FHWA's
INNOVATIVE FINANCE
Quarterly

MIRIAM ROSKIN, EDITOR
MAX INMAN, FHWA MANAGING EDITOR

VOL. 3, NO. 1
SUMMER 1997

Welcome to
INNOVATIVE FINANCE QUARTERLY

Welcome to the inaugural issue of *Innovative Finance Quarterly* – an expanded version of the innovative finance newsletter you've received in the past, either on-line or in print. As always, our goal is to keep you current on cutting-edge strategies for financing highway and transit projects both large and small. With this issue, however, we extend the publication to six pages, introduce some new features, and provide a greater diversity of general interest and technical articles.

Each issue of the new, expanded *IFQ* will typically include the following features:

- Legislative Spotlight: update on relevant actions and proposals on Capitol Hill.
- State Infrastructure Bank Status Report: overview of SIB capitalization, project loans, and credit enhancements offered to date.
- Case Studies: a different project, financing mechanism, or "best practice" each quarter.
- Technical Corner: an in-depth review of a selected financial topic.
- Resource Referrals: suggested places to turn for answers to your toughest innovative finance questions.

In addition, look for special one-time features in each issue. This edition of *IFQ*, for example, provides a *SIB Special* that explores the recent expansion of the SIB pilot program.

We hope you enjoy *Innovative Finance Quarterly*.

We want to know what you think. Please write to us with any comments about the types of information that are most useful to you. We are also soliciting questions for potential inclusion in a question-and-answer column to be included in future issues (we'll respond to your question regardless of its publication in *IFQ*). You may direct your comments and questions to:

Miriam Roskin
Porter & Associates, Inc.
Seattle, WA
Phone: 206/441-9808
E-mail: Miriam.A.Roskin@fhwa.dot.gov

Laurie Hussey
Cambridge Systematics, Inc.
Cambridge, MA
Phone: 617/354-0167
E-mail: llh@camsys.com

In this issue. . .

LEGISLATIVE SPOTLIGHT Transportation Infrastructure Finance and Innovation Act of 1997

On June 25, Senator John Chafee, Chairman of the Senate Environment and Public Works Committee, introduced the Transportation Infrastructure Finance and Innovation Act of 1997 (TIFIA, S.963). The goal of the bill, co-sponsored by Senators Graham, Boxer, Bennett, Hatch, Moynihan, and Lieberman, is to address the funding shortfall for large new transportation investments by providing new tools – secured federal loans, loan guarantees, and standby lines of credit – to project sponsors. While doing so, the bill seeks to make the most of limited federal resources by inducing private and non-federal capital to stimulate new investment in transportation infrastructure.

Program Description and Scope

The federal credit program would complement the State Infrastructure Bank program and other innovative financing techniques by directing resources to transportation investments of critical national importance – intermodal facilities, highways, intercity rail projects, and other investments with national benefits – that otherwise might be delayed or not constructed at all because of their size, complexity, and uncertainty over timing of revenues.

The program would use $800 million in federal budget authority over six years to support as much as $16 billion in federal credit assistance for public and private project sponsors. With the federal role being capped at 33 percent of total project costs, the program could stimulate nearly $50 billion in new transportation investment. The program could be an important step in closing the current funding gap and supporting the national economy in an era of constrained public resources.

Eligibility Requirements

The U.S. Department of Transportation (USDOT) would be responsible for administering the program and selecting projects. To qualify for assistance under TIFIA, a project would have to:

- Be an eligible surface transportation project under Title 23 or chapter 53 of Title 49 of the U.S. Code;
- Be included in a state transportation plan and the approved State Transportation Improvement Program;
- Cost at least $100 million (the threshold for intelligent transportation systems – ITS – projects is $30 million) or 50 percent of the state's most recent apportionment of federal-aid highway funds, whichever is less; and
- Be supported in whole or in part by user charges or other non-federal dedicated revenue sources.

In addition, the project sponsor would have to provide a preliminary rating opinion letter from a nationally recognized bond rating agency. Projects meeting the initial threshold criteria would then be selected based on their ability to generate economic benefits, support international commerce, or otherwise enhance the national transportation system.

