federal aid they receive, perhaps changing the way almost all state transportation projects are financed.

I cannot tell you how pleased (and shocked) I was when I read the final language in the bill. As a representative of the Privatization

Council, I had met with members of Congress to "educate" them on the benefits and mechanics of public-private partnerships. I can't believe they actually listened to me. (Actually, I figure they probably listened to somebody else.)

You see, my past experience with members of Congress was that they usually learn about privatization the same way that Woody Allen read *War and Peace*. Allen said that he read the book in an hour and concluded that it was about Russia.

I believe I know why Congress was listening this time. We all know about the dire straits of the federal government and the desire of Congress to stretch limited funds as far as possible, even if it means having them leveraged by private-sector investment.

Support also emanated from the state and local level, where a general shift to user charges has been under way for more than a decade. Since 1976, the percentage of infrastructure facilities financed with user charges has risen by nearly one-third. This is in response to pressing needs in other areas of government and a powerful resistance to general tax increases.

By shifting to user charges, state and local governments free up general revenues for other uses. Similarly, by building toll facilities instead of freeways, state governments free up highway funds for desperately needed maintenance and rehabilitation.

A public-private partnership can be fostered wherever there are user charges and a self-financing facility. Many people believe that public-private partnerships make full-cost user charges easier to accept. In addition to making tolling easier and allowing the money to be used elsewhere, private toll roads generate tax revenue. The $250 million extension of the Dulles Toll Road near Washington, D.C., by the Virginia Toll Road Corporation is expected to generate more than $500 million in direct state, local, and federal taxes during its 25-year private life.

In general, a private toll project can be expected to yield about $2 in direct tax revenue for every $1 spent to build it. Once the initial investment has been recovered, all of the toll revenues can be placed in the state highway fund.

About 12 states have now passed private transportation infrastructure laws. The following are the basic models for public-private partnerships that are included in ISTEA.

• Build-own-operate (BOO). This type of partnership is unrestricted, but regulated for safety, quality of service, and probably

price or rate of return. No examples exist to date, but proposed high-speed rail projects are similar. Some ISTEA toll projects will probably be BOOs.

- Build-operate-transfer (BOT). This type of partnership is the same as BOO, except that the franchise only lasts for 20 to 40 years. After that, ownership is transferred to the government. One example is the Dulles Toll Road extension project in Northern Virginia.
- Build-transfer-operate. This partnership model is the same as BOT, except that the title is transferred to the state after construction. Full financial responsibility remains with the developer, who collects the tolls. An example is the California model.
- Lease-develop-operate. This type of partnership is ideal for major ISTEA reconstruction projects in which a free facility is being converted (at least temporarily) to a toll facility. The developer takes control and collects tolls, but ownership never changes hands.
- Wraparound addition. In this model, the core facility remains publicly owned, but a private, complementary facility is wrapped around or inside it. Innovative use of Federal-aid rights-of-way is discussed in ISTEA. In California, a private developer is going to build a toll facility down the middle of a congested freeway (SR-91) on Federal-aid right-of-way.

These models are in use all around the world. About 50 such projects are under way.

The public-private agreement is the heart and soul of an ISTEA toll project. It is the contract that the law requires between the grantee and the private tollway developer. Defined in it are the following:

- Responsibilities of each party,
- Standards for safety and design,
- Allowable rate of return for investors,
- Length of the franchise,
- Reporting requirements and inspection rights,
- Incentives and sanctions, and
- Remedies for default by either party.

The ISTEA loan provisions are important public-private partnerships. Transportation infrastructure is not an easy investment for the following reasons:

• Competition from routes and modes;
• Cost overruns and delays (no one will pay more to use the road just because it cost more to build it);
• Hostile legislators and people who just plain dislike roads and tolls; and
• The delay before a profit is made. Profit is not an extra cost; it is the cost of capital, equity capital, just like interest is a cost of debt. However, equity involves more risk.

ISTEA loans, because they are subordinate to all other project debt, become almost a form of equity. In effect, they are the state's investment in the project. With this kind of public commitment, private investors are willing to put their capital at risk. Without it, it takes a lot more Pepto Bismol to make a project work.

As mentioned previously, the law gives states the flexibility to set up permanent state-level revolving loan funds, similar to the state wastewater treatment revolving funds allowed by the Clean Water Act.

Following are several points to remember:

• When the proceeds of bond sales are added to the Federal-aid funds (which are actually state funds reimbursed by the federal government), the resulting sum is several times the Federal-aid seed money.
• Once the initial state money has been loaned, the loan itself, not the specific charges from specific projects, is eligible for Federal-aid reimbursement. That is a great improvement in timing and paperwork.
• Private capital in the project can be used as the state match. FHWA officials are currently deciding whether loan repayments can be used as a soft match for other nontoll projects, even if they are reloaned for other toll projects.
• Making a profit on the loans means that the funds can grow over time.
• Once the fund starts to revolve (that is, as the loans are paid back), the money can be reloaned for any Title 23 project (state, local, or private) without any federal strings attached.

This sounds complicated because it is, but help is on the way. Price Waterhouse is helping FHWA develop a brochure to introduce these concepts. In addition, Price Waterhouse is helping FHWA write an extensive state handbook on how to implement the ISTEA toll and

public-private partnership provisions in each state, including how to set up state highway revolving funds and how to leverage them for other state transportation projects.

State officials and members of metropolitan planning organizations should think about how to take advantage of the new flexibility in ISTEA. How can the public-private partnership and tolling provisions of ISTEA be used to help meet the financial planning and financial feasibility requirements imposed by ISTEA? How can these options be incorporated in routine planning for transportation improvement programs and state transportation plans? How can state laws be changed to provide for creation of public-private partnerships and toll facilities? Will business go on as usual or will the challenge offered by Congress be accepted?

Abbie Hoffman said that in a revolution there is no such thing as an innocent bystander: if you are a bystander, you are not innocent. Please join the revolution that Congress started in 1991.