Innovative Finance

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Franchising Attracts Private Investment

Franchising is becoming an increasingly important technique in the United States for financing transportation improvements, such as toll roads and the deployment of Intelligent Transportation Systems (ITS).

Broadly defined, a franchise refers to the exchange of access to public rights-of-way or other public facilities in return for the satisfaction of public interest obligations, which often include providing services to the public. Franchising can attract private investment by firms that then have the opportunity to generate a profit through their access to the public rights-of-way or facilities. Even in situations where revenues may not provide private firms with sufficient return on investment, as long as the public sector is willing to make up the difference between revenues and adequate profit, private financing of at least part of the transportation improvement project can be achieved.

Franchising historically has applied to natural monopolies where it is uneconomical or disruptive to permit more than one type of private service to install transportation or telecommunications infrastructure within public rights-of-way. Franchising was common during the early years of the mass transit industry, and was the principal means of deploying electric distribution systems as well as cable television.

Today, franchising is taking new forms, some that involve formal franchise agreements and some that do not. Franchising examples include the following:

1. The California Department of Transportation awarded a contract to a private consortium to finance, design, construct, operate, and eventually turn back to the state a toll road on State Route 91. The contract, in the form of a franchise agreement, grants access to public rights-of-way and stipulates the return on investment. The agreement also requires that the tolls charged vary with congestion levels.
2. HELP Inc., a non-profit corporation comprised of states and motor carriers, awarded a franchise to Lockheed Information Services (now Lockheed Martin). The franchise grants access to public rights-of-way in participating states in exchange for installation of electronic equipment. The equipment will be used to monitor motor carriers at weigh stations and to provide related services to states and motor carriers on a fee-for-service basis.
3. The National Capital Region Traveler Information Showcase involves an offer by the States of Virginia and Maryland, the District of Columbia, and other localities to grant access to public rights-of-way and provide some portion of total funding for an Advanced Traveler Information System (ATIS) in the Washington, D.C. metropolitan area. In return, a private consortium will provide the remaining funds for the project and deploy the ATIS.

Recently, the FHWA sponsored a major study entitled *Overcoming Barriers to ITS – Lessons From Other Technologies*, which included the development of model franchise agreements (i.e., legal documents) for deploying Advanced Traffic Management Systems (ATMS) and ATIS. The model franchise agreements provide guidance to public agencies in drafting their own franchise agreements and tailoring them to reflect assumptions such as:

- Degree of cost recovery (e.g., capital costs, operating costs, or total costs plus profit);
- Mix of public (i.e., "free") goods versus private (i.e., priced) goods being provided;
- Nature of services being offered (e.g., basic vs. value-added); and
- Degree of market exclusivity (e.g., monopoly, multiple providers).

Other types of franchise agreements may involve shared resource projects, which refer to the bartering of access to public rights-of-way in exchange for the provision of wireline or wireless communication infrastructure. Franchise agreements can also incorporate ancillary services, such as towing services or food concessions, to enhance revenues and profitability. Finally, franchising can be combined with specific features of the Federal program of innovative finance. For example, private funding contributions can be used as a credit toward a state's matching share for related Federal-aid projects.

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Also in this Issue . . .

Innovative Finance and Financial Managers Conferences Planned

A conference on innovative finance for transportation will be held in Dallas, Texas, from April 23 to 25, 1997 at the Hyatt Regency Hotel at Reunion. The *Transportation Finance for the 21st Century* conference is jointly sponsored by the Transportation Research Board, Federal Highway Administration, Federal Rail Administration, and Federal Transit Administration.

The conference will provide a national forum to present and discuss techniques and case studies of innovative finance being used for highway, transit, and intermodal projects. The conference will include information on bond financing, advance construction, public/private partnerships, State Infrastructure Banks (SIBs), and future directions for innovative finance. Case studies of successful innovative finance projects will illustrate toll financing, credit reform, turnkey and design-build project delivery, and private financing.

