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FEDERAL CREDIT PROGRAM

New TIFIA Funds Available Through "Rolling" Application Process

The U.S. Department of Transportation (U.S. DOT) will have $2.4 billion available for credit assistance during 12 months beginning October 1, 2001. These funds, authorized by the Transportation Infrastructure Finance and Innovation Act of 1998 (TIFIA), can be used as secured loans, standby lines of credit, or loan guarantees to finance up to 33 percent of a surface transportation project generally costing more than $100 million. As shown in the figure, the TIFIA program has current credit assistance commitments of more than $3.1 billion for 10 projects that total nearly $12 billion in costs. This translates into a leveraging ratio of 62:1.

The TIFIA program will accept letters of interest from potential applicants at any time. A project that the U.S. DOT concludes has met all threshold criteria can then apply for credit assistance based on its scheduling needs. This "rolling" process and Notice of Funding Availability, announced in the *Federal Register* on May 18, 2001, replaces the annual fixed-period solicitation used during the first two years of the TIFIA program.

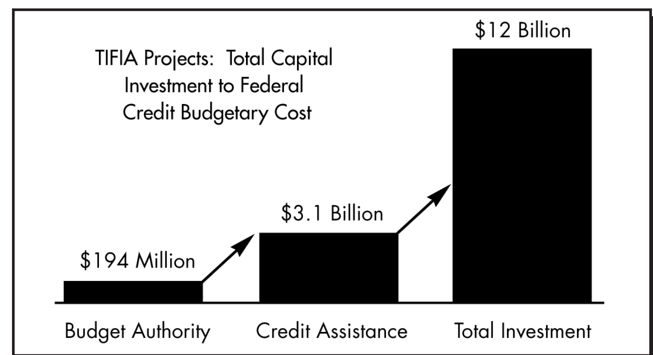
The first applicant to take advantage of the rolling process is the California Department of Transportation, seeking $600 million in credit assistance to help finance the $2.9 billion seismic retrofit of the San Francisco-Oakland Bay Bridge (SFOBB). The U.S. DOT is currently reviewing the SFOBB application.

South Carolina Loan Agreement Executed

On July 11, 2001, the U.S. DOT and the South Carolina Transportation Infrastructure Bank (SCTIB) closed a $215 million TIFIA loan to help replace the existing Cooper River Bridges in Charleston, South Carolina. This $667 million project will construct the longest cable-stayed span in North America, replacing aging twin bridges that cannot support current levels of traffic and impose navigational restrictions on commercial ships using the Port of Charleston. The project includes a $531 million design-build contract, the largest in the history of the South Carolina DOT. The SCTIB pledged hospitality fees collected by Horry County, South Carolina and annual payments from the South Carolina DOT to repay the loan.

Contact:
Mark Sullivan, TIFIA JPO,
202/366-5785.

TIFIA Leveraging To Date – 62:1



SIB UPDATE

SIB Activity Approaches $3 Billion

The volume of State Infrastructure Bank (SIB) activity across the country continues to grow. As of September 2001, 32 states have entered into 250 loan agreements with a dollar value of over $2.8 billion (see table on page 4). This represents 46 additional loan agreements valued at $391 million since March 2001. Nearly two-thirds of the value of new loans was provided to projects from Florida's SIB.

A newly-created state-funded SIB is supporting Florida's increased loan activity, as highlighted in this issue of ***IFQ***. Also highlighted is the Minnesota SIB, which is jointly managed by the Minnesota Department of Transportation and the Minnesota Public Facilities Authority. The Authority has significant experience in the administration of another state revolving loan fund. This partnership allows the two agencies to meld their expertise and evaluate projects for SIB funding both on technical and financial merit.

Contact:
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202/366-2854.

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TIFIA Non-Subordination: Where Are We Now?

TIFIA permits the U.S. DOT to finance on a non-recourse basis up to 33 percent of the cost of qualifying projects. Under the statute, the lien securing a TIFIA credit facility "may [be] subject to any lien securing project obligations" [§183(b)(3)(B)]. The TIFIA loan, however, must "not be subordinated to the claims of any holder of project obligations in the event of bankruptcy, insolvency, or liquidation of the obligor" [§183(b)(6)]. U.S. DOT's TIFIA Program Guide (May 2001) elaborates on this provision stating that "the lien securing the [TIFIA] loan shall be on parity with the lien securing the project's senior debt" in the event of bankruptcy, insolvency, or liquidation (Program Guide, page 2-3). This non-subordination requirement, often termed the "springing lien" by some, has been the subject of extensive discussion within the financial community.

Three years after TIFIA's enactment, and two years into program implementation, what really is the effect of the statutory non-subordination provision that must be part of every TIFIA credit facility?

