Unlocking the Private Sector: State Innovations in Financing Transportation Infrastructure

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Dear Chairman Hatch and Members of the Senate Finance Committee:

It is an honor for me to be here today to discuss the increased use of innovative public-private partnerships to finance, construct and operate major transportation infrastructure projects. My name is David Narefsky. I am an attorney and partner at Mayer Brown, an international law firm headquartered in Chicago. I am co-leader in the Firm's Global Infrastructure Practice Group and regularly advise both state and local governments and private clients in the development and financing of major transportation infrastructure projects.

State and local governments across the country are responding proactively to what is widely recognized as a crisis in the state of our nation's infrastructure by partnering with the private sector to finance, develop and operate major transportation projects. In the last decade or so, we have seen an increasing use of the public-private partnership model, building on approaches developed and refined in Canada, Europe, Asia and Australia and utilizing the innovative financing and regulatory incentives authorized by the Federal Government. As a result, public-private partnerships have played a major role in the successful development most large-scale transportation infrastructure projects completed or under construction in the past decade. Many of these projects are highlighted on the map which is attached to these remarks.

LESSONS LEARNED

Reflecting on the experience of state and local government efforts over the last decade to partner with the private sector in the development of our transportation infrastructure, I would highlight the following as key "lessons learned":

- There is bi-partisan support for public-private partnerships at both Federal and State levels. Federal financing incentives and regulatory flexibility has been encouraged by each of the Clinton, Bush and Obama Administrations. Both Republican and Democratic Governors and Mayors have been strong advocates for public-public partnerships supporting transportation infrastructure.

- Protecting the public interest is paramount: Successful public-private partnerships require the private partner to comply with detailed and comprehensive operating standards, with non-compliance resulting in significant monetary penalties and/or default and loss of the right to continue to operate the project.

- A reliable legal framework is a necessary precondition to getting things done: Private parties investing in a jurisdiction and its infrastructure need to know that the identified sources of revenue will be available throughout the term of the agreement -- and that when project procurement is initiated it will get to the finish line.

- Federal financing incentives, in particular tax-exempt private activity bond and low-cost TIFIA financing, have been critical to successful implementation of transportation public-private partnerships.

- The successful models developed for transportation public-private partnerships are increasingly being applied to other infrastructure assets, including water supply and public buildings such as courthouses and university facilities.

- While there are many types of public-private partnerships, it is critical to know when a public-private partnership is the right structure for the project and to know what type of public-private partnership should be implemented on a project. Not all projects are well-suited for public-private partnership contracting. Certain types of projects are more suited than others for public-private partnerships because of the ability to reduce cost, introduce innovation, and accelerate delivery through a public-private partnership. Knowing which projects those are and then implementing the right public-private partnership model for those projects is critical.

- Important government policy objectives can be incorporated in public-private partnership transactions: These objectives can include labor protections, including requirements for project labor agreements, labor neutrality and card check procedures, wage and benefit requirements and required offers of employment to existing employees; disadvantaged, minority, female, disabled and veterans' contracting requirements. In addition, they can include limitations on toll increases and other fees imposed by private sector partners.

- Having a public champion is critical: Jurisdictions that have been successful in developing public-private partnerships have had a public champion who clearly articulated policy rationale for the project, moved forward with bold initiatives to develop new projects, and developed a vision in the face of uncertainty and at times opposition.

- Successful public-private partnerships result in significantly reduced construction cost as well as lower and more predictable "life cycle" operation and maintenance costs over the useful life of the asset.

- Credibility is important: Successful jurisdictions have credibility with their constituents that they are making the best decisions on projects to implement and the availability of revenue sources; credibility with private sector partners that they will accomplish what they set out to do; and credibility with investors and financing parties that will meet their obligations.

GROUND-BREAKING PUBLIC-PRIVATE TRANSACTIONS

In the United States, the market for long-term leases of existing infrastructure assets – sometimes referred to as "brown field transactions" -- was catalyzed by two transactions that closed in 2005 and 2006—the Chicago Skyway and the Indiana Toll Road. In the Skyway transaction, the City of Chicago received an upfront payment of $1.8 billion, which it used to retire high interest rate debt, establish reserve accounts that significantly strengthened the City's financial position and funded quality of life "safety net" programs for residents most in need. In addition, the winning bidder was obligated to implement significant capital improvements, including long overdue electronic tolling and to comply with comprehensive operating standards.

