

Trends in America



Issue Brief

The Council of State Governments

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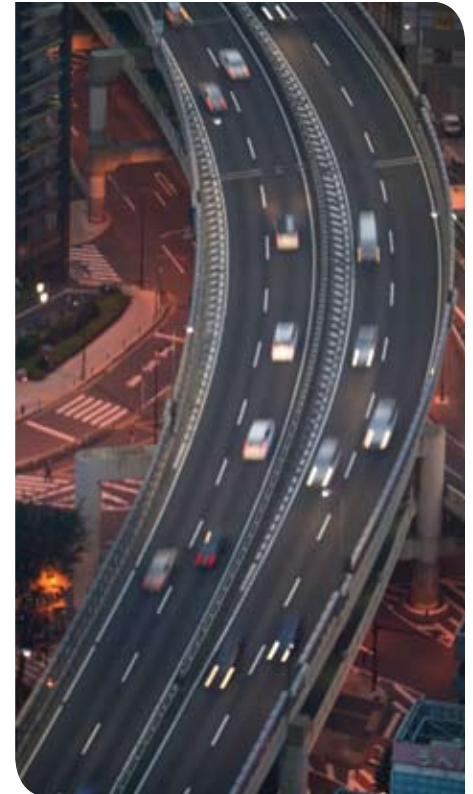
FINANCING TRANSPORTATION INFRASTRUCTURE

Even before the Minneapolis bridge collapse brought concerns over deficient infrastructure to the forefront, growing demands on U.S. transportation systems were straining states' budgets. With increasing congestion, rising fuel costs and the impending Federal Highway Trust Fund deficit, states have been looking for innovative ways to finance transportation infrastructure.

According to July 2007 estimates from the Office of Management and Budget, the Federal Highway Trust Fund will be insolvent by as much as \$4 billion by 2009. The federal gas tax of 18.4 cents per gallon—which pays for more than 45 percent of the nation's transportation infrastructure—has not been raised since 1993, and will fall short by some \$11 billion of planned road projects by 2009, according to a report by the American Association of State Highway Transportation Officials. At the same time, the cost of building and repairing roads is in-

creasing, with construction costs increasing by more than 70 percent in recent years.

The federal government may provide some relief. U.S. House Transportation & Infrastructure Committee Chairman James L. Oberstar of Minnesota has proposed to repair or replace more than 6,000 interstate bridges that are rated structurally deficient. Saying a dedicated source of funding is needed, Oberstar has suggested a 5 cent increase in the gas tax. Congress will also soon begin debating reauthorization of the federal Safe, Accountable, Flexible, Efficient Transportation Act: A Legacy for Users (SAFETEA-LU), which will expire in 2009. Even so, states will continue to grapple with finding creative solutions to financing needed transportation projects. Three methods recently employed by states—public-private partnerships, conversions to toll roads and imposition of a tax for vehicle miles traveled—are examined in this issue brief.



The States Respond

Public-Private Partnerships

The U.S. Department of Transportation defines a public-private partnership as “a contractual agreement formed between public and private sector partners, which allows more private sector participation than is traditional. The agreements usually involve a government agency contracting with a private company to renovate, construct, operate, maintain and/or manage a facility or system. While the public sector usually retains ownership in the facility or system, the private party will be given additional decision rights in determining how the project or task will be completed.”

Since the late 1980s, the use of these partnerships has increased worldwide. Public-private partnerships encompass a wide array of financing and contracting strategies that range from short-term service and operating contracts to long-term concession leases that may turn over control of planning, design, building, operation and the management of transportation facilities to a private entity. Funding for the partnerships may come from a multitude of sources, including tax exempt and taxable bonds as well as private equity.

Proponents say these partnerships allow government to work alongside the private sector in infrastructure procurement while

still meeting the obligations to the public. Typically, the public sector also retains control over infrastructure assets. The partnerships offer an advantage in financing. Because many public sector projects are postponed due to limited resources, private sector financing can speed the delivery of these transportation projects. The partnerships can also encourage increased competition in providing service by encouraging increased participation in transportation projects from the private sector.

Significant transaction costs can be associated with these types of projects, however. The greatest risk to public entities is the potential loss of control. Public-private

partnerships sometimes transfer control of assets to the private sector at the end of the contract, which can be a major concern if the public entity wishes to develop competing infrastructure in the future.

