

# Public Works Financing

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## **Public Money Launches I-495 HOT Lanes Concession**

**By Lori Sharn, Public Works Financing, Washington, DC**

Dynamically priced High-Occupancy Toll (HOT) lanes on the I-495 Capital Beltway around Washington D.C., will be funded with an extraordinary package of private equity, state funds and federal credit assistance, under a public-private partnership agreement signed on Dec. 20.

An 80-year toll concession was awarded by the Virginia Dept. of Transportation (VDOT) this month to Capital Beltway Express LLC, which is owned 90% by DRIVE, Transurban's U.S.-based investment vehicle, and 10% by Fluor Enterprises.

Fluor is also the managing partner and full guarantor of a \$1.35-billion, five-year design-build contract for the I-495 expansion. To secure its guarantee, Fluor will provide a letter of credit for 7.5% of the contract price. Fluor's roadbuilder partner is The Lane Construction Corp., of Cheshire, Conn.

The \$1.93-billion project financing (including Virginia's equity) resulted from an unsolicited proposal Fluor made in 2002 (PWF 7-8/02, p. 3). The company, advised by HNTB, Bear Stearns and Vollmer Assoc., estimated then that revenues would cover \$800 million in HOT-lane improvements. VDOT sought a more comprehensive rebuilding of the beltway so Fluor brought in Australian toll road developer-operator Transurban to help raise the equity needed to fund the larger project.

"It's been a long five-year process to get this done," says Virginia Deputy Transportation Secretary Barbara Reese. "We worked very hard with our private partners and the federal partners to achieve some very strong public policy goals [while] getting the risk allocations right." In addition to expanding capacity on the beltway, the project will replace aging bridges and overpasses. KPMG Corporate Finance advised VDOT on the PPP.

VDOT will retain ownership and oversight of the HOT lanes to ensure that the private operators

meet daily and hourly operational standards set in the concession contracts.

The financing includes \$350 million in private equity, the highest amount ever invested in a U.S. greenfield toll road. Of that, \$88 million will be put in at financial close and \$262 million during construction. VDOT is committing \$409 million in public funds. The U.S. Department of Transportation has approved \$587 million in deferred-interest federal TIFIA loans and another \$587 million in tax-exempt private activity bonds (PABs). It is the first highway project in the U.S. to reach financial close using PABs, which were authorized in 2005 as part of the SAFETEA-LU highway bill.

Transurban told investors the project would have a rate of return on equity of 13%. “We’re taking a lot of risk in the hope that we’ll achieve that return,” says Michael Kulper, Transurban Executive Vice President North America. “There are other HOT lanes in the country, but this one is by far the largest and most complex. We’re making an investment in what is a less-than-proven business.”

He continued: “We have been asked to undertake this financing because the Commonwealth [of Virginia] does not have the funding or debt capacity to finance a project of this magnitude given its other unmet transportation needs.”

Transurban was paid \$12-million at the financial close to reimburse its development costs. It also was paid a base management fee of \$14 million by DRiVe investors. Later, the company will earn margins on its tolling and operations contracts and for toll revenues above performance benchmarks.

Capital Beltway Express will expand the outer lanes and shoulders of I-495 and then convert two center lanes in each direction to HOT lanes, ultimately increasing capacity from eight to 12 lanes. The team will also maintain and operate the project and collect the tolls, with enforcement outsourced to the state. Buses and vehicles with three or more occupants will use the new lanes for free; everyone else will pay variable tolls priced dynamically to keep traffic flowing. All HOT-lane users must be equipped with a transponder. Video tolling is not planned now.

During rush hours, about six hours a day, the toll is expected to be roughly \$1 a mile, or between \$5 and \$6 for the typical beltway trip. Average daily revenue for the HOT lanes is projected to be \$335,000 in 2015. The average real revenue growth rate is predicted at 1.3% for five years and then 1.5% after that.