In the Indiana Toll Road transaction, the State received an upfront payment of $3.8 billion, which it used, after paying down debt, to fully fund its "Major Moves" multi-year transportation program, as well to provide $150 million to each of Indiana's 92 counties for local road improvements. In addition, the winning bidder committed to deliver and additional $500 million in improvements to the Toll Road – including electronic tolling technology, upgraded toll plazas and new lanes to reduce congestion -- and to comply with comprehensive operating standards.

You may have heard recently about the private investors in the Indiana Toll Road going through a bankruptcy proceeding. The public-private partnership transaction documents worked as intended through this bankruptcy, protecting the interests of the State and the traveling public by ensuring the continued smooth operation of the road.

The success of transactions like the Chicago Skyway and Indiana Toll Road led the Commonwealth of Puerto Rico to establish a Public-Private Partnerships Authority. The Authority's mission is to partner with the private sector to make infrastructure projects viable when the funds needed for development were not available in the Commonwealth's Treasury and thereby increase the reliability of services, reduce congestion, provide routine maintenance, improve safety and environmental performance and generally enhance the value of Puerto Rico's infrastructure assets.

In 2013, the Public-Private Partnerships Authority and Aerostar Airport Holdings successfully reached financial closing of a long-term lease for the Luis Muñoz Marín International Airport in San Juan. The San Juan Airport became the first major airport in the U.S. run by a private operator under the Privatization Pilot Program established by Congress in 1996 and administered by the Federal Aviation Administration. Highlights of this transaction include a 35-year contract with over $2.6 billion in value to Puerto Rico through a $615 million up-front payment, fixed annual payments and long-term revenue sharing expected to total at least $500 million, and with the operational risk and responsibility for $1.4 billion in airport capital expenditures shifted to a private entity held to strict operating requirements. The transaction enabled Puerto Rico to pay off significant infrastructure-related debt and also included protections for existing employees of the airport.

The San Juan Airport transaction closed approximately 2 ½ years ago and is widely viewed as a major success: by the traveling public that is benefiting from improved passenger amenities, by the airlines who are benefiting from lower and more predicable rates as well as from implementation of deferred and overdue airport capital improvements, and by the Commonwealth which is realizing increased passenger traffic notwithstanding the island's current economic downturn.

As noted above, San Juan is now the first US airport operated by a private party under the Federal Aviation Administration's Privatization Pilot Program. This Program requires the private party to operate an entire airport –both airside and landside facilities – and to obtain operating certifications from the FAA and the Transportation Security Administration. Two major US airports are currently exploring use of public-private partnerships to achieve major capital improvements without transfer of full operating responsibility to a private consortium and proceeding outside of the Privatization Pilot Program.

In New York City, the Port Authority of New York and New Jersey has just selected LaGuardia Gateway Partners to finance and implement the badly needed and long overdue construction of a new Central Terminal, expected to cost between $3.5 billion and $4 billion. This consortium will also operate and maintain the new Central Terminal under a long term agreement with the Port Authority. Highlighting the long overdue nature of the Central Terminal Project, Vice President Biden recently referred LaGuardia to as "an airport from a third world country."

Denver recently launched the procurement for its Great Hall Project, with the intention of benefiting from private sector imagination and financial expertise to relocate TSA checkpoints and related security facilities from the Airport's main passenger terminal and repurpose this space to provide "best in class" passenger amenities, including public meeting spaces and enhanced food and retail concessions.

PUBLIC-PRIVATE PARTNERSHIPS TO DEVELOP NEW TRANSPORTATION INFRASTRUCTURE

The public-private partnership model described above is no means limited to long-term leases of existing transportation infrastructure. In fact, public-private partnerships are increasingly and more commonly used by state and local governments to access private sector expertise in the construction, financing and operation/maintenance of major new or upgraded infrastructure assets (sometimes referred to as "greenfield transactions"). To illustrate this trend, I have highlighted below several of the most innovative public-private partnerships recently implemented in the US. In each of these transactions, the objectives of the government sponsor have been similar: accelerated project delivery for critically needed new infrastructure assets, reduced construction and life-cycle costs and significant risk-shifting to the private sector.

Texas has been a market leader in the use of public-private partnerships (referred to in that State as comprehensive development agreements) in the construction, financing and operation of new highway and bridge infrastructure. Projects in Texas have ranged from design-build projects, with the State providing all necessary financing and retaining all revenues to full toll concessions, with the private sector retaining all toll revenues and, in some instances, making an up-front payment to the State for the right to collect such revenues. Among the innovative projects currently being implemented by the Texas Department of Transportation (TxDOT) are:

SH 288 Toll Lanes Transaction: Development of new toll express lanes in the Houston area where a private developer is paying TxDOT for the right to develop toll lanes and receive revenues from those toll lanes. TxDOT is receiving the benefit of an expansion of an existing state highway, along with several connecting roads and a new Interstate interchange with the cost and risk shifted to the private sector.