Oberstar and Congressman Peter DeFazio, in a May 10, 2007, letter told state officials, "we strongly discourage you from entering public-private partnerships that are not in the long-term public interest of a safe, integrated national public transportation system that can meet the needs of the 21st century." The letter also said, "the [Transportation and Infrastructure] Committee will work to undo any state PPP arrangements which do not fully protect the public interest and the integrity of the national system."

Public-private partnerships come in various forms. One type is design-bid-build in which the design and construction of the facility are awarded separately. This usually includes a two-step process involving separate phases for design and construction. Another method is the design-build project that combines the design and construction phases into one fixed-fee contract. A third type of partnership is design-build with a warranty. Under this approach, the

design-builder guarantees to meet material, workmanship and/or performance measures for a specified period of time after the project has been delivered. These warranties can last anywhere from five to 20 years. Most public-private partnerships utilize the design-build concept.

Despite federal concern, states are increasingly using these partnerships to fund different types of infrastructure projects. In 1988, Virginia became the first state to enact legislation permitting public-private partnerships for state highways. The Dulles Greenway was the first purely private toll road built in the United States in more than 100 years, with construction of the road completed in September 1995. Financing for the toll road came from a variety of both domestic and international sources, but because initial traffic volume fell far short of the forecast at the time of construction, the resulting financial strain forced a partial sell-off to an Australian company in 2005.

In Georgia, an innovative public-private partnership has been successful. The 17th Street Bridge project in Atlanta involved multiple public agencies at varying levels of government with a cost of \$76 million.

The bridge provides accessibility between several key interstates, Midtown Atlanta and the Atlantic rail station. The success of this partnership derives from its ability to combine accessibility, innovative financing and transit/pedestrian-oriented development. The site on which the bridge was constructed is a remediated brownfield that required significant removal of contaminated soil prior to construction. The bridge opened to traffic only four years after design began, due in large part to Georgia's legislation permitting the use of public-private partnerships in the delivery of needed transportation projects. The involvement and commitment of high level officials from the federal, state and local levels of government and senior officials from federal agencies contributed to the success of the project.

Toll Roads

In 1991, Congress passed the Intermodal Surface Transportation Efficiency Act (ISTEA), which included provisions for toll facilities and public-private cost sharing under the Federal-Aid Highway program. After the passage of ISTEA, many states began implementing tolling programs. In August 2005, the president signed SAFETEA-LU. This bill contained unprecedented opportunities for states to introduce tolls. It appears likely that the U.S. will increasingly rely on tolls to raise needed revenues and improve transportation corridors.

While tolls need not be part of public-private partnerships, they are often a financial element that makes a corridor attractive for private sector involvement. States have increasingly begun to use toll programs in their partnership agreements, though some have been met with both political and environmental opposition.

In 1995, California's SR-91 became the first fully automated, variably-priced toll road in the nation. Tolls on the highway vary from \$1.05 in off-peak periods to \$6.25 during peak periods, but cars with three or more passengers, zero emission

vehicles, disabled persons and veterans ride free during most hours. Revenues generated from the tolls are used to operate and maintain the road. The project has been criticized for perceived environmental impacts as the toll lanes have facilitated sprawl in Riverside County, offsetting many of the environmental benefits originally touted by the project.

Pennsylvania recently announced plans to build up to 10 toll stations along the 311-mile stretch of Interstate 80. The state hopes to generate \$950 million per year through the sale of bonds, partially backed by toll revenue over the first 10 years, with about \$500 million going to road and bridge projects throughout the state. This announcement has sparked controversy between legislators who support this plan and those who denounce it as a way to shift revenue from rural Pennsylvania to urban centers in the state. Since the federal government bans tolls on highways financed with federal money, Pennsylvania's move to impose tolls on a previously free interstate highway is unprecedented. Pennsylvania's toll plan will require approval of the Federal Highway Administration.

In 2008, Virginia will begin a five-year construction project of express toll lanes on the Capital Beltway, slated to cost \$1.7 billion. Carpool lanes are expected to be constructed as well, and the four new lanes that will be added to Interstate 95 will be free for carpools of three or more people. Other drivers will pay a toll that will fluctuate based on traffic volume, known as congestion pricing. Drivers will be alerted by overhead signs displaying the price at any given time. The average trip during rush hour may cost up to \$6.

