Transport report: Skyway's the limit?

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The $1.87 billion paid by the Macquarie/Cintra consortium for a 99-year lease of the Chicago Skyway Toll Bridge grabbed both the headlines and the attention of treasury managers and politicians across the US.
Public-private-partnerships (PPPs) have been rare for public transportation infrastructure in the US, where public ownership and control is the norm. However, the Chicago Skyway project may well herald a dramatic change. The number of major transportation PPPs currently in the works in the US is greater than it has been for many years.

PPPs in the 1990s

The current environment is not a first. In the 1990's there were a handful of transportation projects in the US that fell squarely within the PPP model, not all of which were successful.

The Dulles Greenway project in Virginia, which reached financial close in 2003, initially received wide acclaim and was cited as a possible model for future US PPPs.

However, initial traffic levels were substantially below projections. An adjustment of the toll rates, an increase in the speed limit and some astute financial engineering allowed the initial debt to be successfully refinanced in 1999. Significant traffic growth in recent years has solidified the project's financial stability, as attested to by the additional financing earlier this year and its addition of new lanes in both directions.

The SR91 express lanes project was built in the median of the heavily congested Riverside Freeway in California, pursuant to a 35 year lease from the state to a private entity. The concession included a non-compete provision meant to prevent the public sector from increasing traffic capacity on other roads in the vicinity. That provision proved to be a significant political problem as traffic congestion increased in the late 1990s. Proposals by the state to expand competing infrastructure resulted in litigation in 1999 and the eventual sale of the project to a regional public authority in 2003.

In May 1997, Camino Colombia, Inc. (CCI), a private entity licensed under Texas law to operate toll roads, issued $75 million of notes to finance the 22 mile Camino Colombia toll road in the vicinity of Laredo, Texas, intended primarily for commercial traffic. As with the Dulles Greenway , traffic and toll revenues were significantly below initial projections. CCI defaulted on its debt and, after failed negotiations regarding the future of the toll road, the noteholders foreclosed on the road in 2004 and sold it to the state.

Why did both SR91 and Camino Colombia end up in public hands? One common feature is that neither was based on a true "partnership" between the public and private sectors. There was no sharing of the risks, or potential upside, of the project and little attempt by (or even the ability of) the public and private participants to address the legitimate needs of the other party.

SR91 and Camino Colombia stand in sharp contrast to the Terminal 4 project at JFK International Airport in New York which contains elements of a real partnership between the public and private sector. The Terminal 4 lease expressly provides for the sharing of revenues from various sources by the private operator and the Port Authority and provides for ongoing coordination between the parties regarding operations.

In 1998, the Virginia Department of Transportation awarded the Design Build Finance contract for the 8.8 mile, electronically tolled four-lane Pocahontas Parkway toll road (Route 895) developed by Fluor Daniel, to a non-profit corporation. Like the Dulles Greenway project, initial toll revenues on the Pocahontas Parkway were significantly less than projected. There has been much speculation about the possible transfer of the concession to another entity.

Obstacles to PPPs in the US

Dulles, SR91, Camino, JFK and other PPP projects in the 1990s were dwarfed by the number and size of major transportation projects that were funded by the public sector in the same timeframe, and this pattern has continued for several reasons.

The federal government expends considerable amounts directly on public transportation facilities and provides supplemental funds to state and regional transportation authorities. States utilize a variety of taxes to fund their share of such projects. The states and their various transportation authorities also have ready access to the large, well established and highly liquid tax exempt municipal bond market in the US, a phenomenon unique to the US, which has been a vital, plentiful and reliable source of relatively inexpensive financing.

The lack of a centralized governmental approach to PPP in the US, at both a national and local level, has also discouraged PPPs. One reason for the success of the PFI program in the UK is that the UK government has implemented and promoted the program, often using standard form documents, in a manner impossible in the US. At the state level in the US, a multitude of public authorities may have to be navigated by the private sector participant, from the offices of the governor or city mayor, the state legislature to the city council and local land board, not to mention specialized agencies such as the state, regional and local DOTs, airport authorities and other transportation agencies. These entities may well have competing interests. Commentators have cited, as a key reason for the successful consummation of the Chicago Skyway transaction, the fact that the Mayor of Chicago, one of the main proponents of the program, has unusually wide latitude in implementing decisions regarding city infrastructure.

Federal and state legislation has traditionally discouraged many forms of private participation in public infrastructure programs. Existing federal law limits the ability of public, or private, operators to toll roads that were constructed using federal funding. Public and private operators of airports or terminals that have received federal funding, a class which included the vast majority of major airports and terminals, are prohibited from applying the profits from such operations for non-airport related purposes, again with only limited exceptions.

There has also traditionally been widespread opposition to PPP programs by labor unions, who often fear widespread lay-offs and/or reductions in benefits and pensions if employees are transferred from the public to the private sector. There may also be opposition from public sector officials who believe that they, rather than the private sector, are best qualified to maintain and operate the relevant services. Concerned citizens, as well as public officials, have also expressed skepticism as to the ability of PPP programs to deliver their claimed benefits or have argued that any benefits will be outweighed by increased tolls or other user charges. Local engineering and construction firms, whose participation may well be vital to the success of a PPP program, may be reluctant to depart from the public model that has long been a source of lucrative contracts.

New era for US PPP?

Notwithstanding the challenges, there are reasons to expect PPPs to become a significant presence in US transportation infrastructure. Clearly, the size of the $1.87 billion Chicago Skyway lease payment has whetted the appetite of many in the public sector and caused them to look again at their non-core infrastructure assets as a possible source of revenue.

Compelling factors

The cost of maintaining or replacing key infrastructure in the US in coming decades will be significant. Faced with the possibility of increasing user charges or taxes, or imposing new taxes, to cover these expenses, governmental authorities are likely to find PPP programs a welcome alternative to meet their public transport needs.