SH 183 Managed Lanes Transaction: Development of new toll express lane facilities in the Dallas-Fort Worth area. In this case, the private developer is constructing the road, financing a portion of the construction costs, and operating and maintaining the facility for 25 years after construction. The Texas Department of Transportation is retaining the tolls from the project. The project procurement was structured so that the bidding parties competed to develop the largest-sized project for a total of $850 million that TxDOT had available for the project. The winning bidder agreed to construct not only the base scope of the project but all four additional optional components offered by TxDOT.

Denver FasTracks Eagle P3 Project. On June 2010, the Denver Regional Transportation District awarded the $2 billion Eagle Project P3 concession to the Denver Transit Partners consortium, which achieved financial close on August 2010. The private sector partner will design, build, finance, operate and maintain two commuter rail corridors, and an associated maintenance facility under a 34-year availability payment. One of the new rail corridors will connect Denver International Airport with Denver Union Station. The Eagle Project is a core component of RTD's $6.75 billion voter approved FasTracks transit expansion program, and the only successful project under the Federal Transportation Administration Penta-P Program. This is the first design-build-finance-operate-maintain project for mass transit in the United States, and it is providing significant benefits to RTD:

- Unprecedented risk transfer to the private sector;
- Accelerated project delivery from participation in FTA's Penta-P program;
- Significantly reduced total project cost versus internal estimates;
- Attractive funding through the use of Private Activity Bonds, tax-exempt bonds, and Federal New Starts Funding;

The Eagle P3 Project was the first US public-private partnership structured with government sponsor retaining all project revenues and making annual payments to its private partner, with these payments subject to annual appropriation by the transit agency. These payments are subject to reduction if the project is not constructed by certain time periods or is not constructed or operated and maintained in accordance with the detailed and comprehensive certain standards in the public-private agreement. Eagle P3 also represents the first use tax-exempt Private Activity Bonds for a mass transit project.

Seagirt Maritime Port Terminal. In 2009, the Maryland Port Administration and Ports America Chesapeake, LLC entered into a 50-year, $1.3 billion agreement to expand and operate the Seagirt Marine Terminal in Baltimore. Ports America agreed to make at least $500 million in capital investments to enlarge the Seagirt Terminal, positioning Baltimore as one of only two U.S. East Coast ports with a 50 foot draft to handle the new Super-Post-Panamax cargo ships and help maintain its global competitive position when the Panama Canal expansion is completed. In addition, the State of Maryland received an upfront payment of $140 million that was reinvested in the State's transportation infrastructure, including along the Interstate 95 Corridor and the Chesapeake Bay Bridge. Maryland will also receive both fixed annual payments and variable revenue share payments that will be used to support on-going transportation infrastructure improvements. The project is projected to generate significant economic growth, over 5,000 new and high-paying jobs, and incremental tax revenues of $16 million per year.

East End Crossing. In a transaction that closed in 2013, the private developer, WVB East End Partners, will be responsible for the financing, construction and operation of a new toll bridge over the Ohio River connecting Southern Indiana and metropolitan Louisville, Kentucky. The transaction, which was undertaken by the Indiana Finance Authority, is structured as an availability payment transaction. Under this approach, the state receives revenues from the toll bridge and utilizes those and other revenues to make payments to the private developer during construction and during a 35-year operations-and-maintenance period. The private developer does not take toll revenue risk and instead offers a fixed price for these annual payments from Indiana during the term and finances the transaction based on the promise of the government to make the payments during the term of the agreement. However, Indiana has the ability to reduce its payments if the project is not made "available" either because it was not constructed by certain time periods or was not constructed or operated and maintained up to certain standards in the contract. As a result of this structure and the competitive procurement between four different contracting teams, the price received by Indiana for this project was approximately 20% less than construction estimates.

Rapid Bridge Replacement Project. Taking advantage of public-private partnership legislation signed into law in 2012, the Pennsylvania Department of Transportation undertook a new initiative to address the State's significant and growing inventory of structurally deficient bridges. This initiative resulted in the recently awarded 28-year agreement to Plenary Walsh Keystone Partners to replace 558 of these bridges in just three years, with construction to be completed by the end of 2017. In addition to significant acceleration of construction schedule, it is expected that the average cost for design, construction and maintenance per bridge will be approximately 20% lower than Pennsylvania's estimate of the cost if the work had been performed under standard contracting processes for bridge design, construction and maintenance. As with East End Crossing and Denver FasTracks, the private developer will not take revenue risk and instead will receive fixed annual payments during the term of the agreement and finances the transaction based on the promise of the government to make the payments during the term of the agreement.

