Innovative Program Delivery

Grant Anticipation Revenue Vehicle (GARVEE) Bonds




Essentials of Innovative Finance Workshop
Puerto Rico and U.S. Virgin Islands

Innovative Program Delivery

Grant Anticipation Revenue Vehicle (GARVEE) Bonds




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Outline

Objectives

- Describe the various types and characteristics of GARVEEs
- Identify project eligibility and appropriate uses of GARVEEs
- Understand the pros and cons of different types of GARVEEs
- Explain FHWA's and States' respective roles and responsibilities related to GARVEEs
- Become familiar with examples of State GARVEE program and related projects

Lesson 1

Introduction to GARVEE Bonds

Grant Anticipation Revenue Vehicles

- **Definition:** Bonds, generally tax-exempt, sold by States and backed by and repaid with specific Federal-aid funds
- **Purpose:** Issued to provide new funding to an eligible project or to refinance existing bonds
- **Key Provisions:**
  - No Federal guarantee of repayment; any pledges or obligations must come from State legislation and/or executive authority
  - Local match is required with every debt service repayment
- **Advantages:** Acceleration of construction; low interest rates for new money bonds and re-financings; leveraging of Fed funds
- **Disadvantages:** Cost of interest; loss of future flexibility
- **Administration:** FHWA establishes rules on GARVEEs; States issue the debt and establish the terms of the bonds

Advantages of GARVEEs

- Accelerate the construction program
- Avoid costs of inflation
- Facilitate large project financing
- Promote efficient resource allocation by matching debt term with life of asset
- Provide economies of scale
- Provide benefit of relatively low interest rates

Advantages of GARVEEs (cont.)

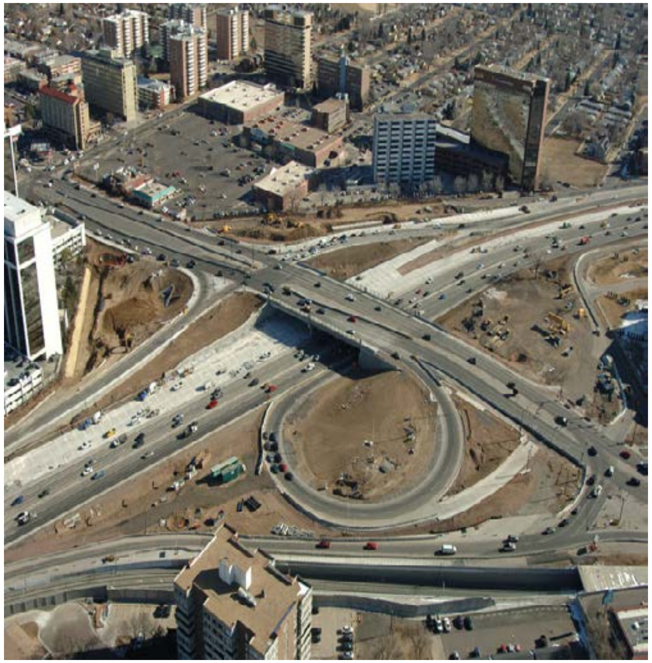
- Provide economic and fiscal stimulus
- Leverage Federal funds
- Increase State's borrowing capacity
- Reduce use of General Obligation (GO) Bonds
- Possibly avoid State's GO Bond debt limits and bond referenda
- Preserve State's general credit rating
- Allow claim of interest and issuance costs as eligible Federal-aid costs

