Public Works Financing

Published monthly since 1988
by William G. Reinhardt, Editor/Publisher
Westfield, NJ

www.PWFinance.net
PWFinance@aol.com

Reprinted from December, 2012

Transportation Policy Review

Toll Concessions as a Paradigm Change

By Robert W. Poole, Jr., Director of Transportation Studies, Reason Foundation

December's biggest transportation PPP story was the rejection by Gov. John Kasich of the proposed long-term lease of the Ohio Turnpike. According to the analysis prepared for the state by KPMG, a 50-year lease was expected to yield a net upfront payment (after paying off outstanding Turnpike bonds) of $1.8 billion plus annual payments of 15% of gross toll revenues for 50 years (with an estimated net present value of $1.5 billion). Instead, Kasich opted to have the Turnpike issue $1.5 billion in additional bonds, the proceeds of which will be used for transportation projects statewide. This alternative he called "unlocking the value" of the Turnpike; others might call it taxing toll-payers to pay for other people's roads.

That a high-profile conservative governor would back away from a toll concession he'd advocated for two years should ring alarm bells throughout the transportation PPP community. In caving in to political pressure against the lease from the Turnpike Commission, trucking groups, labor unions, and some local officials, Kasich implicitly relied on the widespread perception that there is something unseemly about having the private sector take over and run an existing toll road, but not about having the private sector develop new toll projects. But this distinction between greenfield and brownfield concessions is mistaken.

Highways in this country are typically designed to last about 50 years—if properly maintained (which is often not the case). Bridges can last 75 to 100 years, but often need replacement much sooner if their capacity is no longer sufficient. What this means is that a brownfield concession of 50 years or longer will very likely require substantial capital investment to reconstruct much of the pavement during its term of years. And unless economic growth stops, or cars and trucks become obsolete, most such highways and bridges will also require capacity expansion during a 50-year

concession period.

For example, KPMG estimated that the winning bidder for an Ohio Turnpike concession would invest $2.9 billion in capital improvements during the 50-year term. And in the Cintra/Meridiam greenfield projects in Dallas/Ft. Worth (LBJ and NTE), in addition to their initial $4 billion investment to build the new managed lanes, they expect to invest $1.35 billion in capital improvements during the 50-year concessions (plus another $2.2 billion in maintenance costs). In Canada, the concession company that leased Highway 407ETR for $3.1 billion in 1999 has already invested $1.2 billion more on widening and extensions in just the first 13 years of its 99-year concession.

Thus, the principal difference between greenfield and brownfield concessions is not capital investment in construction, but merely the timing and amounts of investment and construction. And from a governance standpoint, a 50-year brownfield concession agreement requires essentially the same provisions as a greenfield concession on a huge array of issues—performance standards, hand-back conditions, toll rates, etc. Furthermore, some of the greatest U.S. opportunities for toll concessions in coming years will be hybrid brownfield/greenfield projects to reconstruct and modernize worn-out Interstate highways using toll finance.

The rest of the world seems to have gotten past this silly greenfield/brownfield distinction. Concessions for new toll roads and bridges had become so mainstream in France, Italy, and Spain by the 1990s that there was little opposition when each of those governments privatized its state-owned toll operators. In South America, most of the billions of dollars' worth of projects that are creating tolled superhighways are in fact hybrid greenfield/brownfield projects in which existing (often two-lane) highways are reconstructed into limited-access four-lane (or greater) tollways. And just this month Turkey selected the winning bidder in a $5.7-billion, 25-year concession under which a consortium will operate, maintain, and modernize nearly 2,000 km of mostly tolled highways along with Istanbul's two suspension bridges.

What's going on here is a paradigm change—a fundamental rethink of the institutional framework for major highways. Instead of being funded, operated, and maintained as government monopolies, highways are becoming a kind of investor-owned network utility. Nearly all other U.S. network utilities—electricity, natural gas, water supply, telecoms, pipelines—are operated as business enterprises (even when, as in most water systems, they are owned by the government). All are paid for directly by their users, which makes it feasible for the utility to finance major capital investments based on a reliable stream of user payments, which can be bonded.

Americans seem quite comfortable with investor-owned utilities. We pay our monthly electric, gas, telecom, and water bills as a matter of course. We're happy that when the network needs to be expanded or refurbished, our bill payments provide a ready source of revenue to support additional bonding. There is no need to wait for years while legislators try to come up with some new source of tax money to fund such projects.

In addition, investor-owned utilities pay state and federal corporate income taxes, to the extent they operate in the black (which depends, of course, on wise capital spending decisions and good

operational management). Most assessments of the benefits of long-term toll concessions (including an assessment last January by the Congressional Budget Office) fail to account for the large tax revenue streams that will be paid as more highways are operated as investor-owned utilities. On its LBJ and NTE projects, for example, Cintra estimates that over the 50-year operating period, the shareholders of these two concessions will pay income taxes with a net present value of $2.6 billion.

Finally, while we all see great potential for pension funds and infrastructure investment funds to provide capital for large-scale projects, most such funds will not want to invest only in greenfield projects. Such a portfolio would be far riskier than one holding a mix of greenfield, hybrid, and brownfield projects. They need—and therefore we all need—lower-risk brownfield projects as part of their portfolios.

Thus, those who have championed PPP concessions because of new construction/new investment opportunities should embrace this overall paradigm change. Major highways in the 21st century should—and can—become investor-owned utilities. To that end, we should advocate and support brownfield leases in addition to greenfield concession projects.