To date, no senior project financing subject to the TIFIA statutory non-subordination requirement has come to market. Thus, there is not yet any market experience with the provision.

But how have market participants analyzed the provision? Some have questioned whether under this statutory structure a TIFIA loan is ever truly subordinated, irrespective of the transaction documentation, to other project debt. Others have urged U.S. DOT, through covenants in the loan agreement, to minimize or eliminate the provision's effect. Still others have concluded that the provision is not a significant impairment to senior financing.

Default and Non-Subordination

There is a widespread perception that "if there's a default, the TIFIA lien springs to parity." That is simply incorrect.

The TIFIA statute has no effect on the negotiated contractual relationship between the senior debt and the TIFIA loan in a mere default situation. Financial deterioration must move beyond – in most cases, well beyond – a default into "bankruptcy, insolvency, or liquidation." A default alone, including a payment default, never of itself creates the conditions for the TIFIA non-subordination provision to come into play.

TIFIA's Credit Risk Window

Perhaps it is most useful to look at the statutory non-subordination provision in the context of the TIFIA program structure. In the interest of building and advancing more transportation infrastructure, the TIFIA program permits the Federal government to take non-investment grade credit risk. But the statute sets bounds on how much risk the government can take in two key ways. First, by capping at 33 percent of total project cost the amount of TIFIA credit support, the statute limits the *amount* of the government's exposure related to any single project. Second, the statute establishes, in effect, a minimum standard for the credit *quality* that U.S. DOT may accept in each project. This minimum standard is established through the interplay of two statutory provisions: 1) the investment grade rating requirement for the senior project obligations (if there are no project obligations senior to the TIFIA facility, then the TIFIA facility itself must be rated investment grade); and 2) the non-subordination provision.

The mechanism of the first credit standard, the investment grade rating, is straightforward: if the project is so speculative that even senior project debt is non-investment grade, the highly speculative credit quality of the project's subordinate debt creates more credit risk than TIFIA permits. The mechanism of the second credit standard, the non-subordination provision, is best understood by examining the rating agencies' approach to project finance credit analysis.

The Rating Agencies' Credit Analysis Approach

The rating agencies have commented on the potential effect of the TIFIA non-subordination provision. Although expressed in different ways, their comments generally support U.S. DOT's view that in project financings appropriate for TIFIA credit assistance, the non-subordination provision does not materially impair the credit of the senior project debt; in fact, its addition to the project's capital structure enhances both the senior debt and overall project credit strength.

All three rating agencies begin their credit analysis of any project financing with the proposition that the project assets (as might be valued in a liquidation scenario) have a relatively low value relative to the project's going-concern value. Thus, they evaluate a project finance credit based on the project's expected cash flow. The effect of this approach is that stronger credits, those with less speculative cash flows, are not significantly adversely affected by the TIFIA non-subordination provision.

Bryan Grote Departs TIFIA JPO

The TIFIA program, at least for the near term, must contemplate a future without Bryan Grote who left his position as chief of the TIFIA Joint Program Office (JPO) on August 24, 2001. Bryan was instrumental in helping conceive, develop, and grow the TIFIA program, which although still in its infancy, is providing significant leverage to major surface transportation projects. His impact on TIFIA and the U.S. DOT's innovative finance program has been profound, and he leaves a legacy of commitment to the Department's role in helping finance the nation's transportation system. His leadership, keen intelligence, and insight will be missed. Max Inman, Chief of the Financial Management Division, will head the TIFIA JPO on an interim basis.

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TIFIA Non-Subordination: Where Are We Now?, continued from page 2

Projects with weaker credits, on the other hand, bear a greater risk that their speculative cash flows will not materialize – and consequently a greater risk that the TIFIA non-subordination provision will come into play.

It is only the projects with the weakest credits that may be affected by TIFIA's non-subordination provision. In some cases, that provision may impair the credit rating and the marketability of the senior project debt. But those projects likely are outside U.S. DOT's range for acceptable credit risk. The senior debt for stronger projects – those less likely to experience cash flow problems – should not be materially impaired by the non-subordination provision in the TIFIA credit facility.

U.S. DOT's Programmatic Approach

When the Federal government acts as a lender in a transaction, it is not a conventional creditor. Its motivations are not purely financial, but leavened by policy considerations. Consequently, the Federal government can be expected to behave differently when financial problems occur. In general, it is likely to be a more forbearing lender than would a commercial creditor. That does not mean, however, that U.S. DOT considers TIFIA facilities to be "soft" loans. To the contrary, U.S. DOT attempts in every TIFIA negotiation to produce a credit agreement that maximizes, consistent with the Department's transportation policy objectives, the prospect for ultimate repayment to the Federal government.