Disadvantages of GARVEEs

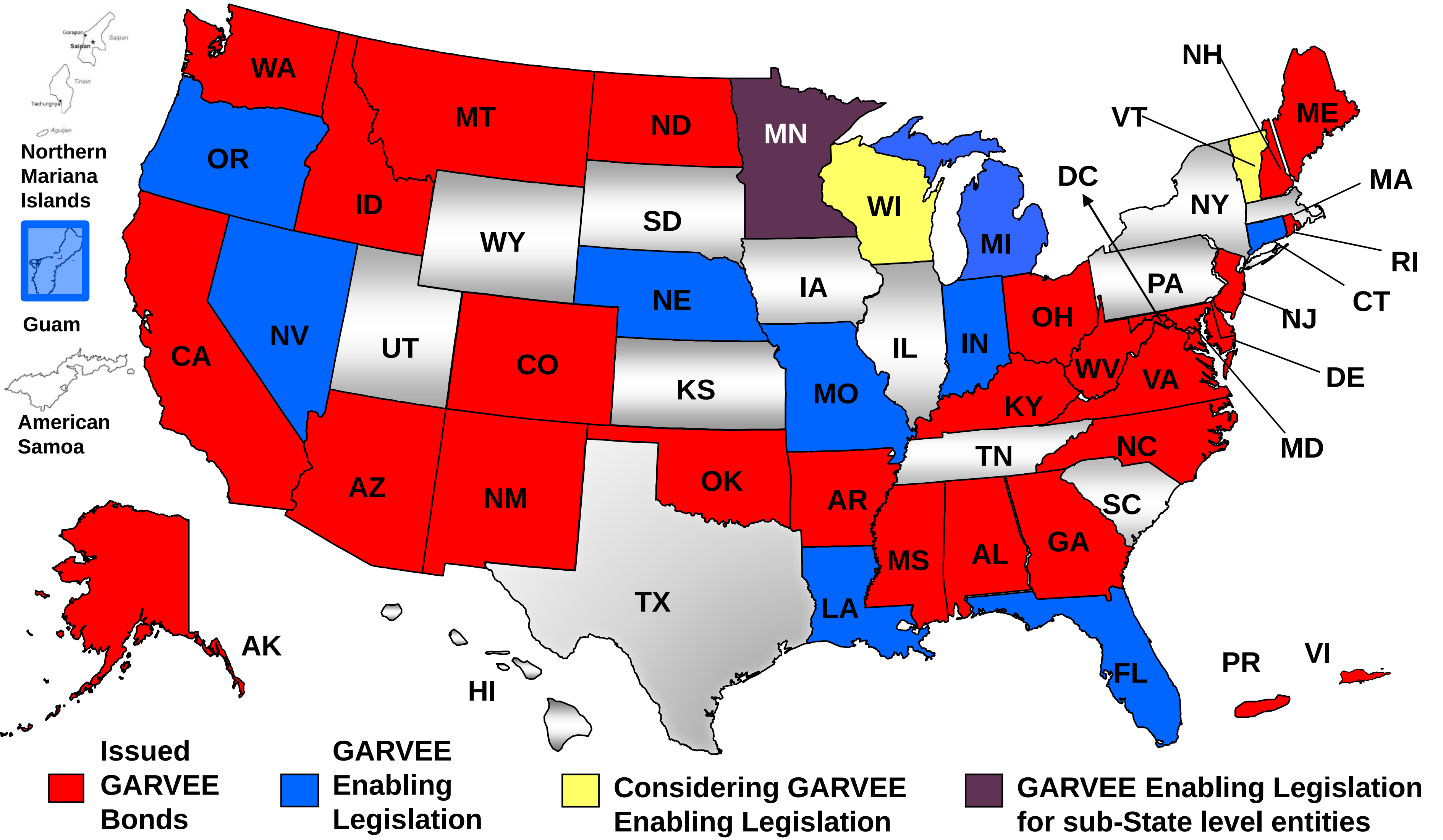
- Debt service reduces financial, programmatic and political flexibility
- May lead to capacity constraints
- May lead to induced inflation
- May limit opportunities for smaller contractors
- Federal-aid used for interest and issuance costs rather than construction costs
- May require enabling State legislation and policy
- Periodic reauthorization risk
- Significant stewardship, oversight and reporting responsibilities for FHWA

Candidate Projects

- Large-scale capital projects with economic life lasting longer than the bond
- Projects whose costs of delay outweigh the costs of financing
- Projects with significant economic development potential
- Projects must be eligible for Federal-aid highway funding and included in the State Transportation Improvement Plan (STIP)



GARVEEs by State (as of Dec. 2012)



GARVEE Ratings

- Factors that affect GARVEE bond ratings:
  - Uncertainty regarding Federal-aid Highway Program funding levels
  - Secondary pledge of State revenues to cover debt service
  - Bond insurance
  - Level of pre-existing GARVEE debt service as proportion of Federal-aid program
  - State's overall credit profile
  - History of timely debt service payments

Lesson 2

Types and Features of GARVEEs

GARVEE Bond Options

- **Bond Type:** Direct or indirect GARVEEs
- **Security:** Standalone, backstopped, and/or insured
- **Interest Rate:** Fixed or variable
- **Maturity:** Long term or short term
- **Uses:** New money or refunding
- **Eligibility of debt-related expenses:** Assessed in coordination with HQ

