INNOVATION BRIEFS
NEWS ANALYSIS

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The "Tipping Point" Scenario Revisited

Back in March 2006, in a Brief entitled "Highway Tolling Has Reached the Tipping Point," we wrote: "Virtually every week brings fresh evidence that highway tolling and private financing are gaining new converts among governors and state transportation officials, in state legislatures, and in the media. Growing transportation budget shortfalls, eroding value of highway tax revenues and a supportive federal policy toward tolling and public-private partnerships have helped to nurture the idea. Fanning its spread are visions of highway projects built entirely with private funds and prospects of multi- billion-dollar concessionary cash payments that could jump start ambitious transportation improvements years in advance of their planned execution."

Since March, we have issued several updates providing additional evidence that highway tolling and private financing have indeed reached the tipping point. As requested by our readers, we present below a compilation of these news items under one cover, arranged in reverse chronological order and updated through the end of July.

July 31: One year after Minnesota's express toll lanes (known as MnPASS) opened to traffic, the official verdict is in—and it is positive. The toll lanes are averaging 17,500 toll trips per week and have generated $865,000 in revenue, about 85 percent of their annual operating cost. A survey of 550 regular users of the toll lanes showed a 95 percent approval rating. Even among non-users the HOT lanes earned a 60 percent approval rating. And no wonder. The HOT lanes have diverted some 3,000 cars per day from using the general purpose lanes, thus helping to lighten traffic and increase speeds for everyone. *Early critics of the program claimed that the toll was inequitable for lower-income commuters. But survey results do not support that concern. The survey showed support for the express toll lanes as strong at lower income levels as at higher income levels. The term "Lexus Lanes," once used as a pejorative shorthand for HOT lanes, is disappearing from usage under the weight of evidence that even drivers of modest means choose to use these lanes and pay tolls when they are pressed for time.*

July 31: Stockholm's demonstration of congestion charging has come to an end. The experiment is seen as having successfully shown that pricing can effectively reduce automobile use. Traffic in the city center went down between 20 and 25 percent according to official estimates, and the use of transit increased. A poll indicated that 52 percent of city residents are in favor of retaining the congestion charge, and 40 percent are against it. However, sentiments among suburban voters are reportedly running strongly against it. On September 17, the day of the general election, Stockholm residents will have a chance to decide whether the congestion charge should be introduced on a permanent basis.

July 28: The North Carolina legislature has approved tolling of a stretch of I-540 now under construction. This would be the first toll facility since the state Turnpike Authority was created in 2002. The bill also identified six other potential toll facilities the Turnpike Authority is authorized to build and operate. Meanwhile, the state Senate has passed a bill sponsored by Sen. Clark Jenkins (D-Edgecombe) that would authorize tolling state highways "contiguous" with toll roads. Currently, state law prohibits tolls on existing free roads

July 6: In his farewell address before the U.S. Chamber of Commerce, Transportation Secretary Norman Y. Mineta said we need "a cultural change" to move from a government-monopoly model for transportation infrastructure toward acceptance of the private sector and market forces. "Virtually every major financial institution on Wall Street has created — or is in the process of creating— an infrastructure fund with transportation as a major component," the Secretary said.

"They correctly recognize the enormous potential in American infrastructure. And it is imperative that future transportation decision-makers continue to foster this interest, not take steps to discourage it."

June 28: The U.S. Government Accountability Office (GAO) has released an exhaustive report on tolling (*Highway Finance: States' Expanding Use of Tolling Illustrates Diverse Challenges and Strategies*, GAO-06-554). "Tolling (i.e., charging a fee for the use of a highway) provides a set of approaches that are increasingly receiving closer attention and consideration," the report states in its introduction. "[It] has promise as an approach both to finance transportation and enhance mobility by managing congestion." Tolling can also enhance private sector participation and investment in major highway projects, the report adds. "Involving the private sector allows state and local governments to build projects sooner, conserve public funding for other projects and limit their exposure to the risks associated with acquiring debt."

