Public Works Financing

Published monthly since 1988
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Reprinted from February 2013

Q&A: Mike Schneider On Transit P3s

Why U.S. Transit PPPs Are So Rare (2/13, p. 3)

"Transit PPPs tend to create institutional mish-mash in the U.S.," says Michael Schneider, a consultant to LA Metro and other transit agencies evaluating private financing and life-cycle benefits. "It's very complex to undertake a rail PPP unless you plan it right from the beginning, and it does not interface with or have an impact on other lines," says Schneider, a principal at HDR/Infraconsult.

There are few U.S. projects that meet that criteria, he says, so transit PPPs are relatively rare. The $2-billion Denver Eagle PPP worked as a DBFOM concession in 2010, but for specific reasons:

• The project had a champion in Cal Marsella, the Regional Transportation District's former CEO.

• In creating Denver's Regional Transportation District, the enabling legislation required RTD to contract out at least 15% of its operations, so private participation was part of the culture.

• The Eagle projects are all new parts of the system. The PPP commuter rail line to the airport uses a different technology from the rest of RTD's trains and it doesn't interface with any of RTD's other lines, so it made sense, says Schneider.

Three other U.S. transit projects worth $10 billion may also be developed as PPPs in the next few years:

• The proposed $450-million Red Line commuter rail project in Charlotte, N.C., is being developed as a PPP with availability payments funded mainly through value capture mechanisms employed along the entire 25-mile corridor.

Twelve major development projects with a diversity of building types have been described in detail to potential underwriters, with good results "The capital markets are very interested in that project," says Mark Briggs, Parsons Brinckerhoff's expert in value capture who is advising the city.

Charlotte has asked the state to use its AAA-credit to back the local assessments. A go-ahead decision is hoped for in a few months from North Carolina's new governor, Republican Patrick McCrory.

• The Chicago Transit Authority (CTA) has more than $5 billion in capital improvements planned for its Red Line, including a modernization project on the North Side, as well as a long-discussed southern extension of its busiest line, from 95th Street south to 130th Street.

CTA this month hired Goldman Sachs and Chicago-based Loop Capital Markets LLC and Estrada Hinojosa & Co., of Dallas, to assess delivery alternatives, including a PPP for the extension. The financial advisors will be unpaid during year one and may be terminated at the end of the second year of their four-year contract.

• In December, Gov. Kitzhaber of Oregon asked his legislature to approve a $450-million bond issue to fund Oregon's share of the $3.5-billion I-5 road and rail bridge across the Columbia River to connect Portland and Vancouver. PPP development is being considered. n

PWF: When does DBOM or DBFOM work with transit?

Mike Schneider (MS): Unless you're going to get a savings resulting from O&M efficiencies, which generally imply a more efficient labor structure than current, you're not going to get any savings on a P3 that you wouldn't get on a DB, on a transit project.

Most transit contract operators are not interested in non-right-to-work states and getting into that labor conversation at this point. That's because the savings are not necessarily going to be in the first five years. But if you have a union renegotiation every 5 years, 10 years, 15 years, and that negotiation is with a private operator as opposed to a public operator, then maybe you will be able to do what the bus operators have done, which is to change work rules and not necessarily wage rates. For a project that has a lot of ridership concentration in the morning and evening, a change in work rules might be a really effective thing. Bus service is far more labor intensive than rail so the gains are much greater.

That has happened on the transit side in various applications including Los Angeles, with Foothill Transit in the San Gabriel Valley of Los Angeles. The cities formed a joint powers authority, negotiated with LA Metro to take over the lines that Metro was previously running and then negotiated with a commercial transit operator to provide the labor and O&M for the new lines. They're saving 40 to 50% of what it would have cost under the Metro arrangement.

Question: That's not possible for rail transit?

MS: A lot of the authorities are asking about that, including New York MTA's East Side Access. But if you were to privatize all of the systems and maintenance of the track and the electrification and the fixed facilities on a rail line, and not include the operations of the vehicles and their maintenance, you get into a difficulty.

Question: Why?

MS: Let's say you're getting unusual wear on the track. Is it because the private sector concessionaire who is maintaining the track has not done its job, or is it because the unions in the public sector that are maintaining the rolling stock haven't trued the wheels in an appropriate way. So who is causing the wear?

The leads to the conclusion, if you're going to privatize rail in a PPP you're going to have to bundle things that have an impact on one another. That's a really important concept. If you're going to take a piece of something and make it a private-sector commission or concession and not other things that are involved in using it or can affect it's performance or wear, then you get into the same exact interface debate that P3s are supposed to alleviate.

It's very complex to undertake a rail P3 unless you plan it right from the beginning, and it does not interface with or have an impact on other lines.

Question: Who is doing that now?

MS: Nobody, and for good reason. The principal railroad privatization activity in this country is commuter rail and why is that? It's not the LIRR or Metro North. It's the 30 or 40 new commuter rail authorities that are starting from scratch with a new institutional authority. The game is acquire commuter rail vehicles, pull them with a diesel locomotive, pick up riders, charge fares, those services are being contracted out because there is no legacy union or no legacy operator.

You can ring-fence it in a way that you know you can generate the metrics, the measurement, that will allow you to gauge the availability payment. Without that key mechanism it is very difficult to determine success or failure and alleged blame if anything goes wrong.