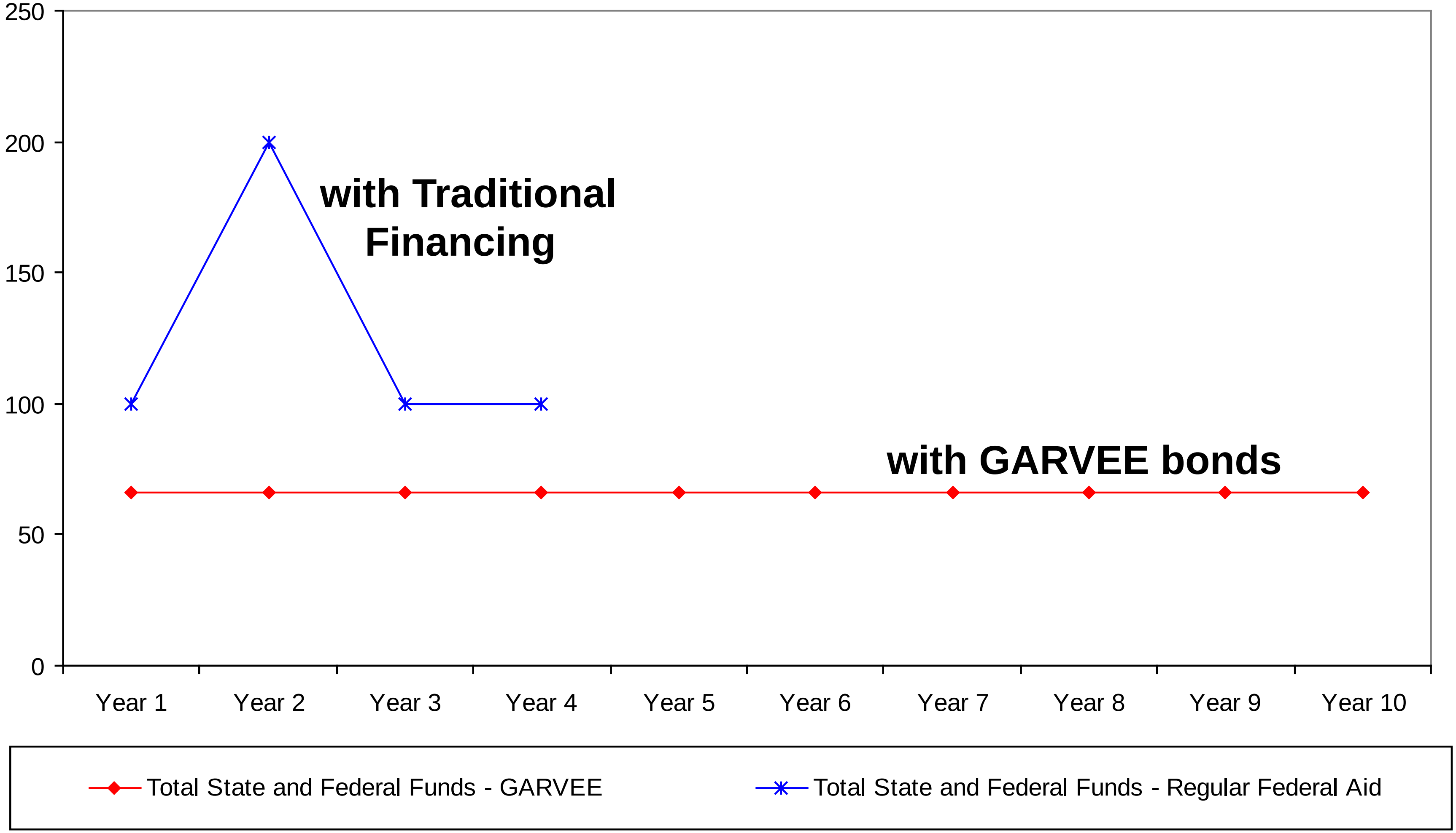
Direct vs. Indirect GARVEEs

Direct GARVEEs	Indirect GARVEEs
• Secured by specific future Federal-aid apportionments • Bond proceeds pay for specific project(s) • Require FHWA Division approval & oversight • Total debt service costs (including interest & issuance costs) are eligible for reimbursement	• Better term: “non-GARVEE” debt • No FHWA role • Secured by anticipated Federal-aid reimbursements on eligible projects paid with State funds • Interest & issuance costs not eligible for Federal reimbursement

GARVEE Security Options

- **Standalone or non-recourse GARVEEs**
  - Future Federal-aid funds serve as the only security backing the Federal share of the obligation to investors
  - No pledge of State funding other than required match
- **Backstopped GARVEEs**
  - Additional State revenues pledged in case Federal-aid highway funds prove insufficient
  - Often lower interest costs on the bonds
- **Insured GARVEEs**
  - Guarantees payment of bonds for life
  - Comes at a cost (premium charged)