In practice, the effect of the statutory non-subordination provision is to ensure that U.S. DOT's borrowers take seriously their Federal indebtedness and, in the event of financial difficulty, engage U.S. DOT in serious workout negotiations. Since the U.S. DOT's interest is in building transportation projects, it is difficult to envision a circumstance where the Department would want to use its position as a creditor to cripple a project's viability as an operating transportation facility. The TIFIA statute empowers the Secretary to engage in workout negotiations, and it specifically authorizes him to offer debt service deferral for up to 10 years after the project's substantial completion in the context of a workout plan that offers the government "reasonable assurance of repayment" [§183(c)(4)(A), (C)]. U.S. DOT has a clear policy interest in engaging its borrowers in workout negotiations before availing itself of its non-subordination rights, and it has the statutory authorization to make those workout negotiations meaningful from the borrower's standpoint.

In short, in U.S. DOT's view, the purpose of the non-subordination provision is not to elevate the Department's credit position in times of financial disaster, but to ensure that borrowers will – long before financial disaster is imminent – engage in meaningful restructuring negotiations.

Actual incorporation of the TIFIA non-subordination provision into transaction documentation has varied, depending on the unique aspects of the specific deal. What U.S. DOT has not done, and cannot do, however, is contractually agree never to avail itself of the additional security the statutory non-subordination provision provides.

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TIFIA TRIVIA

The "TIFIA Trivia" box provides responses to questions posed by our readers and other observers. We hope you find this "TIFIA Trivia" section useful and that you will submit questions to either of the ***IFQ*** co-managing editors (Max Inman or Suzanne Sale, FHWA, at 202/366-0673).

Question

What are some important features of a TIFIA credit structure?

Answer

- Through TIFIA, U.S. DOT is a minority investor – by statute, credit assistance is limited to 33 percent of project costs.
- Payment terms are flexible: debt service payments (but not necessarily principal amortization) must begin within five years of project completion, may be structured according to project cash flows, and may extend until 35 years following completion. If the project fails to generate sufficient revenue during "ramp-up" to make scheduled loan payments, the Secretary may allow such payments to be deferred (with interest accruing) during the 10-year period following substantial completion.
- Although significant flexibility exists (e.g., five-year grace period for beginning of debt service, back loaded payments, extended maturity), the amortization schedule will be structured according to the project's needs. For projects with tax-based revenues, the sponsor should not expect U.S. DOT to automatically agree to the most lenient terms permitted by the statute.
- U.S. DOT will closely examine the disposition of residual revenues (remaining after satisfaction of operating and maintenance and debt service expenses). Unless U.S. DOT is receiving at least current interest on the TIFIA loan, residual revenues generally may not be "freed up" for returns on equity contributions or other purposes desired by the project sponsor.
- It is important to note Congressional intent relative to the repayment structure for TIFIA credit assistance as reflected in the TIFIA Conference Report – "The Conference would like the Secretary to encourage Federal borrowers to prepay their direct loans or guaranteed loans as soon as practicable from excess revenues or the proceeds of municipal or other capital market debt obligations."

SIB Highlights

Florida's SIB Program Enhances Its Flexibility

Through the creation of a state-funded SIB, Florida has added to the flexibility of its already active SIB program. Florida's SIB is a revolving loan and credit enhancement program consisting of a Federal-funded SIB account and a state-funded SIB account. The Federal-funded SIB is capitalized with Federal money matched with state money as authorized under Section 1511 of TEA-21, while the state-funded SIB is capitalized with state money only. In June of 2000, Governor Jeb Bush signed a bill into law to create Section 339.55, Florida Statutes, which authorized and funded a state-funded SIB. This SIB will be capitalized with $50 million per year from state funds for state fiscal years 2001 through 2003.

The Florida SIB can leverage funds through loans and credit enhancement assistance to improve project feasibility. The amount of any loan or other assistance may be subordinated to other debt financing for a project with an investment grade rating of "BBB" or higher. Loans from the SIB may bear interest at or below market interest rates, as determined by the Florida Department of Transportation (FDOT). In order to receive financial assistance from the SIB, a public or private entity must submit an application to FDOT. Awards are made based on project priority, project feasibility, ability to repay the loan, and the amount of funds remaining in the balanced SIB finance plans. Applications for SIB loans may be accepted at any time during a fiscal year and evaluation and awards for SIB loans will be processed up to twice each year.

Since inception of the state-funded SIB in June 2000, Florida has completed two application cycles with set timeframes for applications and awards. During the first award cycle ending October 2000, FDOT received 15 applications and awarded eight projects. During the second award cycle ending April 2001, FDOT received 16 applications and awarded five projects.

