Washington State Transportation Commission

Report to Legislature: Implementation Issues Related to the Transportation Innovative Partnership Act of 2005

Overview

The Transportation Innovative Partnership Act (ESHB 1541, enacted in the 2005 legislative session) directed the Washington State Transportation Commission to adopt administrative rules to implement a new public-private partnership (PPP) program for transportation-related projects in the state. The Commission has forwarded the first draft of these rules to Transportation Committee legislative leadership, as required by law.

In the course of developing these rules, the Transportation Commission has received several comments, suggestions, opinions and criticisms from various public and private sector stakeholders and citizens. Our in-depth review of the elements necessary to carry out a successful public-private partnership program has brought to the surface additional public policy issues. The following is a brief summary of these issues, which have been organized under four main topics: (1) financing issues; (2) process issues; (3) resource issues; and (4) technical issues.

We hope the foregoing will be helpful if you decide to modify or refine the Transportation Innovative Partnership Act or the administrative program structure necessary to deliver successful projects in our state.

If you have any questions or would like to discuss this further, please contact our Administrator, Reema Griffith, at 705-7070.

Dan O'Neal, Chair

Dick Ford, Vice-Chair

Ed Barnes, Commissioner

Robert S. Distler, Commissioner

Elmira Forner, Commissioner

Carol Moser, Commissioner

Dale Stedman, Commissioner

Financing Issues

The financing provisions generated the most comments, opinions and suggestions. Although the Commission has concerns about the mandatory use of state-issued debt for any state transportation project, we recognize the Legislature is unlikely to revisit this decision without some experience with the statute that was recently enacted. Nonetheless, we offer the following observations:

Since the enabling legislation was first drafted (fall, 2004), the public-private partnership industry has seen a rather significant shift in financing techniques for PPP transportation projects in the United States. Prior to this time, the most prevalent forms of PPP financing were some version of tax-exempt debt issuances, backed by future toll revenues. The policy question presented by the original Tacoma Narrows Bridge agreement was whether the public was better served with state-issued tax-exempt debt, or with tax-exempt debt issued by a non-profit corporation. It was demonstrated that a lower toll rate structure could be achieved with the state-issued debt, primarily due to the lower interest rates available; therefore, the legislature adopted that financing approach specifically for the Tacoma Narrows Bridge project. With the enactment of SHB 1541, the Legislature then institutionalized this financing approach for all state-owned transportation projects procured under the new Transportation Innovative Partnerships Act.

However, any comparison of the two financing approaches considered during the TNB era has become obsolete. The use of 63-20 financing (non-profit tax-exempt issuance) for transportation projects is no longer prevalent. Restrictions on the use of the such debt, particularly the inability to mix private equity with tax-exempt financing, has made 63-20 financing rare for transportation projects. The newest trend in PPP financing is the use of private concession agreements, where the public sector owner essentially leases a transportation facility to a private entity. The private entity is entitled to charge and collect tolls on the facility for a term of years, usually ranging between 35 to 99 years, depending upon the facility and the policy goals of the public sector. In exchange for this concession, the public sector typically receives a very large up-front lump sum payment. This is the basic financing structure used in the Chicago Skyway concession agreement, which netted the city of Chicago a cash payment of $1.83 billion from a private consortium of developers, Cintra of Spain and Macquarie Bank of Australia.

These public-private concession agreements are extremely complicated and highly customized to fit a particular project or situation. They do not lend themselves well to a simplistic comparison of financing costs. Indeed, it's entirely possible for a concession to be undertaken that does not require the issuance of any project-related debt whatsoever. This only underscores the inadequacy of attempting to *legislate* a perceived "best" approach to financing transportation infrastructure. While interest rates and costs of issuance are very significant factors, they are no longer determinative of the total public value of a particular financing deal. For example, the ability of a private firm to

take advantage of the U.S. tax code—particularly the depreciation of capital assets--provides a considerable source of value to the private sector that the public sector is otherwise unable to capture. In the recent Chicago Skyway deal, it has been estimated that approximately $330 million of the $1.83B private investment was immediately recouped by Cintra-Mcquarie in the form of depreciation write-offs—a return of 18% to the private sector.

This is just one small example of how new market entrants, particularly international financiers, have impacted and changed the landscape for PPP's in the United States over the last year and a half.

For our state, if the financing restrictions contained in RCW 47.29.060 are intended to ensure the lowest possible cost to the toll payers, that statute may be ineffective in delivering on this promise, because it assumes that state-issued debt will always result in the lowest cost. While this was probably a safe operating assumption at the time the legislation was drafted (when interest rates and cost of issuance were reliable leading indicators for lowest resulting toll rates), the advent of entirely new financing approaches leaves RCW 47.29.060 frozen in time, perhaps failing to accomplish the desired policy goals of the legislature.

For these reasons, some consideration should be given to articulating (in legislation) the policy goals the legislature wants to achieve in PPP transportation infrastructure financing. Such an approach could avoid the problems found in the current statute, where attempting to regulate the means and modes of financing may lead to a result opposite of what was intended (i.e., state-issued debt might *not* result in lowest or best cost for toll payers).