Traditional Financing vs. GARVEE Bonds Cash Flows



GARVEE Maturity Options

- In the past, GARVEEs have been structured to be repaid over one or more traditional reauthorization cycles (6, 12, 18 years)
- However, GARVEE term can be selected to:
  - Reflect expected life of asset or improvement
  - Take advantage of interest rate environment at issuance date
- Currently, 10- to 15-year term is common

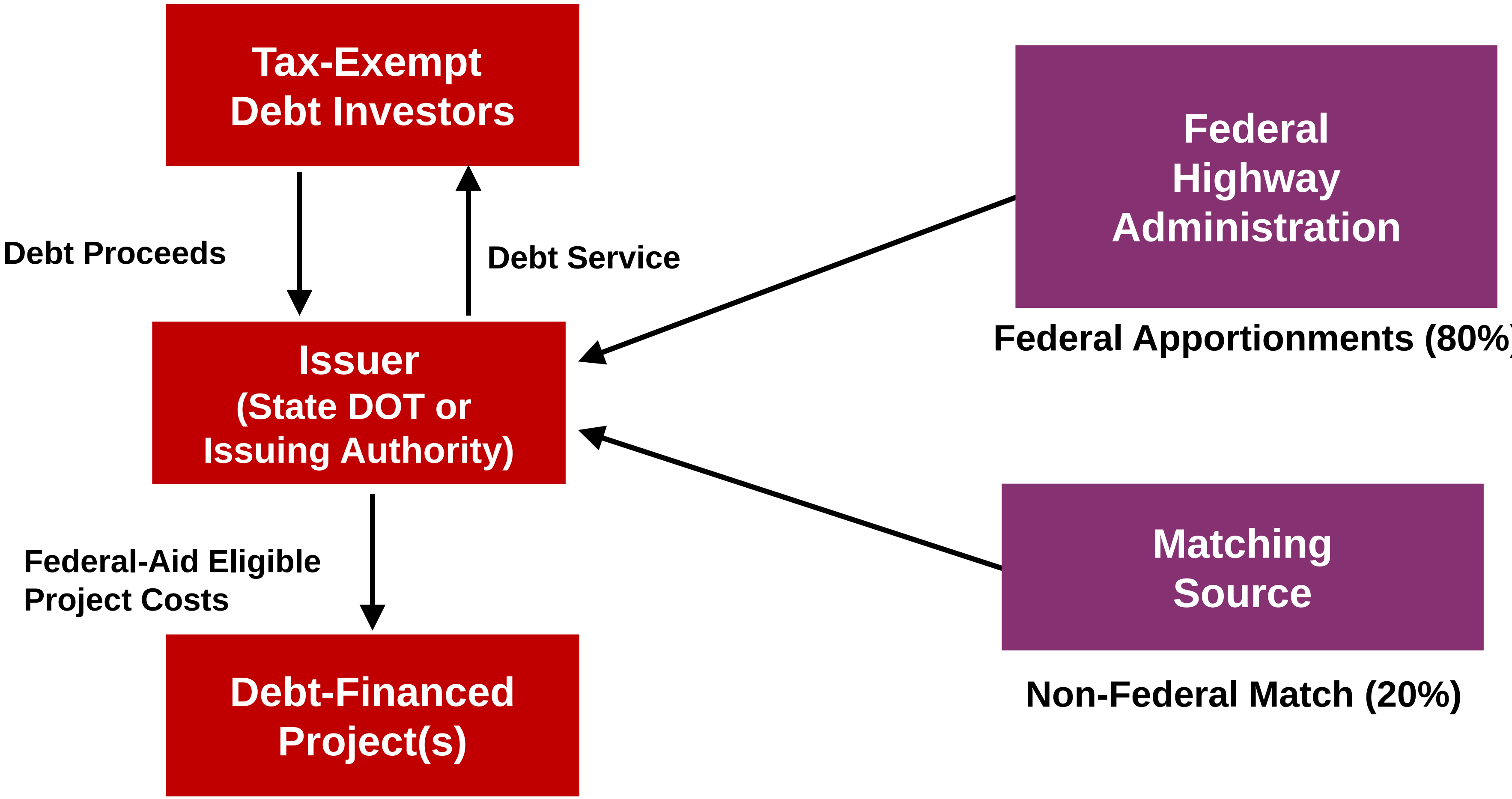
Uses of GARVEE Bond Proceeds

- **New money:** Bonds issued to provide new or additional funding for a project
  - Gross funded – Deposit exact amount required to pay for project
  - Net funded – Amount deposited plus interest earnings sufficient to pay for project
- **Refunding:** Bonds issued to refinance certain existing bonds (proceeds used to repay old GARVEEs)
  - Produce interest cost savings
  - Restructure debt service
  - Release issuer from restrictive operating covenants