Financial Products

Under TIFIA, USDOT could offer secured loans, loan guarantees, and standby lines of credit. *Secured loans* would be structured with flexible repayment terms (allowing sponsors to defer principal and interest payments for up to 10 years) to match project revenues, and would improve the caliber of the senior debt by offering financing on a junior-lien basis. The loans could be in an amount up to 33 percent of the cost of a project and have a final maturity date as long as 35 years after construction. Interest rates on loans would be established at the time loan agreements were executed and would be set at the prevailing yields on U.S. Treasury bonds issued for comparable terms. After substantial completion of a project, the Secretary of Transportation would have the chance to sell or reoffer the loan into the capital markets, provided that the reoffer could be made on favorable terms.

In lieu of a direct loan, USDOT could provide a federal *loan guarantee* to encourage capital market investments in transportation infrastructure. Similar to the secured loans, the loan guarantees would secure debt with flexible repayments terms, improve the rating on the senior debt, and attract non-federal financing by limiting the federal role to 33 percent of the total cost of a project. The interest rates on the private debt, however, would be determined by the borrower and lender, subject to the approval of the Secretary of Transportation.

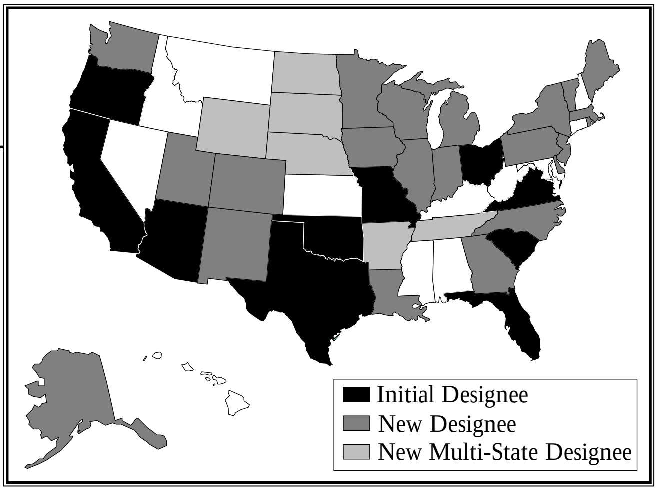
USDOT could also provide a *standby line of credit* to assist projects in attaining an investment-grade bond rating and securing bond insurance by providing a secondary source of capital during the first 10 years following project completion. The standby line of credit would take the form of a future government commitment to make one or more direct loans. If drawn upon, the proceeds could be used to support debt service payments, operating and maintenance costs, extraordinary repair and rehabilitation costs, and costs of unexpected environmental requirements. The total line could not exceed 33 percent of project costs. Up to 20 percent of the line could be loaned in any given year, and any draws would need to be repaid from project-related revenues within 30 years of project completion.

continued page 6

SIB SPECIAL SIB Pilot Expands

New States, New Money

At a White House briefing held on June 19, 1997, Vice President Gore announced USDOT's approval of 29 new participants in the State Infrastructure Bank (SIB) pilot program. This brings total participation in the pilot program to 38 states plus Puerto Rico, as shown in the map below. The group of 39 includes two regional infrastructure banks. In these cases, two or more states have banded together to form a SIB that will serve multi-state transportation needs.



New Allocations Announced

When Vice President Gore announced the new SIB participants, he also announced the distribution of an extra $150 million made available for SIB capitalization. These allocations are highly flexible, as the funds may be used to capitalize highway accounts, transit accounts, or both, at each state's discretion.

The $150 million will be distributed among the states in accordance with each state's plans to use other eligible federal transportation funds and non-federal funds to capitalize their banks. This method of distribution creates a favorable environment for fast-moving projects, as a state that shifts regular grant funds into its SIB has a strong incentive to advance SIB-assisted projects especially quickly. Irrespective of other funding plans, each new participant is guaranteed a minimum share of $1.5 million, and each of the initial 10 participants is guaranteed a minimum share of $3.0 million.

The $150 million comes from the U.S. Treasury's General Fund rather than the Highway Trust Fund, and was appropriated for the SIB pilot program under the 1997 DOT Appropriations Act (PL 104-205) It is important to remember that the special General Fund allocations are merely a fraction of total federal funds available for use as seed capital. Each SIB participant can also transfer up to 10 percent of most categories of federal surface transportation funding into its SIB, using highway funds to capitalize SIB highway accounts, and transit funds to capitalize SIB transit accounts. Taking both General Fund and Trust Fund sources of funds into account, nearly $3 billion will ultimately be available for capitalizing the SIBs throughout the life of the pilot program.