Since FDOT provides transportation services to the public and does not serve as a private bank, below market rate loans are a subsidy FDOT has been willing to provide to further develop transportation projects that can be delivered earlier, or that may not otherwise be built to better serve the traveling public. FDOT requires that the project sponsor propose an interest rate pertaining to the loan and repayment stream. The net present value of the repayment stream is a key component of the evaluation of the loan when awards are made.

Florida is currently developing a web-based SIB application process and project sponsor progress reporting features to better serve loan applicants and recipients. These program enhancements will be operational later in 2001.

Two examples of successful projects awarded loans through the Florida SIB are:

- **Regional Intermodal Center in Downtown Orlando.** The Regional Intermodal Center will function as the focal point for the Central Florida Regional Transportation Authority's LYNX three-county service area. The new center will replace the existing regional bus terminal and facilitate connectivity between existing and proposed transportation modes such as rail. Project costs total $29.2 million with state-funded SIB loan assistance of $7.96 million at an interest rate of five percent. LYNX currently does not have senior debt, but may issue debt senior to the SIB loan with the concurrence of FDOT. LYNX representatives affirm that "the State Loan program ... provides transit agencies the opportunity to leverage funding and generate additional funding sources for buses and other capital improvements. The ability to secure a loan at below market rates, to match a grant and to advance a major intermodal facility project several years ahead of schedule is significant for the region."

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State Infrastructure Bank Loan Agreements by State

As of September 2001

State	Number of Agreements	Loan Agreement Amount ($000)	Disbursements to Date ($000)
Alaska	1	$2,737	$2,737
Arizona	28	303,375	164,154
Arkansas	1	31	31
Colorado	2	400	400
Delaware	1	6,000	6,000
Florida	32	465,000	94,000
Indiana	1	3,000	0
Iowa	1	739	739
Maine	23	1,780	759
Michigan	23	17,034	13,033
Minnesota	7	66,124	29,581
Missouri	10	69,251	66,754
Nebraska	1	1,500	0
New Mexico	1	541	541
New York	2	12,000	12,000
North Carolina	1	1,575	1,575
North Dakota	2	3,565	1,565
Ohio	35	146,624	102,550
Oregon	9	11,483	11,181
Pennsylvania	15	14,600	14,600
Puerto Rico	1	15,000	15,000
Rhode Island	1	1,311	1,311
South Carolina	5	1,502,289	510,428
South Dakota	1	11,740	11,740
Tennessee	1	1,875	1,875
Texas	32	80,001	69,617
Utah	1	2,888	2,888
Vermont	3	1,030	0
Virginia	1	18,000	18,000
Washington	1	700	0
Wisconsin	2	1,188	1,188
Wyoming	5	49,090	32,614
	250	**$2,812,471**	**$1,186,861**

Note: Includes both Federal and State SIB programs.

SIB Activity Approaches $3 Billion, continued from page 4

- **Lee Roy Selmon Reversible Express Lanes**. This project for the Tampa Hillsborough County Expressway Authority (THCEA) will increase urban traffic mobility in a highly congested area of Tampa to the Port of Tampa by improving access and adding needed capacity to the expressway during peak travel periods. The project will utilize reversible auto-only lanes and electronic tolling and lane management without the need for any additional right-of-way. The total project cost is $290.8 million with state-funded SIB loan assistance of $35 million at an interest rate of 3.5 percent subordinated to senior debt rated "A" by the international bond rating agencies. THCEA may issue additional debt senior to the SIB loan with the concurrence of FDOT. THCEA officials state that "the subordinate loan program ... permits 'gap' funding until project revenues ramp-up and reliable (bondable) toll revenue streams are established. Also, projects are completed many years earlier, thus generating new transportation funding (toll revenues) and most importantly delivering needed facilities to the customer."

In total, the Florida SIB has awarded loans to 32 projects. As shown in the table below, Florida has leveraged $3,034 million in transportation projects with $465 million in SIB funding. This is a significant return on investment (6.5 times) that is providing valuable transportation assets and options to the traveling public in Florida.

More information about the Florida SIB is available at www.dot.state.fl.us/financialplanning/sib.asp.

Contact:
Lowell Clary,
Florida Department of Transportation,
850/414-4455.

Minnesota's Transportation Revolving Loan Fund

Minnesota's SIB, referred to as the Transportation Revolving Loan Fund (TRLF), was established in 1997 to provide loans and other financial assistance to cities, counties, the state, and other governmental entities for all phases of Federal-aid eligible transportation projects. Borrowers can pledge any type of repayment source. However, the TRLF is restricted from providing financing for toll or congestion pricing projects.