PPPs also offer government officials the benefit of transferring to the private sector the day-to-day burdens of operating and maintaining a large facility, thereby permitting government officials to focus on the already burdensome task of governing.

Political environment

The political and legislative environments have also become much more favourable to PPPs in recent years. Although attempts by the Reagan Administration in the 1980s to introduce more private involvement in the public sector did not result in the consummation of many PPPs, they did at least re-introduce the concept of PPPs into the public policy forum. The Clinton Administration of the early 1990s made PPPs one of the key planks of its plan to reform the federal government.

Federal initiatives

The Bush Administration has also been very active in promoting PPPs, with the Federal Highway Administration (FHWA), which distributes significant federal funds for state highway construction, holding out PPPs as a potential solution to the country's transportation infrastructure needs. The FHWA has organized a number of workshops for state transportation authorities and other interested parties to promote the use of PPPs. In 2004 the FHWA introduced an experimental program with the objective of identifying "for trial evaluation and documentation public-private partnership approaches that advance the efficient delivery of transportation projects while protecting the environment and the taxpayer". In August 2005, the President signed the long delayed federal highway Bill, which provides for up to $286.5 billion to be spent on road construction and related transportation expenditures. In keeping with the Administration's agenda, the legislation is designed to encourage transportation PPPs and provides for the issuance of up to $15 billion of tax-exempt Private Activity Bonds.

Another key federal legislative development is the Transportation Infrastructure Finance and Innovation Act of 1998 (TIFIA). Under the TIFIA program the US DOT is empowered to provide secured loans, loan guarantees and standby lines of credit to public or private entities in connection with qualifying transportation infrastructure projects, with a view to leveraging federal funds by attracting private investment. TIFIA financing is particularly well adapted to toll road projects due to the length of its term (potentially up to 30 years), the fact that it is subordinated (other than in a foreclosure situation) and the permitted deferral of commencement of repayment for up to five years after completion of the project (the crucial "ramp-up" period when toll revenues are least predictable).

State programs

Legislation to encourage PPPs has been enacted in at least 26 states. The details of such legislation are beyond the scope of this article. However, legislation pending in the New York is noteworthy, not only for the enormous scale of potential PPPs in New York, as has been well reported, but because it is illustrative of the legitimate concerns that need to be addressed in order to achieve consensus among the various constituencies. While permitting long-term PPP concession arrangements for roads, bridges, tunnels and other public transportation facilities throughout the state, the New York legislation (at least as initially proposed) would limit the imposition of tolls to transportation facilities that currently impose tolls, that are newly constructed or that increase capacity. In addition, the proceeds received by the public sector participant from any applicable PPP project may be expended only on capital improvements to the state's public transportation infrastructure.

US PPPs in the Current Decade

Even before the Chicago Skyway transaction, the pace of PPP development in the US was accelerating. Although only a small number of projects have been consummated, the number of PPPs proposed in the first half of this decade is far greater than has been seen for many years. Following are some representative examples.

In July 2002, the South Suburban Airport Coalition, comprised of several municipalities in the Chicago, Illinois metropolitan area, proposed the construction of a new airport southwest of Chicago, based on the PPP model. Although the project faces many challenges, including opposition from those who prefer the expansion of O'Hare International

Airport, the coalition has attracted several additional municipalities to join its ranks since its formation. The State has commenced the acquisition of a portion of the property required for the project, which was granted FAA approval in June 2004.

The SR125 project in California, a new 9.3 mile, four lane state-of-the-art electronic toll road, which will be financed, built, operated and maintained by a private entity under a 35 year concession, reached financial closure in May 2003. A ten year extension of the concession is currently under consideration to compensate the private operator for cost overruns that are the responsibility of the public sector. Not surprisingly, certain public officials are pushing to dilute a non-compete clause (which limits the ability of the State to build competing infrastructure) as a condition to such an extension.

The Trans Texas Corridor is the largest PPP project to be proposed in the US to date, with an overall price tag of $145 billion to $184 billion. The 50 year plan calls for the construction of up to 4,000 miles of toll roads, in four distinct corridors, accompanied by freight and commuter rail and utility services. In December 2004, a Cintra-Zachry consortium was brought in by TxDOT as a "strategic partner" for one sector of the project. The consortium is expected to develop master development and financial plans for this sector, which is estimated to cost between $29 billion and $36.7 billion.

In July 2005, Virginia received a proposal from a private consortium to improve, operate and maintain the existing state-operated Dulles toll road (which connects to the private Dulles Greenway toll road) for a 50-year period. The consortium estimates that total private investment under its proposal would exceed $1 billion. In accordance with state law, Virginia has invited competing bids. In August 2005, Macquarie Infrastructure Group announced that it had agreed to purchase an 86.7% interest in the owner of the Dulles Greenway toll road for $533 million.

Conclusion

There has been a slow but steady increase in the number of proposed and consummated US PPP projects over the last decade. The Chicago Skyway is likely to add momentum to the PPP bandwagon.
Recent US experience with PPPs demonstrates some vital lessons. The risks and benefits must be allocated appropriately between the public and private sector participants. The terms of the arrangement must be clearly documented. Each of the parties should be satisfied that it can truly live with the terms and conditions of the PPP for the entire term of the project. As the SR 91 project demonstrated, non-compete provisions, while much sought after by the private sector partner, may well prove to be politically unpalatable to the public sector participant as time goes on.

There must be a real element of "partnership" between the participants, something that clearly was missing in the Camino Colombia project. The ultimate success or failure of the project may well depend on the capacity of each party to recognize and accommodate the needs of their private or public sector partner.