There are obviously several other issues related to the use of state-backed debt for PPP projects, many of them debated in the 2005 legislative session. We do not endeavor to reopen those debates at this time. But it is incumbent upon us to report the recent changes in the public-private partnership industry since those legislative deliberations occurred, highlighting the challenges posed by RCW 47.29.060 (financing provisions).

Process Issues

The statute requires a two-step process for considering unsolicited proposals for transportation projects: first, the submission of a conceptual proposal, and if the state is interested in proceeding further, the submission of a detailed proposal. While this approach to unsolicited proposals is common in other states, many of those same states report that this two-step process is sometimes unnecessary; some projects have already been developed beyond the conceptual stage by the public sector entity. It would save both time and money if the private sector were permitted to proceed directly with a

detailed proposal (obtaining a waiver from the state to skip the first step), where conditions warrant. If a single-step process were allowed, a proper review of the proposal by the Commission will require resources (primarily in consultant and/or staff expertise) commensurate with the more compressed timeline for review (*see* "Resource Allocation Issues," *below*).

Resource Allocation Issues

Funding an Effective PPP Program

To effectively carry out a Transportation Innovative Partnership Program, the state must have some financial resources (i.e., budget appropriation) committed to the program and any resulting Commission review and approval. Presently, there are 21 other states with PPP laws for transportation, yet only 8 to 10 of those states are considered to have an active program. Those that are inactive have remained dormant due to lack of resources allocated to effectively administer a program. Simply having a public-private partnership law will not result in public-private projects. If the legislature opts not to fund a program at this time, it must be recognized that the private sector could catch the state on its heels beginning January 1, 2007, when the moratorium on unsolicited proposals is lifted and the state must analyze and decide whether a PPP submittal merits development. Lacking adequate resources to undertake a thorough review could leave the state ill prepared to distinguish viable proposals from unviable proposals.

Competition Among States

The number of states looking to enact PPP laws or to activate their programs has increased markedly since the Chicago Skyway concession transaction closed in January 2005. Immediately on the heels of that deal, the Governors of Indiana and New Jersey each announced their intentions to pursue PPP agreements similar to the Chicago Skyway for their state transportation facilities. In the aftermath of Hurricane Katrina, Louisiana is seeking to attract public-private partnerships to expedite reconstruction of their transportation infrastructure.

Each state seeking a public-private partnership project is competing with other states for the resources and work force of the private sector. Consultants to states with PPP programs are strongly advising that a marketing component be included in PPP programs. Closer to home, Oregon had a substantial portion of their modest program budget allocated for marketing activities and costs. The fruit of Oregon's marketing effort is the on-going negotiations on three PPP projects, with an announcement of a deal expected within the next few weeks. On the horizon for both Oregon and Washington is the I-5 Columbia River Crossing project, which could be procured through a public-private partnership.

If the state is to have an active PPP program, the reality is that resources are needed to effectively compete for highly qualified private partners. Resources include not only state funds, but also a commitment and involvement from top state elected and appointed officials to actively recruit the top private partners in the world.

Providing Funds for Stipends

A third issue relates to the awarding of stipends to proposers, in the context of a competitive solicitation process. While many private sector firms feel stipends help promote competition for projects by mitigating the business development costs for proposers, only a few states report granting stipends. Although the statute does not prohibit awarding a stipend to firms submitting proposals, the 2005-07 budget does not contain adequate funding to allow the state to provide such a stipend.

Technical Issues

Specific Statutory Authority for Participation in Joint Ventures

Some lawyers have pointed out that the state, acting through WSDOT, may lack specific authority to participate as members of joint venture entities under Washington law. Joint ventures better enable risk shifting to a private developer for the production of public assets, either on a build-to-suit or a turnkey basis. Although the statute *implies* the state may participate in joint venture-type arraignments, more specific legal authorization is desirable.

Clarifying which Projects (or portions) are Subject to Public Works Contracting Procedures

The statute seems to assume that all public-private projects will be public works projects, or at least a substantial portion of the project would constitute a public works project. This likely will be the case for the vast majority of projects considered by the state. However, there are smaller niche projects where the primarily public benefit resides in the revenue-generating potential of the project, rather than in the development of a publicly-owned facility. The statute is somewhat unclear about whether projects that provide public benefits only through revenue generation (such as a fast-food franchise at a ferry terminal) are considered "public facilities," which could trigger an unintended application of chapter 39.04 et. seq., the traditional public works contracting processes.

Allowing PPP Projects Unrelated to Tolls to Proceed Immediately

The enabling legislation does not allow TIP projects to proceed until the Statewide Tolling Study is complete (ETA: summer, 2006). Yet there are potential TIP projects *not* related to the tolling study, where the projects are ancillary to a transportation route, such as refurbishment of Colman dock ferry terminal, construction of rail or intermodal terminals, or even improvements to highway safety rest areas. These projects are not germane to the issues presented in the Statewide Tolling study, and potentially could be undertaken within the next six months—before the completion of that study. Clarifying that these non-toll projects are able to proceed immediately under the TIP program would allow potential projects to move forward without unnecessary delay.