Lesson 3

GARVEE Process

GARVEEs – Flow of Funds



GARVEE Bonds Issuance: 8 Steps

1. **State** seeks approval for Advance Construction (AC) of GARVEE project(s)
2. **State** makes election to receive reimbursements for construction or debt service
3. **FHWA (Division Office)** approves project as debt-financed project and negotiates project Memorandum of Understanding (MOU) between FHWA and the State
4. **State** issues GARVEE bonds and uses proceeds for construction of Federal-aid eligible projects

GARVEE Bonds Issuance: 8 Steps

5. **State** requests partial conversion of AC project(s) for semiannual/annual debt service payments

6. **FHWA (Division Office)** obligates Federal funds for requested debt service payment

7. **State** claims reimbursement for Federal share of debt service, and FHWA pays State or trustee account directly

8. **State** uses Federal-aid reimbursement for debt service on bonds

Who Controls GARVEE Bonds?

- FHWA sets the rules on GARVEEs:
  - Project eligibility
  - Expense eligibility
  - Oversight & monitoring
- State, however, issues the debt and establishes the terms of the bonds

State Role

- Authorize through enabling legislation
- Place limits on the volume of GARVEE debt that can be issued
- Structure revenue pledge
- States (bond issuers) and credit markets determine:
  - Coverage ratios
  - Interest rates
  - Term of the obligation
  - Level of debt service reserves
  - Use of bond insurance

Federal Role

- Provide AC project approval
- Ensure Federal project and process requirements are met
- Negotiate MOU
- Advise on eligibility of debt-related expenses
- Ensure matching requirements are met for debt service payments
- Ensure annual debt-service payments are included in STIP/TIP
- Periodically report on GARVEE activities for information purposes

Lesson 4

Examples of GARVEE Programs

Alabama

- Initially issued in 2002 = $200 million
- Refunding in 2011 = $91 million
- County bridge program
  - Replacement of 1,300 weight-restricted bridges across 67 counties
  - $50 million match from G.O. bonds, approved by voters
- Challenges – significant administrative requirements
  - Using GARVEEs at the program vs. project level

Alabama (cont.)

- New bond issuance: Alabama Transportation Rehabilitation and Improvement Program (ATRIP)
  - ATRIP will be used for the rehabilitation and improvement of local transportation infrastructure. Projects are submitted to an Advisory committee and selected based on criteria such as safety, economic impact, industrial impact, education impact, connectivity, project delivery, innovation, and partnership
  - Sold as of Dec. 19, 2012 for a life of 13 years
- Bonds are rated ‘A’ by Standard & Poor’s
  - Total bond sale of $327,935,000
  - Goldman Sachs has calculated that True Interest Cost to be 2.27%
  - There are to be multiple issuances under the ATRIP program for a $1 billion total bond program

Ohio

- First State to issue GARVEEs
  - Bonds issued by the Treasurer of State on behalf of ODOT
- 14 issuances as of 2012 = $1.9 billion
- Debt service < 20% of Federal-aid funds
  - Federal Funding is set aside off-the-top for forecasted debt service
- Additional Covenant – Other Lawfully Available Funds
  - State gas tax and other state highway appropriations
- Issued to increase the size of the Construction Program
  - Not for specific projects

Ohio (Cont.)

Benefits

- Generates up-front capital by leveraging future federal funds
- Build now at historically low borrowing rates, reducing inflation costs on needed projects
  - November 2012 issuance 2.08%
- Able to spread the cost over the useful life of asset
  - Construction costs only