The Minnesota Department of Transportation (Mn/DOT) and the Minnesota Public Facilities Authority (MPFA, the agency that administers Minnesota's Waste Water and Clean Water revolving loan funds) jointly administer the TRLF. Mn/DOT evaluates the technical merit of project applications, while the MPFA evaluates the financial merit. This interagency partnership enabled Mn/DOT to develop and operate the TRLF without the addition of any staff.

To date, the TRLF has been capitalized with approximately $58.5 million (a $3.5 million Federal grant, $31.5 million in Federal ISTEA advance capitalization funds, $16.5 million in state general funds, and $7 million in state trunk highway funds). These funds have been leveraged through the sale of revenue bonds to enable the approval of over $110 million in loans to 21 projects.

Seven of these 21 projects are currently under agreement, with an additional 10 expected to close by the end of the calendar year. These projects range from a $535,000 loan to a city with a population under 5,000 for approach work on a Federal-aid bridge project to a $15 million loan to Mn/DOT for advance acquisition of right-of-way to preserve a new principal arterial corridor.

Also of note is a $21 million leveraged loan from the TRLF's Transit Account to the Metropolitan Council (the Twin Cities' metropolitan planning organization) for the completion of 53 transit capital projects ranging from vehicle rehabilitation to bus lane and shelter construction. The interest rate for the loan is 2.71 percent. The repayment source is regional property taxes, and the repayment term is variable depending on the useful life of the projects. It is estimated that the Metropolitan Council will save approximately $4 million over other financing options.

Overall, the TRLF has been a very successful tool for enabling the timely completion of transportation projects that lack current funding.

Contact:
Brad Larsen,
Minnesota Department of Transportation,
651/282-2170.

Florida Department of Transportation – State Infrastructure Bank

As of June 30, 2001

Type of SIB	Number of Projects Awarded	Total Project Costs	Total SIB Assistance	Amount Disbursed	Repayments Received
Federal	22	$2,246 million	$304 million	$48 million	$12 million
State	10	$794 million	$161 million	$46 million	$0 million
Total	**32**	**$3,040 million**	**$465 million**	**$94 million**	**$12 million**

GARVEE ROUNDUP

GARVEEs In Action

States are continuing to advance highway projects using the Grant Anticipation Revenue Vehicle (GARVEE) tool. The **Arkansas** State Highway Commission issued $185 million in direct GARVEE bonds on July 10, 2001 to finance a new round of Interstate rehabilitation projects. This is in addition to the $175 million in GARVEE bonds issued last year. The last piece of Arkansas' currently authorized $575 million GARVEE program will be sold in 2002. Through June 2001, 32 projects have been contracted to improve 224 miles of Arkansas' Interstate System. The three-year program will improve a total of 380 miles of Interstate highways in the state.

The Governor of **Georgia** announced plans in late June for an $8.3 billion statewide transportation program that will be funded in part through GARVEE bonds. The program includes adding more miles of high-occupancy vehicle, or HOV, lanes in the metropolitan Atlanta region and transit improvements. While Georgia officials are still working out the details of the financing plans, the use of GARVEEs is expected to shorten project completion times from 17 to 22 years to as few as seven years.

The **Montana** Transportation Department is considering using GARVEEs to fast-track a $125 million reconstruction project on U.S. 93. The GARVEEs are expected to be issued in late 2003 or early 2004. The issuance will not require new legislation since Montana has had statutory authority to issue highway construction bonds since the early 1980s. While the existing legislation grants the authority to issue debt, it does not specify which funds must be pledged for repayment of that debt (state or Federal).

The **Ohio** Department of Transportation, the first state to leverage Federal funds through GARVEEs, is planning to sell a third GARVEE issue of $100 million in mid-September. Looking ahead, three additional bond issues are planned for the 2002-2004 period.

Contact:
Jennifer Mayer,
FHWA Western Resource Center,
415/744-2634.

GARVEE Transactions to Date (July 2001)

State	Date of Issue	Face Amount of Issue	Rating Moody's/ S&P/Fitch	Projects	Backstop Financed
New Mexico	Sep–98 Feb–01	$100.2 million $18.5 million	A3/A–/na A2/A/na	New MexicoState Route 44	No backstop; Bond insurance obtained
Ohio	May–98 Aug–99	$70 million $20 million	Aa3/AA–/AA–	Spring-Sandusky Project	Moral Obligation pledge to use state gas tax funds and seek general fund appropriations in the event of Federal shortfall
Arkansas	Mar–00 Jul–01	$175 million $185 million	Aa2/AA/na Aa2/AA/na	Interstate Highways	Full faith and credit of state, plus state motor fuel taxes
Colorado	May–00 Apr–01	$537 million $506.4 million	Aa3/AA/AA	Any project financed wholly or in part by Federal funds	Federal highway funds as allocated annually by CDOT; Other state funds
Arizona	Jun–00 May–01	$39.4 million $142.9 million	Aa3/AA–/AA– Aa3/AA–/AA–	Maricopa freeway projects	Certain sub-account transfers
Total		**$1,794.4 million**			