A survey conducted by GAO showed that a total of 23 states have plans to build toll road facilities. Of these 23 states, 16 have existing toll roads and are planning additional toll roads and 7 are planning their first toll roads (the 7 states are Alabama, Mississippi, Missouri, North Carolina, Oregon and Washington). Of the 24 states that are already operating toll roads five opened their first toll roads in the last 15 years. They include California, Colorado, Minnesota, South Carolina and Utah. The primary reasons given by state officials for using or considering the tolling approach was to respond to shortfalls in transportation funding shortfalls, to finance new capacity and to manage congestion.

The GAO report is the latest manifestation of the growing consensus within the public policy community about the promise of tolls as a supplementary source of highway revenue and a tool of congestion management. GAO is a well respected source of analysis and policy recommendations to the U.S. Congress, and its positive assessment of tolling is bound to carry considerable weight in the deliberations of the Congressional Transportation Policy Commission and in the development of the next surface transportation reauthorization legislation.

June 20: Harris County Commissioners have voted unanimously to continue running the county's toll road system rather than selling or leasing it to a private entity. Their decision comes after they have had a chance to review the conclusions of a four-month study of various options by teams from JP Morgan/Popular Securities, Goldman Sachs/Loop Capital and Citigroup/Siebert Brandford Shank. The Commissioners' decision came as no surprise given the cautious position taken by the two teams studying the sale and concession options, the unambiguous recommendation by the third team that the county retain ownership and operation of the toll road system, and the conservative conclusions of the county's financial advisor, First Southwest. The JP Morgan team estimated the sale value of the toll road assets at between $3 billion and $20 billion. However, the team cautioned that it would be imprudent for the county to make a decision based on the highest value, as the estimates would vary depending on the level of control the county wished to retain after the sale and the rate at which tolls were permitted to increase. The Goldman Sachs team estimated the value of a concession in the range of $7.5 billion to $13 billion depending on the length of the concession (50 -75-99 years). It, too, stressed that the value would depend on the extent of oversight and control the county wished to retain over the leased system, and the percentage of revenue sharing it negotiated. The Citigroup team recommended that the county consider the value of its own bonding capacity which it estimated in the range of $8.2 to $20.6 billion, assuming certain changes in debt structure and toll policy. The common thread running through the three studies and the review by First Southwest was a conclusion that the county's toll road system is financially sound and the county should be cautious about changing its status quo. A decision about its future should not be based on "how much upfront money the county could garner, but on a financial alternative... that would be in the best interest of the public and the motorists." The Commissioners' decision leaves no doubt as to what they deem to be that alternative.

June 5: The first project under the umbrella agreement negotiated last year by the Texas Transportation Commission with Cintra-Zachary (TTC-35) has been made public. It will be a 40-mile extension to Texas 130 toll road, built by the private consortium under a revenue sharing concession agreement. Under the agreement, the consortium will finance, build and operate the facility for 50 years. The project came up for formal approval before the Texas Transportation Commission on June 29.

June 2: Denver has inaugurated express toll lanes on a stretch of I-25 running north-south through the central business district. The two-lane facility has been converted from lanes formerly reserved for high occupancy vehicles (HOV). Tolls are set at different rates through the day to manage traffic volumes and maintain free flow conditions. Variable message signs display the current toll rate at entry points. The Colorado DOT hopes that success on I-25 will bolster its case for a network of at least six other express toll lanes on existing freeways around Denver. The Federal government has given the project its enthusiastic support. "What we are celebrating today is an option that we can take to avoid sitting in traffic..You use the lanes when you want to." said Federal Highway Administrator Rick Capka at the opening ceremony. *Denver is the fifth jurisdiction in the nation to implement express toll lanes. The other four are Orange and San Diego counties in southern California, Houston and Minneapolis. But this looks only like a beginning. There are at least 12 other express toll lane projects under development across the country.*