The process by which regular federal highway apportionments are designated for potential transfer into the SIB is known as advance capitalization (ACAP). The advance capitalization process can be tricky, so this issue of *IFQ* presents a description of ACAP – what it is and how it works – as this quarter's Technical Corner (see page 4).

Technical Assistance Available

FHWA has prepared a set of materials designed to demystify the occasionally obscure mechanics of the SIB pilot. To date, these materials comprise:

(1) SIB primer – explains what SIBs are and how they may be used;

(2) SIB report to Congress – an early evaluation of the SIB pilot's progress as of March 1, 1997;

(3) State-by-state capitalization tables – display the maximum amount of federal funding that states may use to capitalize their highway accounts;

(4) A sample cooperative agreement – provides an example of a compact under which a state, FHWA, and/or FTA agree to basic implementation rules for the SIB's highway and/or transit accounts; and

(5) Sample state enabling legislation – provides an example of basic statutory language that some states need to establish their SIBs and potentially leverage the banks' holdings.

Additional materials are currently being developed. Copies of all materials are available from FHWA: contact the financial manager in your state's FHWA Division Office or Cynthia McDuffie at FHWA headquarters (202/366-0673) for copies. The report to Congress and other selected materials are also available through the innovative finance home page at "http://www.fhwa.dot.gov/innovativefinance".

The Federal Transit Administration (FTA) is also developing SIB transit related materials. Contact Paul Marx at 202/366-1675 for more information.

Contacts:
Max Inman, FHWA, 202/366-0673 or
Lucinda Eagle, FHWA, 202/366-5057.

SIB Financial Activity
August Update

SIB activity is on the rise, with the number of loans made by the pilot SIBs growing to five as of August 1, 1997. The following exhibit summarizes the key features of the loans and the projects they are assisting.

SIB Loans as of August 1, 1997

State	Loan Amount	Project	Project Value (estimated)
Ohio	$10,000,000	Butler Regional Highway	$120,000,000
Ohio	$10,000,000	Butler Regional Highway	
Ohio	$15,000,000	Butler Regional Highway	
Ohio	$7,800,000	Great Lakes Science Center Parking Facility	$7,800,000
Missouri	$1,180,000	Springfield Transportation Corporation	$33,000,000

Capitalization Activity

As of August 1, 1997, latest information available showed that the 10 initial states participating in the SIB pilot program had deposited a total of $80.4 million in federal highway funds into their banks' highway accounts. With non-federal matching funds, total SIB capitalization is more than $120 million. The 29 new SIB designees can begin capitalizing their banks once they have signed cooperative agreements with FHWA and/or FTA.

Other Developments

- State legislatures in Oklahoma, South Carolina, and Texas have all signed new legislation to broaden the types of financial assistance that their SIBs may provide. In Texas, for example, the new legislation gives the SIB, via the Texas Department of Transportation, the ability to 1) make loans to entities in addition to the Texas Turnpike Authority, and 2) issue bonds and other debt instruments in order to leverage the SIB's contributed capital.
- Section 350 of the National Highway System Designation Act of 1995 (NHS Act, P.L. 104-59) required USDOT to review the status of the SIB pilot program as of March 1, 1997. USDOT has recently released its report to Congress for general distribution. The report describes the 10 pilot states' actual and anticipated progress towards capitalization of their banks and provision of assistance to project sponsors. The report also discusses preliminary indications of the effectiveness of the SIB pilot program in increasing transportation investment levels, reducing project costs, and accelerating project completion. Please contact Cynthia McDuffie (202/366-0673) to obtain a copy of the report, or connect to the innovative finance home page at "http://www.fhwa.dot.gov/innovativefinance" and click on SIB Report to Congress.