### **Comprehensive Agreement**

Terms of the comprehensive agreement between Capital Beltway Express and VDOT include:

- Concession term—80 years (includes expected five year construction period)
- Dynamic tolling—no restrictions on toll rates

- No termination for convenience
- Protection against excessive HOV usage
- Contractual protection from certain taxes and discriminatory changes in law
- Concessionaire option to propose new lanes as HOT lanes
- Concessionaire compensation for VDOT improvements to the Beltway that have a revenue impact
- Refinancing allowed subject to investment-grade rating
- Revenue sharing with VDOT—5%, 15% and 30% of gross revenue—once returns exceed a 12.98% internal rate of return on equity

Business terms of an in-principle agreement were announced Sept. 10 (PWF 9/07, p. 8). The public and private teams pushed hard in the final days to get the deal closed before the holidays and before the \$1.35-billion fixed price for the design-build contract from Fluor Lane LLC would expire on Dec. 31. Work will begin in the spring and must be finished by spring 2013. If construction goes 24 months beyond the deadline, Virginia could terminate the contract and the team would lose its entire investment.

Work includes replacement of \$250 million of aging infrastructure, including 42 bridges and overpasses, plus upgrades to 11 key interchanges. Most challenging will be an interchange at Springfield, Va., to create a seamless HOV network on I-95/395, the Capital Beltway, I-66, the Dulles Toll Road and planned HOV lanes on an arterial road.

### **Credit Crunch Impact**

Closing was complicated by the problems in the credit markets, with the monoline insurance industry essentially shut down to writing policies at competitive rates on greenfield assets. Transurban decided to put off selling the private activity bonds for several months to see if the market improves.

However, the bonds could be sold immediately at a maximum interest rate of 5.35% under an alternative arrangement. Team financial advisor DEPFA, an AA-rated commercial bank, has executed a binding commitment to step up with a letter of credit guaranteeing that interest payments would be made if project revenues fall short. This letter of credit could also be syndicated among multiple banks to achieve an even lower interest rate. The bonds have been deemed investment grade by Fitch Ratings. Goldman Sachs is committed as bond underwriter. The bonds' underlying rate has been fully hedged for 20 years. A new non-profit 63-20 corporation in Virginia was set up by the law firm Orrick to be the conduit issuer of the bonds, and will have no ongoing role or oversight.

### **Deal Makers**

Key to making the numbers work were the large contribution from VDOT and the flexible federal credit assistance. The financial structure maximizes the amount of the Transportation Infrastructure Finance and Innovation Act (TIFIA) loan, which will have a fixed interest rate of 4.45% for 40 years. The amount of TIFIA loans cannot be more than 33% of all project costs or be more than senior debt. On the HOT lanes project, the concession company's failure to repay the TIFIA loans cannot trigger a default for 15 years, and only paying less than 25% of the interest after that can cause a default.

No repayment of principle will be required for the first 25 years on either the loan or the PABs, which also have a 40-year term. In addition, no interest payments will be required on the TIFIA loan for the first 10 years—covering five years of construction and the first five years of operation—although the interest will continue to accrue and add to the total debt. This allows new projects time to ramp up and produce revenue.

“We may well elect to pay some interest,” once the project begins operation, Kulper says. “It depends on how the project is performing.”

If the projected revenues from the HOT lanes increases, Transurban will be entitled to make distributions to equity. However, a share must go to TIFIA to cover a portion of the interest during the years interest is capitalizing.

### **HOT Market**

The financing and the performance of the beltway project will be closely watched by private and public entities eyeing similar projects in congested urban areas. Final proposals will be due next year on managed lane projects for I-595 in the Miami area and on the LBJ (I-635) freeway in Dallas. Transurban-Fluor signed an interim agreement in 2006 to develop HOT lanes on I-95/395, which will connect with the beltway to form a 70-mile HOT lanes network in Northern Virginia. Transurban is also targeting Atlanta, and claims that the Virginia projects give it “first-mover advantage” elsewhere.

In a presentation on HOT lanes opportunities, Transurban says HOT lanes have the potential to generate more revenue than traditional toll lanes, because there is no cap on rates. But because this upside is hard to model, Transurban says it will not include it in base-case calculations on HOT lanes projects.

On the beltway project, ARUP performed stress tests on the traffic model as the lender's advisor. According to Transurban, ARUP's results show that conservative assumptions were used and that maximum revenue would be achieved at 25% higher tolls than modeled.