Challenges

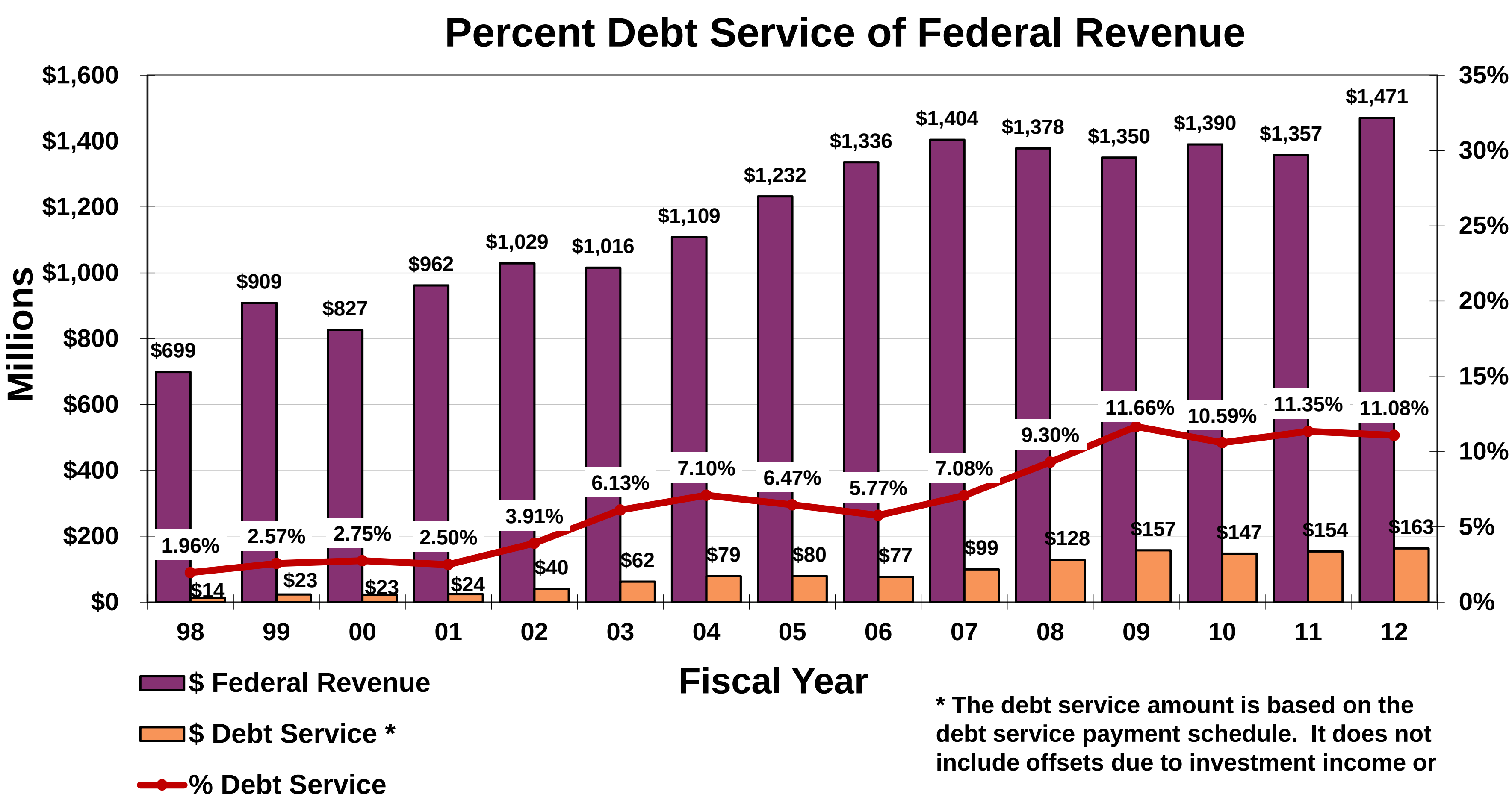
- Administration – Proceeds used on multiple projects
  - Assigning proceeds and debt service to each individual project
- Records Retention
  - Varies depending on length of project, could be up to 20–30 years

Ohio (Cont.)

Best Practices

- Maturity – (Term of Bond) – Stay within 2 Federal Reauthorization periods. 10 -12 years.
- Spending of Proceeds: How quickly will bond proceeds spend out?
  - Ensure we stay within 18 to 24 months due to IRS arbitrage issues.
- Detailed spreadsheet maintained to assign bond proceeds to each individual project, and to then prorate debt service for reimbursement by FHWA, on a project-by-project basis.

Ohio (Cont.)



* The debt service amount is based on the debt service payment schedule. It does not include offsets due to investment income or

Lesson 5

Session Summary

Review of Objectives

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GARVEE Resources

- Innovative Program Delivery Office

  www.fhwa.dot.gov/ipd

- AASHTO Center for Excellence in Project Finance

  www.transportation-finance.org

- Title 23 Section 122

  www.access.gpo.gov/uscode/title23/title23.html

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