June 1: After months of study, the Washington State Transportation Commission has issued a preliminary report and recommendations for a statewide tolling strategy. "Tolling has worked effectively in other states, and it can in Washington as well," said Transportation Commission Chairman, Dan O'Neal. The report, prepared for the Commission by Cambridge Systematics, recommends that the state "should use tolling to encourage effective use of the transportation system and provide a supplementary source of transportation funding." During the last two week in June, the Commission will present the preliminary results and seek public input at a series of public meetings throughout the state. The final study will be completed in July 2006 and presented to the Washington State Legislature for action. *While there have been numerous surveys of public opinion (see below), this is the first case where tolling policy will be the subject of a statewide public consultation. The state of Washington and its legislature are known for their progressive stance on transportation, and their position on tolling will no doubt be watched with interest by other jurisdictions. Washington's decision to adopt a favorable posture on tolling and public-private partnerships is bound to carry influence with other states which are faced with similar questions of how to fund their growing transportation needs.*

May 30: Illinois' Commission on Government Forecasting and Accountability, the General Assembly's fiscal watchdog unit, has chosen Credit Suisse from among five bidders to carry out a feasibility study of privatizing the Illinois Tollway system. The aim of study, to be completed in about six weeks, is to evaluate "the potential monetary value of a long term concession and lease" of all or part of the Illinois tollway system, and determine "a potential timeline of how long a transaction of this nature will take." *The testimony of most of the expert witnesses invited earlier to appear before the Illinois Senate Appropriations Committee was openly in favor of public-private partnerships and private toll concessions.*

May 30: Credit Suisse scored another coup with an announcement that it has formed a one billion dollar joint venture with General Electric to invest in energy and transportation infrastructure assets world wide. Brian Finn, CS's director of alternative investments said that the company sees "a real untapped opportunity for investments in this attractive asset class." The partners estimate a potential market for infrastructure investments at $500 billion over the next five years. *Credit Suisse/GE joins a select circle of private equity funds and investment banks which have made public their intention to invest in transportation infrastructure. Earlier announcements came from The Carlyle Group, JP Morgan, and Goldman Sachs. Merrill Lynch, Citigroup, Morgan Stanley, and UBS are also rumored to be thinking of throwing their hat into the ring, not wanting to be left behind. The big unanswered question: will other U.S.-based private equity firms, including such giants such as Blackstone, KKR,, Texas Pacific Group, Bain Capital and Thomas H. Lee Partners, follow Carlyle's example and start including infrastructure assets in their portfolios.*

May 24: The House Subcommittee on Highways and Transit held a hearing on "Financing Highway Infrastructure," intended to explore the role of public-private partnerships and private sector financing of highway infrastructure. Testifying before the committee were Indiana's Governor Mitch Daniels, Virginia's Governor Tim Kaine and Oregon's DOT Director Matthew

Garrett. A panel of financial experts rounded out the testimony. Gov. Daniels summarized succinctly the rationale for the private concession of the Indiana Toll Road: "Indiana will soon cash a check that closes the infrastructure gap most had believed insoluble. To bring in $3.8 billion through higher fuel taxes, Indiana would have had to more than double its existing gas tax. If we had attempted to close the gap through additional bonding, we would only have been able to borrow about one third of this figure before colliding with marketplace limits." *The hearing marks the first time that a congressional committee hearing has focused specifically on the potential role of the private sector in meeting future highway financing needs. "Recent high profile lease agreements for highway toll facilities in Indiana, Virginia and Chicago have brought these issues to th forefront of the debate on the future of infrastructure financing," said the Committee announcement. The May 24 hearing was intended to be the first in a series on this topic. The hearing and prospects of continued congressional focus on tolling and public-private partnerships suggest that these issues will receive increased recognition in the future transportation legislation.*