The U.S. Department of Transportation has formally authorized South Carolina to move forward with plans to build an 80-mile stretch of Interstate 73 as a toll road and to use the revenues from the project to finance its construction. The project is the first undertaken as part of the U.S. DOT's Interstate System Construction

Toll Pilot Project, established under SAFETEA-LU. This program authorizes construction of up to three new interstates as toll roads if tolls can be shown to be "the most efficient and economical way to advance the project."

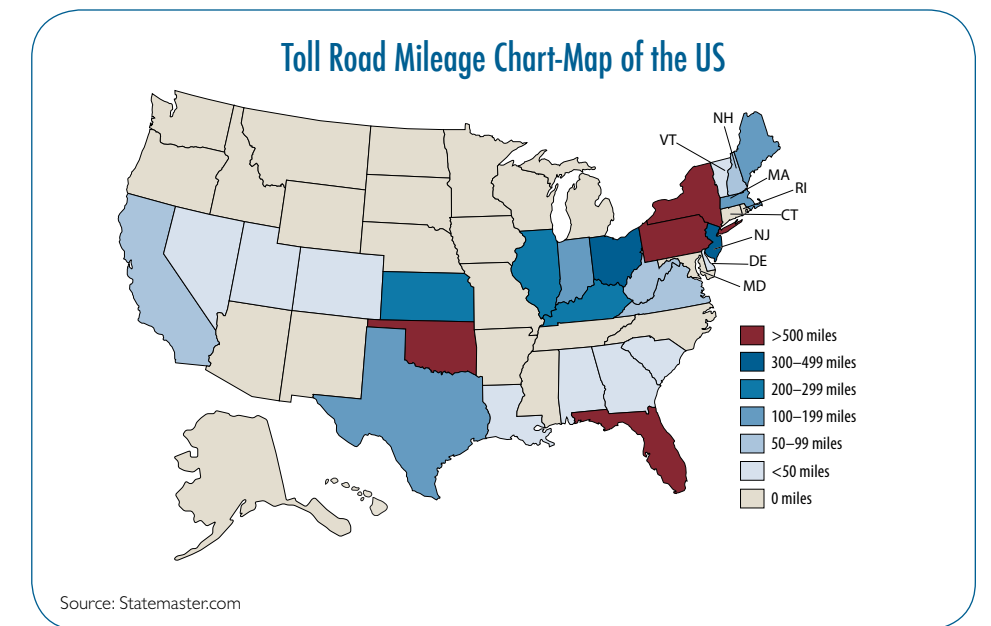
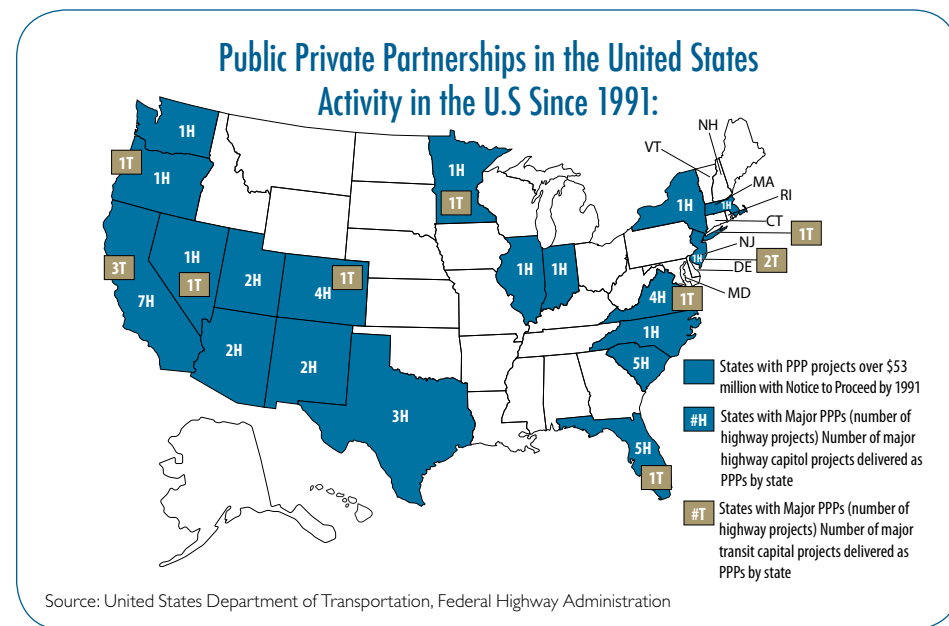
In 2003, Texas adopted a law to authorize the Trans-Texas Corridor—a \$184 billion, 4,000-mile network of toll roads, rail and utility corridors. Under the agreement, Spain's Cintra Concessions will pay the state \$2.8 billion and will collect tolls from the roads for the next 50 years. The network of roads would cut through parts of rural Texas—a source of controversy. Environmentalists argue this agreement threatens to sidestep environmental protections, and the Sierra Club and Environmental Defense oppose the project.