Innovative Finance Website Unveiled

The National Cooperative Highway Research Program (NCHRP) Innovative Finance Clearinghouse –

Innovative Finance.org

– was officially launched on June 15, 2001. The web site is available at http://www. innovativefinance.org/ and provides comprehensive information on all aspects of innovative surface transportation finance.

FHWA, Federal Transit Administration, and Federal Railroad Administration have all supported the creation of the site by making materials and links available for posting, as have several state DOTs.

The site is updated on a month-ly basis. All ***IFQ*** readers are encouraged to use the site as a regular reference and to enrich it by sharing their own innovations with InnovativeFinance.org.

GARVEE "Questions of the Quarter"

Each issue of ***IFQ*** features questions and answers on the GARVEE program. This issue focuses on limits set on GARVEEs. Note that answers to these questions are not regulatory or legislative, but represent FHWA's current administrative interpretations. If you have questions or want to confirm any of this information, please contact your local FHWA Division office, or the GARVEE contacts listed in the Fall 2000 issue of ***IFQ***. GARVEE guidance is also available at www.fhwa.dot.gov/innovativefinance/garguid1.htm.

Where can GARVEEs be found in legislation or regulations?

The term "GARVEE" was invented by FHWA, so it does not appear in any legislation. The legal authority to reimburse debt and interest is found in Section 122 of Title 23 of the United States Code.

Are GARVEEs backed by a Federal guarantee?

No, there is no Federal guarantee for GARVEEs. GARVEEs can only be backed by a pledge of the state or local government, or other issuing entity.

Does FHWA set limits on GARVEE amounts?

No, neither legislation nor administrative policy sets limits on GARVEE amounts.

What is a recommended/suggested guideline on the proportion of future Federal-aid apportionments to be dedicated to repayment of GARVEE debt?

There is no official guidance or recommendation on this. Many states have tended to limit the percentage in some fashion, ranging from 10 percent to 50 percent.

Does FHWA set limits on GARVEE terms?

No, neither legislation, regulations, nor administrative policy limits GARVEE terms. The market determines what term is an acceptable risk, and over how many anticipated highway funding reauthorizations a debt instrument should span.

What is a recommended/suggested term limit for GARVEE debt?

There is no recommended or suggested term. Most states have issued debt between 10 and 15 years. Since highway reauthorization bills typically have covered four to six years' worth of funding, most GARVEEs to date will probably span two to three highway authorization periods.

Does FHWA set limits on GARVEE interest rates and issuance costs?

No, all interest and issuance costs are eligible. State and local governments will use their own procedures to ensure that interest rates and issuance costs are reasonable, based on current market conditions.

EVENTS AND RESOURCES

FHWA Workshop Announcements

The American Road & Transportation Builders Association's (ARTBA) **13th Annual Conference on Public-Private Ventures** will be the venue for a FHWA workshop focusing on the building blocks of innovative finance. The 2001 Public-Private Ventures Conference is being held at the Hyatt Regency on Capitol Hill, October 10-11, 2001. The half-day workshop is scheduled from 8:00 to 11:45 a.m. on October 10, at the beginning of the Conference's two-day program.

The workshop will provide a comprehensive overview of innovative finance, featuring the "tools in the toolbox" and how they can be applied to meet transportation funding needs. The workshop will feature a roundtable discussion with transportation experts, providing an opportunity for interactive dialogue on a wide spectrum of innovative finance issues.

More information is available on the conference web page: http://www.artba.org/meetings_events/2001/ppv/ppv_2001.htm

Contact:
Michael F. Martin, ARTBA, 202/289-4434.

The Transportation Research Board's (TRB) Committee on Taxation and Finance and FHWA will be co-sponsoring a **Transportation Project Finance Workshop** in Washington, D.C. on Sunday, January 13, 2002 from 1:30 to 5:00 p.m. at the Washington Hilton in the International East Room. This workshop is being held as part of TRB's 81st Annual Meeting from January 13-17, 2002.

The workshop will address the latest developments in innovative financing techniques, covering a range of approaches from GARVEEs to TIFIA. The emphasis will be on applying the tools and best practices.

More information is available on TRB's web page: http://www4.trb.org/trb/annual.nsf

Contacts:
Jon Williams or Mary Kissi, TRB, 202/334-3205.

