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The Limitations of Availability-Payment Concessions

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As I researched and wrote the chapters on highway PPPs in the Reason Foundation's 2011 Annual Privatization Report, I was struck by an ongoing trend away from traditional toll concessions and toward availability-payment concessions. This is especially the case in Canada and Europe. In the former, there is only one true toll concession: Highway 407 ETR in Toronto. Of the other motorway and bridge projects in Public Works Financing's database, Canada has 21 availability-pay concessions either financed or under development (worth $9.7 billion) and 16 hybrids (tolled facilities with the concessionaire compensated via availability payments from the government) worth $13.9 billion. And in Europe, the U.K., Germany, and most of Eastern Europe are implementing mostly availability-pay concessions. Toll-concession pioneers Spain and Portugal have gone back and forth between toll and availability concessions, and even France is embarking on its first availability-pay concession (near Marseilles).

Two factors seem to account for this trend. One is political resistance to tolling, especially in jurisdictions where it has little or no history of use. More recently, the global credit crunch has made many concession financiers more risk-averse, and they have been eager to trade the security of an essentially guaranteed annual revenue stream for the uncertainty of a toll revenue stream.

The trend has even begun showing up in the United States. Two such projects are under construction in Florida (Port of Miami Tunnel and I-595) and three others are in various stages of procurement: Presidio Parkway, Knik Arm Bridge, and Goethals Bridge. Of the 29 major U.S. concession projects in the pipeline, I would not be surprised to see quite a few proposed as availability-pay concessions.

I think this trend is unwise, for a number of reasons. Both Spain and Portugal offer warning flags, suggesting that availability-pay concessions are not as risk-free as some financiers have assumed. As early as 2006, the Portuguese government realized that the debt obligation it had taken on via numerous shadow-toll and availability-pay concessions was unaffordable, and it began converting shadow-toll concessions to toll concessions in 2010. That same year, the Court of Auditors rejected nearly all the recently approved availability-pay concessions. And as part of the EU/IMF financial bailout in 2011, one condition of the Euro 78 billion (US$105 billion) deal was an external review of all such concessions. Infrastructure Investor reported in September that Portugal's roads agency may default by 2014, making it unable to meet its remaining availability-pay obligations. Investors have also recently become concerned that one of Spain's regional governments, Castille-La Mancha, is nine months behind on its shadow toll payments for the Autovia de la Mancha motorway (see p. 20).

It is becoming apparent that a commitment to make availability payments for 35 or 50 years entails risk, too—some are calling it "appropriation risk." As governments come under serious fiscal stress, and their credit ratings are downgraded, they may start prioritizing who gets paid (as Castille-La Mancha appears to be doing).

Some state DOTs and legislators in this country may not fully realize that a set of availability-payment obligations can add up to a significant amount of debt. Some U.S. states have already gotten themselves in rather deeply by issuing GARVEE bonds that tie up a large fraction of their expected future federal highway grant revenues—which might or might not be there over the next 30 years, at least in the magnitudes suggested by historical growth trends.

I readily admit that availability-pay concessions have some points in their favor. In cases where tolling would defeat the purpose of the project (e.g., the Port of Miami tunnel, which is intended to divert truck traffic to the tunnel to get it off the streets of downtown Miami), using availability payments makes it possible to gain many of the benefits of the long-term concession model, despite the lack of a toll revenue stream. These benefits include getting the project done now (as opposed to perhaps 20 years in the future), shifting construction cost risk and completion risk to the private sector, and achieving life cycle cost savings due to long-term ownership-type incentives. Those are very important improvements on conventional public-sector procurement and management of highways.

But that list of benefits leaves out three of the most important benefits of the toll concession model. The major transportation infrastructure problem facing the United States today is a huge shortfall in investment, because traditional fuel taxes are running out of steam. The only major new source of revenue we have is tolling. A concession based on availability payment is a financing mechanism; it is not a funding mechanism. We will only bring in large amounts of net new investment if we make much greater use of tolling as a new revenue source.

Of almost equal importance is smarter project selection. When prospective

concessionaires have to figure out how to make a new bridge or highway project pencil out as a business venture, we get a powerful mechanism for weeding out poorly justified projects in favor of those that have a solid business case. That mechanism only works if the prospective developer/operator envisions the project as a business that must satisfy its fee-paying customers. Portugal got into trouble by creating a new Euro 5 billion (US$7 billion) highway program in 2008-09 that would never have penciled out as a set of toll concessions; the country already had a significantly higher motorway density than the E.U. average.

The third benefit to the public sector stems from the second: transferring traffic and revenue risk from the state to investors. A significant part of a proper value-for-money analysis of a proposed greenfield toll concession is the value of this risk transfer. Most start-up toll projects are high-risk ventures, at least in their early years. To the extent that we need new tunnels, new bridges, and new major highways, the last thing we should be doing is saddling fiscally stressed state governments with greenfield tollway risk.

Yet that is precisely what hybrid models do, in which tolls are charged by the state while the concessionaire is paid via availability payments. To be sure, this kind of hybrid does address the need for additional transportation revenue. But it does not inherently improve project selection (see Portugal), and it puts the traffic and revenue risk squarely on the shoulders of taxpayers.

But in today's de-leveraged and fiscally stressed world, will anybody accept true traffic and revenue risk? Mitchell Gold of Bank of America Merrill Lynch answered that question in the affirmative, in the September issue of this newsletter. While agreeing that there is plenty of capital around for availability-payment bonds, "there's also very good demand for higher yielding BBB category bonds that might be sold more with a full traffic-risk structure." And while not all highway concession firms may want to bid on traditional toll concessions these days, as long as well-qualified companies are willing to bid, the public sector should take full advantage.

In my view, 21st-century limited-access highways should come to be seen as another category of investor-owned utilities, like electricity, gas, etc. Once people become accustomed to paying their monthly highway bill (as they do their mobile phone, gas, water, and electricity bills), tolling will gain far wider acceptance as just another utility charge. Toll concessions, using nationally inter-operable all-electronic tolling, are the path to that very desirable future.