State, metropolitan, and local government officials with finance, budgeting, planning, and programming responsibilities should consider attending this conference. Others who will benefit include transit properties and toll authorities, and private sector financial institutions with an interest in public/private partnerships. Opportunities will be provided for peer-to-peer contact with colleagues from around the country.

Contact:
Mary DeMinter, TRB, 202/334-3205. For hotel reservations, contact the Hyatt at 800/233-1234.

The *1997 National State/Federal Financial Managers Conference* will be held from March 4 to 6, 1997 at the Radisson Hotel in Kingston Plantation in Myrtle Beach, South Carolina. The conference, which is jointly sponsored by the FHWA and South Carolina Department of Transportation, will be preceded by a meeting on March 3 of the American Association of State Highway and Transportation Officials (AASHTO) Subcommittee on Financial Management.

The conference will address topics ranging from public/private partnerships to performance measures. Several breakout sessions will include presentations on SIBs, partnering, unobligated balances, Surface Transportation Program (STP) pilots, cash forecasting, and much more. There will be opportunities to exchange information and to attend several trade shows over the course of the three days.

Transportation officials from Federal, state, and local governments with financial management responsibilities are encouraged to attend this conference.

Contact:
Debra R. White, South Carolina Department of Transportation, 803/737-1243. For hotel reservations, contact the Radisson at 800/333-3333.

State Infrastructure Banks Update

States Sign SIB Agreements; Ohio Makes First Loan Under SIB Pilot Program

Nine cooperative agreements have been signed with states to establish SIBs. The nine states that have signed agreements are Arizona, Florida, Missouri, Ohio, Oklahoma, Oregon, South Carolina, Texas, and Virginia. California is in the final stage of completing its cooperative agreement.

Seven states have transferred Federal funds to their SIB accounts. Ohio's SIB has made the first loan of the pilot program in the amount of $10 million to Butler County to support a likely $100 million bond issuance. The other states are currently working with project sponsors to determine which projects will be assisted most effectively by the SIBs.

The fiscal year 1997 U.S. Department of Transportation (U.S. DOT) Appropriations Act enabled the Department to increase the number of states participating in the SIB pilot program and included an additional $150 million to capitalize pilot SIBs. The U.S. DOT is in the process of selecting additional states ready to implement a SIB from among the 26 applications it has received.

The additional $150 million will be disbursed to the initial ten SIBs and any additional states selected for pilot SIBs. Due to Congressional outlay constraints, the actual amount distributed to states participating in the pilot program is limited to $22.5 million in fiscal year 1997. According to the Appropriations Act, these funds cannot be distributed until April 1997 and will be available to capitalize both highway and transit SIB accounts.

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SIB Questions Answered on FHWA's *Innovative Finance* Home Page

In the August, October, and December 1996 issues of *IF*, updates were provided on the State Infrastructure Bank (SIB) pilot program established under the National Highway System (NHS) Designation Act of 1995. Another forum for SIB information has been created on the FHWA's Innovative Finance home page. This page contains answers to commonly asked questions about SIBs. Some of these questions and answers are as follows:

Q Will a state be bound to any future guidance that may be developed after signing a SIB cooperative agreement?

A Yes. While the U.S. DOT has endeavored throughout the SIB pilot program to implement Section 350 of the NHS Designation Act in a way that places the fewest burdens on the states, Section 350 requires the Secretary to issue future guidance. This guidance will be based in large part on the questions and answers provided to states in the SIB program. All comments received from the states will be considered before future guidance is issued by the Department.

Q What financing instruments in addition to United States Treasury securities may the Department approve to earn interest on the investment income generated by funds contributed to an account of the SIB?

A Any investment instrument in which the state invests its own money will be considered acceptable to the Department. If the state cannot demonstrate that it invests its own funds in a particular investment instrument, the state should apply to the Department in writing. All interest earned on capitalizing funds (including Federal-aid funds and state matching funds) must be credited to the initial capitalizing account.

Q Does the use of Surface Transportation Program funds to capitalize a SIB require approval of a Metropolitan Planning Organization?