May 19: Georgia Transportation Partners, a consortium of Bechtel, Peter Kiewit and Sons, and C.W. Matthews, a local road contractor, have signed a "Developer Services Agreement" with Georgia DOT to carry out preliminary design plans and traffic-revenue studies for projects involving express toll lanes on I-75/I-575 and truck-only lanes on I-75 in the Atlanta region. Decision whether to proceed with construction would come in about two years. The Agreement has been negotiated under Georgia's one-year old Public-Private Initiative law. *The private parties' financial exposure at this stage is limited only to about $5 million. A financial plan to be developed as part of the initial phase will determine how the project should be financed in the long term (bonding, bank debt, bank debt + equity, long-term concession, etc). Although several U.S. private equity groups, notably, Goldman Sachs, Carlyle and JPMorgan, have announced plans to enter the field of infrastructure financing, our domestic construction industry appears so far more comfortable using the interest-free-municipal-bond-financing model rather than private equity financing as pioneered in this country by the Australian-based Macquarie Infrastructure Group. The GTP proposal will show to what extent the road builders are still wedded to public financing.*

May 19: Pursuant to an Interstate Toll Road Compact, North Carolina and Virginia are contemplating the imposition of a toll on I-95 at the border of the two states. The revenue would be split between the two states and used to improve the highway. *Tolling of Interstates is generally prohibited, but Section 1216(b) of TEA-21 (reauthorized in SAFETEA-LU) allows up to three existing Interstate facilities to be tolled "for the purpose of reconstructing or rehabilitating Interstate highway corridors,"each facility to be located in a different State. Two of the available slots have been conditionally awarded earlier to Virginia (I-81) and Missouri (I-70) and the remaining third slot has recently been applied for by South Carolina. According to an FHWA spokesman, " While we have reserved these slots for these facilities in these States through a "conditional provisional acceptance," neither facility has yet been fully approved for the 1216(b) program and does not yet have tolling authority. Unless Virginia decides to withdraw I-81 from the program, Virginia cannot use tolling authority under the 1216(b) program for any other facility, including I-95. However, since one slot is still unreserved, North Carolina is eligible to toll I-95 under the 1216(b) program."*

May 16: Transportation Secretary Norman Y. Mineta has announced a six-point plan to combat traffic congestion (*National Strategy to Reduce Congestion on America's Transportation Network* (http://www.dot.gov/affairs/dot5706.htm). The initiative will seek to implement congestion pricing and variable toll demonstrations under "Urban Partnership Agreements" with selected cities. It will further seek to "reduce or remove barriers to private sector involvement in the construction, ownership, and operation of transportation infrastructure" by encouraging states to enact enabling public-private partnership legislation. (The remaining four objectives call for promoting operational and technological improvements, establishing a "Corridors of the Future" competition; targeting major freight bottlenecks; and accelerating major aviation capacity projects.) *The latest initiative places the Department of Transportation squarely on the record in support of tolling and road pricing as tools for combating traffic congestion.*

May 10: Great Britain's new Transport Secretary, Douglas Alexander, has endorsed his predecessor's plan to work toward a national road pricing system and pledged to support development of appropriate technology to implement areawide road charging with a $20 million fund. Alexander's initiative was in response to Prime Minister Tony Blair's directive to the new Minister that "we need to advance the debate on the introduction of a national road-user charging scheme. The successful roll-out of local schemes funded from the Transport Innovation Fund will be critical. I would like you to identify the other key steps for the successful introduction of road-user charging within the next decade." *Blair's proposed time frame for implementing a country-wide road charging system contrasts with the more conservative— and realistic— estimates in this country that it might take up to 15 years to transition from the existing fuel tax-based revenue system to a mileage-based system.*