TECHNICAL CORNER Advance Capitalization

Pressures to reduce the size of the federal deficit affect all aspects of the transportation funding. The SIB pilot is no exception. Subsection 350(g) of the NHS Act, the legislation that established the SIB pilot program, requires that annual expenditures of federal funds under the SIB pilot program mirror the pattern of expenditures assumed for other elements of the federal-aid program. To ensure that the pattern is upheld, only a portion of total funds eligible for transfer to the pilot program may actually be used as seed capital in any given year. Advance capitalization (ACAP) is the tool that allows states to capitalize their banks in accordance with the disbursement constraint imposed by subsection 350(g).

One key to understanding ACAP is to recognize that it is not a commitment. ACAP is patterned on advance construction – an existing federal-aid highway funding strategy – in that it merely preserves a given project's future eligibility for federal participation. In the case of the SIB pilot program, the SIB is considered to be the "project." Thus, all that an ACAP amount does is preserve the state's right to use current federal highway apportionments for the purposes of SIB capitalization at a later date.

When (and if) a state decides to convert all or part of an ACAP amount into actual SIB capitalization funds, the subsequent steps are *transfer*, *obligation*, and *outlay*. ACAP sets the stage for these steps by establishing the baseline against which these amounts are calculated. For federal highway funds, the maximum pattern of expenditure extends over nine years. In the first year of an ACAP amount's availability, transfers, obligations, and outlays may not exceed 15 percent of the

continued page 5

ACAP, continued from page 4

ACAP amount, and in subsequent years, 53%, 16%, 5%, 3%, 3%, 2%, 2%, and 1%, respectively. This outlay rate pertains to highway funds only; a different outlay rate is assumed for transit accounts.

The following example of the ACAP process is greatly simplified for the sake of illustration. It serves as a worksheet to describe how ACAP, the General Fund (GF) distribution approved under the 1997 DOT Appropriations Act, and the subsection 350(g) disbursement limitation interrelate and ultimately determine the level of funding available for obligation and expenditure each year.

A few hints:

ACAP Baseline

The amount shown is equal to 10 percent of apportionments and allocations for most federal-aid highway (FAH) program categories.

General Fund Distribution

1. The ACAP and transfer steps are not used for the GF allocation. Also, the disbursement limitation multipliers (15%, 53%, 16%, and so on) only take effect at the point of outlay. For regular ACAP requests, the disbursement constraint is applied at the point of transfer.
2. The example shows the GF allocation being used to capitalize the sample SIB's highway account. Readers are reminded that the GF allocation is available for capitalizing both highway *and* transit accounts.

Obligations

The example shows the state choosing to obligate the maximum amount possible in each of the two fiscal years shown. However, it didn't have to do so, since obligational authority is cumulative. For example, if the state didn't obligate its full $20 in 1997, it could obligate the remainder in 1998 – plus the additional $55.65 that becomes available for obligation in 1998.

Hypothetical Example: ACAP Process for New Designees, Fiscal Years 1997 and 1998 (Highway Account)

FY96 and FY97 apportionments eligible for transfer to the SIB pilot	FY97 ("Year 1") ACAP baseline	FY97 FAH transfers and obligations for the SIB pilot program	FY97 General Fund distribution	Maximum total obligations	Maximum outlays (i.e., bank deposits)
$100	$100	[(.15)(97ACAP)] =[(.15)($100)] =$15	$5	[(.15)(97ACAP)]+ [(1)(97GF Dist.)] =[(.15)($100)]+[(1)($5)] =$20	[(.15)(97ACAP)]+ [(.15)(97GF Dist.)] =[(.15)($100)]+[(.15)($5)] =$15.75

For the sake of illustration, assume that FY97 is the final year of the SIB pilot program. That would cause FY98 ACAP, transfers, obligations, and outlays to look like this:

FY98 apportionments eligible for transfer to the SIB pilot	FY98 ("Year 2") ACAP baseline	FY98 FAH transfers and obligations for the SIB pilot program	General Fund distribution	Maximum total obligations	Maximum outlays (i.e., bank deposits)
$0	$0	[(.53)(97ACAP)] =[(.53)($100)] =$53	$0	[(.53)(97ACAP)]+ [(1)(97GF Dist.)] =[(.53)($100)]+[(1)($0)] =$53	[(.53)(97ACAP)]+ [(.53)(97GF Dist.)] =[(.53)($100)]+[(.53)($5)] =$55.65

How does this example relate to your state? FHWA has prepared 39 spreadsheets that use actual numbers to display the maximum amount of federal highway funding that each SIB participant could potentially obligate and deposit by the end of fiscal year 1997.