The project will be financed partially through tolls and income from real estate along the corridors. However, this project has been very unpopular in Texas due to public opposition to tolls, angry landowners and concerns over private control. In April 2007, both houses of the legislature passed measures that included a two-year moratorium on the creation of private toll roads. Texas House Bill 1892 places a two-year

freeze on many components of the Trans-Texas Corridor along with other comprehensive toll-road development agreements.

The Trans-Texas Corridor program has attracted the attention of the Federal Highway Administration, which outlined its concern about the proposal from a "transportation-policy perspective" in a letter to the Texas Department of Transportation. The letter stated that "if signed into law, some of the proposals could impact the state's eligibility for receiving federal-aid highway funds."

In 2006, Indiana enacted legislation authorizing a \$3.8 billion lease of the Indiana Toll Road for 75 years. According to the terms of the agreement, Statewide Mobility Partners, a partnership of Spain's Cintra and Macquarie, has the right to impose and collect tolls. However, these entities cannot raise tolls during periods of congestion above toll rate caps, which are set according to an established rate schedule. A portion of the funds from the toll road will be used for job training in Gary, Ind., but there are no provisions to provide new transit access connecting the low income and minority areas of Gary and Hammond with the higher





wage communities south of the toll road. Foreign control of Indiana infrastructure has been a very controversial issue surrounding the project.

Most state toll efforts concern new roads, but states are also looking at tolls as a method to manage existing highways. The Maryland Department of Transportation is proposing to add one toll lane in each direction on the Capital Beltway while upgrading an existing line in each direction to a toll-managed lane, rather than adding new lanes.

Mileage-Based User Fee Evaluation

Another way states are creatively looking at transportation infrastructure financing is the imposition of a tax for vehicle miles traveled. The Oregon legislature mandated a mileage-based road user fee evaluation as a way to examine a potential source

of new revenue to replace the fuels tax as the primary source of revenue for Oregon's roads. The pilot projects are overseen by the Oregon Department of Transportation. Motivation for the pilot projects come from concerns about the eroding purchasing power of the fuels tax, which is not indexed for inflation. Other concerns include voter reluctance to approve periodic increases in the tax rate and continued increases in the fuel efficiency of new vehicles, such as hybrids. Given this set of issues, the Oregon legislature asked the task force to evaluate the potential of alternate strategies to replace the fuels tax, with a focus on implementing a mileage-based charge.

Oregon recently concluded a pilot program designed to test the feasibility of a tax on vehicle miles traveled. Twenty trial vehicles were equipped with on-board tech-

nology in the fall of 2005, and in the spring of 2006, 260 trial participants in Portland had the on-board equipment added to their vehicles. Volunteers for the one-year program used a mileage-counting device for in-state travel and purchased gas at select stations in northeast and southeast Portland. For one year, participants paid distance charges rather than the fuels tax when they filled up at the gas station. The fuels tax was then deducted from the bill and the mileage charge was added.

The Oregon DOT expects to demonstrate the feasibility of both mileage-based user fees and congestion pricing in this pilot project, with the final report expected in September 2007. Based on the results of the pilot program, the department will draft model legislation for the Oregon legislature to consider in 2009.

The Future of Transportation

States are not waiting on the federal government to furnish them with innovative solutions to solve transportation needs or to provide them with additional funding. States are instead partnering with private entities and also exploring innovative financing solutions to accomplish needed goals.

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Trends in America

The most dominant characteristic of the 21st century is not just change, but the rate of change. Understanding change is the first step toward identifying and implementing effective responses. Trends in America Issue Briefs are designed to help state leaders promote positive change through forward-looking policies and strategic investments.