May 8: "The public is amenable to using tolls to fund specific projects." That was one of the conclusions of a Washington State Transportation Commission study of public attitudes about managing congestion and funding transportation infrastructure. The public attitudes study, which included a statewide survey of motorists and interviews with local leaders from around the state, is part of a larger tolling study conducted by the Commission at the request of the state legislature. *The conclusions of the Washington State study are consistent with the results of public opinion surveys in several other states, notably California, Minnesota, Virginia and Colorado.*

May 8: The financial press is taking an increasing interest in tolling and private infrastructure financing. The latest manifestation is a cover story in Barron's (*Toll-Road Sales* by Andrew Barry, 5/8/2006) which predicts that there might be as many as 25 road privatization deals in the United States in the next three years (an estimate we find grossly unrealistic). Earlier, a *Wall Street Journal* story listed 10 toll road projects with an estimated value of $25 billion as proposed or in development by private firms (*Making Public Highways Private*, by Laura Meckler, WSJ, 4/18/06). *Other toll/PPP-related stories have appeared in Bloomberg.com, Crain's, The Bond Buyer and Public Works Financing. But the ultimate imprimatur and anointment came in the form of a discussion (and Jim Cramer's positive assessment) of the investment potential of tollroad concessions on CNBC's Mad Money.*

May 5: California's legislature has passed a public-private partnerships legislation (AB 1467). The bill authorizes up to four "comprehensive development lease agreements" with public and private companies, two in Northern California and two in Southern California. But the bill prohibits imposing tolls on "noncommercial vehicles," i.e private automobiles, and stipulates that the state legislature must enact a statute authorizing each specific lease agreement. *The latter requirement may discourage private companies from participating in the program. The legislature's intent to micromanage the selection process will give opponents an opportunity to demagogue any private project to death -- perhaps not necessarily through an outright rejection but by attaching so many restrictive conditions as to make the project unworkable and causing the applicant to withdraw. Other jurisdictions have wisely left project approval in the hands of transportation officials at the state transportation agencies.*

May 2: Australian-based private toll road operator Transurban and the Virginia Department of Transportation have reached agreement on a 99- year concession transferring to Transurban the right to operate, maintain and collect tolls on Richmond's 9-mile Pocahontas Parkway. VDOT will retain significant oversight over Transurban's operation of the facility. The agreement calls for capped toll levels not to exceed a 50-cent increase through the end of 2010, with incremental and indexed toll increases thereafter. *The concession agreement also calls for a sharing of profits with the state over the full 99-year term of the concession — a possible harbinger of what other states might demand in the future, as they gain more experience and sophistication in negotiating road concessions.*

April 24: Spanish infrastructure firm Abertis (full name: Abertis de Infraestructuras, S.A.) has agreed to acquire the Italian toll road operator Autostrade S.p.A. The merger will create Europe's largest toll road company with a capitalization of over $30 billion, combined revenue of $7.5 billion and a 4,200- mile network of toll roads in Spain, Portugal, Italy and France. *The merger was partly motivated by Abertis' desire not to be left behind in bidding for road and other infrastructure concessions throughout the world. The combined company is expected to become a major global player in the growing market for toll road concessions, and is reportedly eying opportunities in the United States as well as in Europe and South America.*

April 24: New York's Gov. George Pataki is attempting to gain support for leasing the Tappan Zee Bridge, according to a report in Crain's New York Business (*NY Pursues Bridge, Road Privatization*, 04/30/06, Vol. 22, No. 17). Pataki's administration believes leasing state transportation assets to private companies could generate billions of dollars in revenue for transportation improvements. Leasing the Tappan Zee Bridge alone could provide $30 billion in revenue, according to state officials. *Other transportation assets of potential interest include the Triborough Bridge and the Queens-Midtown Tunnel. However, Pataki, a lame duck governor, has limited influence to overcome opposition of some powerful state legislators.*

April 21: Almost 80 percent of drivers in Metropolitan Denver think that express toll lanes in congested freeway corridors are a good thing according to a poll released by the Colorado Tolling Enterprise. *These results are consistent with other surveys that have been conducted in California, Minnesota and Virginia.*

April 13: The Arkansas Highway Commission has given a go-ahead for construction of Arkansas' first toll road, a planned 15-mile bypass around Bella Vista in northwest Arkansas. "Traditional funding streams aren't going to get it built, so we've got to look at alternative, innovative financial strategies like tolls," said Mike Malone, executive director of the Northwest Arkansas Council, praising the Highway Commission's decision.