Contacts:
Max Inman, FHWA, 202/366-0673 or Miriam Roskin, Porter & Associates, 206/441-9808.

RESOURCE REFERRAL FHWA's Regional Finance Centers

Expansion of the SIB pilot program. The TE-045 innovative finance research initiative. Financial Management Improvement Projects. Reauthorization proposals.

With so much afoot in the world of federal transportation finance, states and metropolitan planning organizations are developing a healthy appetite for prompt and reliable technical assistance. As always, USDOT division, regional, and headquarters offices stand ready to help, but recently another excellent resource has emerged: FHWA's Regional Finance Centers. In late 1996 FHWA established two finance centers – Western and Eastern – to assist front-line field offices in serving FHWA partners and customers. In particular, the finance centers focus on addressing questions concerning the financial aspects of 1) the traditional federal-aid program, and 2) new innovative finance initiatives, including SIBs. The WFC and EFC also coordinate and conduct training sessions on the Financial Management Information System (FMIS), development of State Transportation Improvement Programs (STIPs), Financial Management Improvement Projects (FMIPs), and various aspects of innovative finance.

WFC maintains an extensive home page with links to reauthorization fact sheets, training schedules, current and back issues of the regional finance centers' newsletters, and other helpful reference materials. You'll find the home page at "http://www.wfc.fhwa.dot.gov". The home page also provides contact names and numbers for each of FHWA's nine regions. EFC is currently developing a home page as well – *IFQ* will publish the address as soon as it's available.

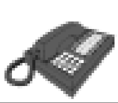
Regional Finance Center Contacts:

Eastern Finance Center		
Region 1 (CT, MA, ME, NH, NJ, NY, RI, VT, Puerto Rico)	Mike Fazioli	518/431-4224 x216
Region 3 (DE, MD, PA, VA, WV)	Audrey Davis	410/962-0077 x3042
Region 4 (AL, FL, GA, KY, MS, NC, SC, TN)	John Jeffers	404/347-4071
Region 5 (IL, IN, MI, MN, OH, WI)	Mike Rosenstiehl	708/283-3515
Western Finance Center		
Regions 6 and 7 (AR, IA, KS, LA, MO, NB, NM, OK, TX)	Sue Kiser	916/498-5009
Region 8 (CO, MT, ND, SD, UT, WY)	Jennifer Mayer	415/744-2634
Region 9 (AZ, CA, HI, NV)	Russ Fosha	415/744-2655
Region 10 (AK, ID, OR, WA)	Leslie Harris	503/326-5953

TIFIA, continued from page 2

Conclusion

The credit program established under TIFIA is a limited, six year pilot program. The program is designed to overcome current market gaps by familiarizing investors with the risk and financial profiles associated with large startup transportation infrastructure projects. Ultimately, a successful program could put itself out of business by demonstrating to private investors the long-term feasibility of this class of transportation investment, thus phasing-out federal credit participation in these large transportation projects.



Contacts:
David Seltzer, FHWA, 202/366-0397 or
Bryan Grote, FHWA, 202/366-0673.

FHWA's INNOVATIVE FINANCE Quarterly

Miriam A. Roskin, Editor
Porter & Associates, Inc.
206/441-9808
FAX: 206/441-9852
miriam.a.roskin@fhwa.dot.gov

Laurie L. Hussey, CS Managing Editor
Cambridge Systematics, Inc.
617/354-0167
FAX: 617/354-1542
llh@camsys.com

Max Inman, FHWA Managing Editor
202/366-0673
FAX: 202/366-7493

A REMINDER TO READERS

FHWA does not maintain a mailing list and does not distribute *IFQ* directly. *IFQ* is available as an insert to the *ITE JOURNAL* and *AASHTO JOURNAL*, and is available electronically through:

- ITE's WWW Home Page: "http://www.ite.org" (select "Reference Library")
- FHWA Federal-Aid Financial Management Division's WWW Home Page: "http://www.fhwa.dot.gov" (select "Major Program Areas" and then "Innovative Finance")

IFQ is also provided to the following organizations for redistribution and/or as information for their membership:

- 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)