Question: Why was Denver Eagle able to do this?

MS: They had a champion for a long time in Cal Marsella, Regional Transportation District's CEO when he was there, who was very much a proponent of the private sector.

In creating the RTD the state required as part of its enabling legislation to permit RTD to operate, that it contract out at least 15% of its operations. That is unusual, that usually does not occur, so that set the stage obviously.

Thirdly, these are all new parts of the system. In fact the commuter rail line to the airport is a different technology and it doesn't interface with any of RTD's other lines, so it makes sense.

Question: Why wasn't a DBF alternative considered for Crenshaw or the other transit DBs?

MS: We looked at a DBF approach, but what's the point? Metro has a AAA credit rating; it's great at borrowing money; we have a TIFIA loan; we don't need PABs; and there is an institutional force against involving a life-cycle interest of the private sector, which would be the only way it would have made a difference.

So there's no point in doing a DBF because money is cheaper to be borrowed from the public sector, and there's no point in doing an equity investment because you're not going to be operating it anyway, so just having Metro move from DBB, which they've done everything except one small piece of one project, to DB, we declared victory. That was a major movement.

Besides no one is going to do the "F" piece unless you've got an iron-clad payback mechanism and you've got a return, not on your investment, but a return on your renting the money.

Question: Just like the Presidio Parkway availability-pay project in San Francisco?

MS: Right, it's effectively a private sector bond deal. You'd have to have all the same covenants and all the same guarantees, just like Presidio Parkway deal. A cabinet-level agency forced Caltrans and the California Transportation Commission to make a commitment that's never been made before in California, which is an off-the-top, multi-year, commitment to availability payments. In effect, this has exactly the same, if not more, power than would a bond covenant or typical bondholder indebtedness coverage ratios, so that's why Presidio is happening.n

Letting the nation's roads and bridges deteriorate may worsen traffic congestion and add to our commuting woes, but when water and sewer systems begin to fail, our very civilization is at risk. That is the message of a recent story in The Washington Post drawing attention to the alarming state of the nation's water and sewer infrastructure. The story looks at the Washington D.C. system as a poster child for neglected and dilapidated municipal utilities. The average District water pipes are 77 years old and a great many were laid in the 19th century, notes the Post article. Emergency crews rush from site to site to tackle an average of 450 breaks a year. ("Billions needed to upgrade America's leaky water infrastructure," by Alfred Halsey III, January 2, 2012).

Antiquated municipal water and sewer systems are indeed a ticking bomb, all the more so since their deterioration, unlike that of highways and bridges remains invisible until a break occurs. But maintaining water and sewer infrastructure in a state of good repair is a fairly straightforward challenge, for water supply and sewers are a public utility. As such they are in a position to cover their maintenance and replacement costs through user charges. To be sure, we, the ratepayers, may have to face higher fees in the future, fees that reflect the rising cost of maintaining aging water and sewer lines. But then, we've been paying ridiculously low fees for the enormous convenience of municipal water and waste treatment systems, not to mention for the public health benefits of avoiding cholera epidemics, such as the outbreak that decimated the population of Paris in the 1830s.

Finding resources to keep the surface transportation infrastructure in a state of good repair is a more complicated challenge. There are no rate payers to charge and no political support for raising fuel taxes or imposing tolls. Politicians and the public seem to attach a low priority to fixing aging transportation infrastructure. The issue did not even make the top ten list of public priorities in the latest Pew Research Center survey of domestic concerns. Nor has the subject of transportation ever come up in the numerous policy debates held by the Republican presidential candidates.

There are various theories as to why the public seems so indifferent. One widely held view is that people simply do not trust the federal government to spend their tax dollars wisely. As proof, evidence is cited that a great majority of state and local transportation ballot measures get passed because voters know precisely where their tax money is going.

Another explanation, and one that I find highly plausible because it reflects my own experience, has been offered by Charles Lane, editorial writer for the Washington Post. Lane wrote in an October 31, 2011 Washington Post column,"How come my family and I traveled thousands of miles on both the east and west coast last summer without actually seeing any crumbling roads or airports? On the whole, the highways and byways were clean, safe and did not remind me of the Third World countries . . . Should I believe the pundits or my own eyes?" asked Lane.

Along with Lane, I think the American public is skeptical about alarmist claims of "crumbling infrastructure" because they see no physical evidence of it. State DOTs and transit authorities take great pride in maintaining their systems in good condition. Collapsing bridges, happily, are few and far between. The oft-cited "D" that the American Society of Civil Engineers has given America's infrastructure (along with an estimate of $2.2 trillion needed to fix it) is taken with a grain of salt, says Lane, since the engineers' lobby has a vested interest in greater infrastructure spending. So do the legions of road and transit builders, rail equipment manufacturers, construction firms, planners and consultants.

This does not mean that the country does not need to invest more dollars in preserving and expanding its road and transit infrastructure. Only that, in making a case for higher spending, the transportation community must do a much better job of explaining why, how, where they propose to spend those dollars. Unsupported claims that the nation's infrastructure is "falling apart" just will not do. We must learn from state and local ballot measures to document our needs with enough specificity so that the public has the confidence that their money will be spent wisely and well.