TECHNICAL CORNER

Concessions: An Option to Reduce Project Costs and Accelerate Major Projects

Given the significant unfunded transportation infrastructure needs in this country, governments at all levels are exploring more innovative financing and contracting approaches to stretch limited resources. In the 1990s, new partnerships between the private and public sectors emerged, facilitated by a more favorable legislative and regulatory framework at both the Federal and state levels. While there has been progress in advancing transportation infrastructure investment through new financing tools and partnership models, there are a number of public-private approaches that offer untapped "potential" for accelerating transportation projects and reducing costs. One such approach, used in Europe for several decades, is the concession concept.

Concessions are a contracting arrangement where a government executes a long-term contract for the construction and operation of highways and bridges. In Europe, the concession concept has been an effective alternative to conventional contracting techniques. For example, concessions were used in France between 1960 and 1997 to build a 6,500 kilometer expressway network. In addition, Portugal is currently using 16 concessions to complete its primary national network. Concessions also have been used extensively in Mexico and South America, to construct and operate major transportation facilities such as toll roads, bridges, and airports.

Concessions are typically awarded to a private or quasi-private company for a long-term period, generally ranging from 10 to 35 years. Companies receiving these contracts – referred to as "concessionaires" – agree to perform one or more of the design, build, operate, finance, and maintainance activities for a given project over the contractual term. At the conclusion of the contractual term, the concession is either extended or the underlying transportation facility is turned over to the state. Concessionaires bear project risks, including the risks inherent in construction and traffic projection, and are paid by the state in several ways. Payments to concessionaires are based on either facility usage/availability or a negotiated payments schedule, as defined in the contract documents.

Benefits of Concessions

In general, concessions can provide several key advantages over traditional contracting for the construction and operation of transportation facilities: 1) project costs are reduced; 2) project completion dates are accelerated; 3) project risks are assumed by concessionaires; 4) private sector efficiencies, innovation, and expertise flow/accrue to the state; and 5) private sector financing augments the capital otherwise available to the state.

The decades-long European experience with concessions bears out these advantages. For example, in the United Kingdom, significant project cost savings were shown to be afforded through concessions. Specifically, one report on the U.K. experience concluded that projects completed by concessionaires cost up to 30 percent less than projects directly managed by the government. In Portugal, the national concession program has allowed the government to complete its primary national system up to eight years faster than had the conventional budget allocation and project construction processes been used.

One reason for the success of concessions in Europe is that private sector firms can borrow at interest rates very similar to those paid by governments. In the United Kingdom, for example, the difference is under one percent. Because European governments, unlike their counterparts in the U.S., are not authorized to issue tax-exempt bonds they do not benefit from the lower interest rates of such borrowings. Accordingly, the interest rate gap between public and private borrowings in Europe is small, and private companies can "recoup" their

Prominent Concession Developed Road-Related Infrastructure Projects

Project Name	Project Location	Year Opened	Concession Period
The Prado-Conrdage Tunnel	Marseille, France	1993	32 Years
The Confederation Bridge	Prince Edward Island, Canada	1997	35 Years
The Vasco da Gamma Bridge	Lisbon, Portugal	1998	33 Years
A50 Shadow Toll Road	Stoke to Derby Link, UK	1998	30 Years
The Highway 91 Express Lanes	California, United States	1999	35 Years
The Johannesburg Maputs (N4) Highway	Southeast Africa	1998-2000	30 Years
N.V. Westerscheldo Tunnel	Westerschelde River, The Netherlands	2003	To be sold by LLC after construction

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slightly higher interest costs through the many efficiencies and innovation inherent in private sector operations.

Concessions in the United States: What Are the Issues?

An apparent challenge to implementing a concession program in the U.S. is the gap between the cost of public and private financing. In other words, while states can issue tax-exempt municipal bonds at very low-interest rates, private firms must pay the higher rates prevailing in the corporate market. For example, in mid-2001, states could issue bonds with a 10 to 12-year maturity at rates of four percent or less, depending on their overall credit rating and the underlying collateral. Private sector borrowings, however, carried substantially higher rates; in mid-2001, private sector borrowers often paid seven percent or more for the same 10 to 12-year instrument.

In order to successfully launch a U.S. concession program, a strategy needs to be developed to bridge this interest rate gap and "marry" the efficiencies of the concession program to the benefits of tax-exempt, low-interest rate borrowing. For example, the financing phase of the project could be undertaken by an entity legally authorized to issue tax-exempt debt. However, all other portions of the project – design, construction, operation, and maintenance – could be the responsibility of the concessionaire.