April 10: Under a bill (S 1777) introduced by State Senator Raymond J. Lesniak, a 49-percent stake in the New Jersey Turnpike Authority would be sold to private investors. The proceeds, estimated at $6 billion, would be used to fund outstanding state pension obligations, raising immediate questions whether this would be a an appropriate use of the capital. *The NJ Turnpike Authority owns and operates two of the nation's most lucrative toll roads: the 148-mile New Jersey Turnpike and the 173-mile Garden State Parkway. The Authority collected nearly $716 million in toll revenue in 2004 and had total revenues of $829 million. Private investor participation would no doubt oblige the Authority to pay more attention to the return on capital. Currently, the Turnpike and the Parkway are among the least expensive – and least productive– toll roads in the country, charging a mere 5.5 cents and 2.2 cents per mile respectively.*

March 28: The San Francisco County Transportation Authority has announced its intention to study the feasibility of establishing a cordon-type congestion-charging zone for downtown San Francisco. The study will be funded with a one million dollar grant from the Federal Highway Administration. *San Francisco's initiative is motivated by London's successful experience with its congestion charging scheme, now in its third year of operation. However, we doubt that the London model is transferable to San Francisco. San Francisco's core area has more off-street parking capacity, its employment is more dispersed, and most congestion occurs not on city streets but out on freeways and bridges leading into and out of the city. The political environment of the two cities also is different. London's Mayor, Ken Livingstone, had enough political clout to impose the congestion charge on his own authority. In San Francisco, political power is more diffuse and there appears to be no one that has enough political courage to champion such a controversial proposal and enough influence to win over a skeptical electorate.*

March 15: Governor Mitch Daniels has signed a landmark bill authorizing a concession of the 157-mile Indiana Toll Road to the Macquarie-Cintra consortium for 75 years. In exchange, the state will receive an upfront payment of $3.8 billion with which the Governor intends to finance a program of highway improvements across Indiana, called "Major Moves." As one of our colleagues remarked, "For those of us who are used to waiting decades for the funding needed for projects to advance, this transaction is mind numbing. Suddenly, the State's entire 10-year plan is funded." *Some media dispatches chose to focus on the fact that the bill "squeaked by" in the House by a mere three votes. Undoubtedly, the measure suffered in the final weeks from adverse publicity generated by the Dubai port deal and the nativist sentiments that it aroused. But the anti-foreign opposition, we suspect, will be short lived, as the public learns of improvements in the toll road's operation by its new "owners" and as the U.S. investment community becomes more involved in concession-type deals.*

March 10: The Carlyle Group, one of the largest and most respected private equity firms, has announced creation of an Infrastructure Investment Team "to conduct investments in the infrastructure sector, including investments in transportation facilities..." The team will engage in public-private partnerships with governments at all levels as well as purchase projects outright or through long-term concessions, thge announcement said. The eight-member team will be co-headed by Robert W. Dove, former Executive Vice President of Bechtel Enterprises and Barry Gold, former Managing Director at Citigroup/Salomon Smith Barney. "The U.S. is finally starting to realize what the rest of of the world has learned, that private dollars can help to alleviate persistent infrastructure challenges," said David Rubenstein Carlyle's CEO in announcing the initiative. *In our January/February Brief, "Private Toll Road Financing: Will the US Transportation Community Rise to the Challenge?" we asked rhetorically "What would it take to persuade private equity funds to participate in toll road financing?" Our thanks to the Carlyle Group for providing the answer.*

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