Again, I thank the Committee for the opportunity to discuss the increased use of innovative public-private partnerships to finance, construct and operate major transportation infrastructure projects.

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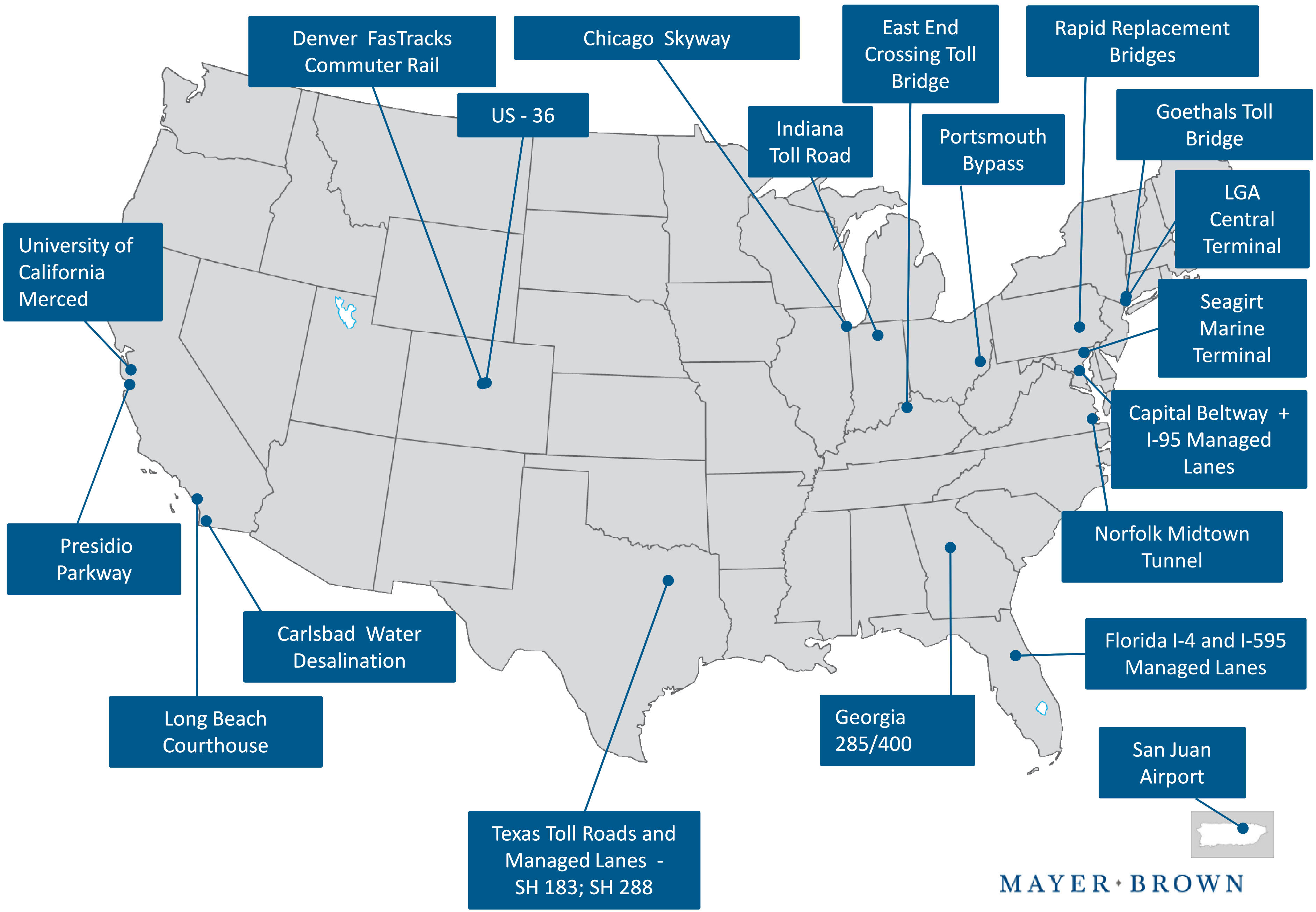
Private Investment in Public Infrastructure – Representative Transactions



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