Basic Implementation Steps for a Concession Procurement Approach

- State enacts enabling legislation, if required.
- State issues a request for letters of interest from the engineering, construction, and finance community to assess the level of industry interest and allow time for teams to form.
- State issues requests for qualifications/requests for proposals (RFQ/RFP) to potential concessionaires for one or more of the following activities: design, construction, operation and/or maintenance; the RFQ/RFP could solicit private involvement in a range of projects or could target participation in a specific project.
- Potential concessionaires submit bids/proposals to the state, which then follows its regular evaluation and selection process.
- State provides capital or a 63-20 corporation issues tax-exempt debt to reduce project financing costs.
- State takes appropriate steps to ensure that the legal structure of the concession does not impair the tax-exempt status of any state borrowing.
- If financing is through a 63-20 structure, the state takes appropriate steps to ensure that the concession's scope is defined as project/program management to ensure a 63-20 corporation's operational responsibility and related tax-exempt status.

This differs from the European model, where concessionaires typically agree to finance all or part of the project.

Entities authorized to issue tax exempt debt in the U.S. typically fall into two main groups: 1) states and local governments and 2) so-called 63-20 corporations. States and local governments have a long history of issuing tax-exempt debt, and often use this authority to issue bonds to finance needed transportation projects. Similarly, 63-20 corporations, which refer to single-purpose, not-for-profit corporations established under Ruling 63-20 of the Internal Revenue Code, are legally entitled to issue tax-exempt debt on behalf of the public entity and thereby benefit from the same low interest rates paid by states and municipalities. Such 63-20 corporations have recently been used in South Carolina and Virginia to finance major transportation projects (see ***IFQ***, Volume 6, No. 2, Summer 2000 for a description of Virginia's Pocahontas Parkway project, financed by a 63-20 corporation).

Where a state chooses to raise the needed project capital through a 63-20 approach, care should be taken to structure the transaction in a way that does not jeopardize the borrowing's tax-exempt status. Under current law, the Internal Revenue Code limits the extent to which a private concessionaire may be employed on a project seeking to access the tax-exempt bond market. Where a 63-20 corporation is used to raise the necessary capital, the concession arrangement may need to be defined as a fee-based management contract, so that the corporation retains operational responsibility and its ability to issue tax-exempt debt.

Where Do We Go From Here?

Over the last decade, transportation legislation and policies at both the national and state levels provided opportunities for encouraging greater private sector involvement in transportation development and operation. Emphasis should continue on removing the barriers to private investment and developing implementation strategies for building highway facilities through new contracting approaches, such as the concession model.

A more responsive legislative environment could facilitate new public-private partnerships. In some states, enabling legislation is needed in order to implement concessions. Implementing legislation typically determines the kinds of partnership arrangements into which the government can enter and prescribes the procurement process. Also it should be recognized that strong public sector support among key stakeholders (the state DOT, the legislature, and the Governor's office) and extensive outreach are important to the success of any public-private partnership.

Changes in the tax code could help make the concession approach more financially feasible. In this regard, draft legislation, entitled the Multimodal Transportation Financing Act (Multitrans), was introduced in the U.S. Senate in May 2001. The Act provides tax incentives for public-private partnerships in financing highway, mass transit, high-speed rail, and intermodal transfer facilities projects. This bill would lift the current restrictions on tax-exempt bond financing for public agencies seeking greater private participation in these types of projects.

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Finally, FHWA as part of its Special Experimental Project No. 14 (SEP-14) continues to encourage the use and evaluation of promising innovative contracting practices proposed by state transportation and highway agencies and others. FHWA as a joint industry effort recently conducted a European study tour to gather "best practices" information on innovative contracting and financing. The report, which will provide more comprehensive information on the European experience with concessions, will be issued in Spring 2002. These Federal initiatives to promote innovative contracting practices can foster positive changes to our traditional ways of doing business and result in worthwhile improvements that will benefit the Nation's highway users.

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TIFIA JPO Adds a Veteran Banker

On May 7, 2001, Ms. Cheryl E. Jones joined the TIFIA Joint Program Office (JPO) as a Project Finance Advisor. Ms. Jones, who has more than 25 years experience in public finance investment banking and advisory work, has managed varied financings during several tax law eras, priced securities under a broad variety of changing market conditions, and implemented a wide range of innovations. She has served as senior manager or financial advisor for more than $40 billion of tax-exempt and taxable securities for transportation, real estate, economic development, education, water and sewer, public power, airport and seaport, and general government issuers. Ms. Jones graduated from Boston University and holds an Ed.M. from Harvard University and an MBA from Columbia University. With the addition of Ms. Jones to the TIFIA JPO, which already includes Suzanne H. Sale and Robert C. Brown, the U.S. DOT now has three capital market finance experts on its staff.

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