A Surface Transportation Program (STP) funds, Interstate Reimbursement Segments funds, or other Intermodal Surface Transportation Efficiency Act (ISTEA) equity funds that are attributable to an urbanized area may be used to capitalize a SIB only upon concurrence in writing by the Metropolitan Planning Organization (MPO) for the area. Other STP (statewide) funds that are not attributable to an urbanized area do not require MPO approval. It is stressed, however, that while up to 10 percent of the eligible categories of funds (including STP funds) can be deposited into the SIB, this does not relieve a state from the minimum funding requirements within a particular apportionment category, as defined in Title 23.

Q Does Section 350 prohibit financial assistance from the SIB to take the form of a grant?

A Section 350 states that "initial assistance" from a SIB cannot be in the form of a grant, and the Congressional Conference Report on Section 350 states that "Federal funds contributed to a SIB may not be used as a grant." Therefore, the first use of the funds cannot be a grant, although the law does not explicitly prohibit grants as a second use of the funds. However, Congress envisioned the SIB program as providing a self-renewing source of transportation funding through the repayment proceeds derived from SIB loans. The granting of these repayment proceeds will diminish the capacity and effectiveness of the SIBs over time, and states are discouraged from making grants from the SIB.

Many more answers to questions about the SIB program are provided on the FHWA Innovative Finance home page. To access the home page, enter the URL "http://cti1.volpe.dot.gov/fhwa" and choose Program Areas *and* Innovative Finance *from the menu of options.*

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Some Definitions. . .

Here is some help to understand the meaning of. . .

Advance Construction is a technique that allows a state to initiate a project using non-Federal funds while reserving eligibility for future Federal-aid funds. After an advance construction project is authorized, the state may convert the project to regular Federal-aid funding provided that Federal funds are available for the project. The use of advance construction allows a state to deliver transportation benefits to the public earlier, to better coordinate transportation development with a state's economic initiatives, and to preserve a project's eligibility for Federal aid.

Partial Conversion of Advance Construction is a form of advance construction in which the state converts, obligates, and receives reimbursement for only part of its funding for an advance construction project in a given year. This removes any requirement to wait until the full amount of obligational authority is available. Obligational authority is the ceiling or limit on the total obligations that can be incurred for Federal-aid highway programs during a year.

A Rating Agency is an organization that provides ratings of securities issues. Agencies performing the evaluation of an issue's credit worthiness include Standard & Poor's Corporation, Moody's Investors Service, Inc., and Fitch Investors Service.

Bond Ratings are designations of the quality of bonds or notes. Ratings are provided by agencies or corporations (rating agencies) that seek to render a professional judgment considering the quality of the security being rated.

Subsidy Cost, as defined in the Federal Credit Reform Act of 1990 (FCRA), is the "estimated long-term cost to the government of a direct loan or loan guarantee calculated on a net present value basis, excluding administrative costs." Under the FCRA, the budget reflects the authority and outlays needed to cover the subsidy costs of loans or loan guarantees at the time they are extended to borrowers.

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Innovative Finance Course Dates

Upcoming sessions of the FHWA's Innovative Finance and Statewide Financial Planning Course offered to states and Metropolitan Planning Organizations include the following:

- February 4-5, Nashville, Tennessee
- February 25-26, February 27-28, Atlanta, Georgia
- February 6-7, Carson City, Nevada
- March 10-11, Philadelphia, Pennsylvania
- February 13-14, Honolulu, Hawaii
- March 20-21, Ames, Iowa
- February 19-20, Lansing, Michigan

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- FHWA Federal-Aid Financial Management Division's WWW Home Page: "http://cti1.volpe.dot.gov/fhwa" (select "Program Areas" and "Innovative Finance")

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- National Association of Regional Council's (NARC's) Association of MPOs (AMPO)
- ITS America
- American Public Transit Association (APTA)
- Surface Transportation Policy Project (STPP)
- State & Territorial Air Pollution Program Administrators/Association of Local Air Pollution Control Officials (STAPPA/ALAPCO)
- Association for Commuter Transportation (ACT)