Joint Montgomery County State Legislative Delegation Priorities Hearing

Testimony by Brad German
Co-Chair of Citizens Against Beltway Expansion (CABE)
November 14, 2018

Thank you for giving Citizens Against Beltway Expansion (CABE) this opportunity to share some of our concerns about the Governor's potentially disastrous plan to widen the Beltway for four privatized toll lanes, like the ones in Northern Virginia where rush-hour tolls can top $45 per trip.

CABE represents individuals, community groups, and non-profit organizations who have come together to promote better transportation solutions without Lexus Lanes. It was originally founded to oppose a similar project proposed by then-Governor Ehrlich and came out of hibernation in July.

We share the concerns others are raising about this project's impact on family homes, communities, businesses, storm water management, the environment and historic sites like National Park Seminary. However, I would like to use my time to focus on what we believe the legislature can do to stop this project by reining in unchecked, reckless central planning by the Maryland Department of Transportation.

1. We urge you to reassert your role as stewards of taxpayer funds.

P3 toll road projects like the one proposed for I-495 have a history of dependence on unbudgeted taxpayer support.

Some 40% of the nation's P3 toll lanes have renegotiated their contracts to get taxpayer help when the original traffic and revenue projections fell short. P3 toll roads in Texas and Indiana have had to file for bankruptcy. A New Mexico P3 road, which coincidently involved M-DOT Secretary Peter Rahn, needed millions of tax dollars to replace unsafe asphalt. I've attached news articles about these and similar issues to my testimony.

We do not believe the governor should have carte blanche authority to commit Maryland taxpayers to decades of support for for-profit toll road companies who have carte blanche authority to set tolls.

To protect the public interest, there must be legislative review, approval and oversight of any and all implicit taxpayer subsidies or guarantees for privatized toll lanes on I-495. The same goes for setting tolls on privatized lanes.

2. Ensure the state takes local interests into account. Please give county governments the authority to meaningfully influence “exceptional” state projects and studies, including the Managed Lane Study. Amend the law so local government can participate in decision-making about privatized toll lanes on I-495 as true partners instead of leaving them as mere bystanders.

3. Require real transparency and give the public a serious good-faith opportunity for public comment. Rather than informing the public, M-DOT’s check-the-box town-hall meetings inflamed public anxiety and opposition to Beltway expansion for privatized toll lanes.

The public should know at least as much about this project as the vendors attending state project briefings – and the public should know it at the same time the vendors do.

One good step would be to make the monthly interagency Managed Lane Study working group meetings public. Another would be to enable the Maryland-National Capital Park & Planning Commission (M-NCPPC) or other working group members to release relevant documentation, at any time, to keep the public informed.

We also urge you to require future public meetings on Beltway expansion to take place in communities adjacent to the Beltway right-of-way and to hold them at times fully conducive to public participation.

In conclusion, we urge you to oppose the Governor’s proposal for high-cost privatized toll lanes on the Beltway. We do not believe they will fulfill any of his promises and reduce congestion, stay within the existing right-of-way, or pay for themselves.

We look forward to working with you and your colleagues to find better solutions to our traffic challenges than the Governor’s flawed, expensive, and counter-productive Beltway Boondoggle.

Thank you again for allowing us, and so many other Montgomery County community-based organizations, including “Don’t Widen I-270.org” and the Sierra Club’s Maryland Chapter, to share our views.

Attachments to Citizens Against Beltway Expansion
Joint Delegation Prioirities Hearing Testimony
November 14, 2018

AlbuquerqueJournal

Warranty loophole costs millions

By Colleen Heild / Journal Investigative Reporter

Updated: Sunday, April 7th, 2013 at 12:18am

U.S. 550 south of Cuba to Bloomfield was rebuilt and widened more than a decade ago, with repairs and maintenance work covered by a controversial $62 million warranty. But the state has paid more than $10 million in unexpected repair costs. (Dean Hanson/Albuquerque Journal

ALBUQUERQUE, N.M. — The 118-mile stretch of U.S. 550 to the Four Corners could be the most pampered roadway in New Mexico.

That shouldn't come as much of a surprise, because more than a decade ago the state shelled out $62 million for a controversial 20-year warranty on the $323 million reconstruction and widening of the highway between San Ysidro, northwest of Albuquerque, and Bloomfield.

The first of its kind warranty in the country was aimed at protecting the public from maintenance and repair costs on the road for two decades.

But the Journal has learned of a costly loophole in the warranty coverage guaranteed by the private contractor, a subsidiary of the Kansas-based billion-dollar private corporation, Koch Industries Inc.

A liability limit tied to the escalating cost of asphalt materials was inserted in the Koch warranty contract. That has forced the state Department of Transportation to pay nearly $14 million so far in unexpected repair costs – money that could have been used on badly needed road repairs elsewhere in the state.

To date, the state has picked up about one-third of the $41 million spent to maintain the road under the warranty, which took effect in 2001. The loophole is expected to cost the state another $10 million before the warranty expires in eight years.

"It didn't seem like a big deal at the time," former DOT chief Pete Rahn said of the warranty provision. "But obviously, if we knew then what we know today, then we would have approached that differently, I'm sure."

Fifteen years ago, Rahn headed up the DOT under the administration of Republican Gov. Gary Johnson and spearheaded the road reconstruction deal – which he continues to defend as a good one for New Mexico.

“Frankly, this is still a heck of a deal,” Rahn said, noting that the Koch subsidiary has paid out nearly $28 million on warranty repairs. “That whole (road widening) package was a heck of a deal for us.”

But while sharing in the ongoing repairs, the state is still paying off the warranty. A decision to refinance the project bonds under Democrat Gov. Bill Richardson in 2004 means the state won’t pay off the U.S. 550 project until well after the warranty has expired.

And the state must continue sharing the warranty repair costs or risk invalidating the agreement – which would leave the DOT on the hook for all repair and maintenance costs, DOT officials say.

In the meantime, other New Mexico roads and bridges have fallen behind on necessary repairs, according to a recent Legislative Finance Committee staff analysis. The unmet needs are estimated at more than $1.5 billion.

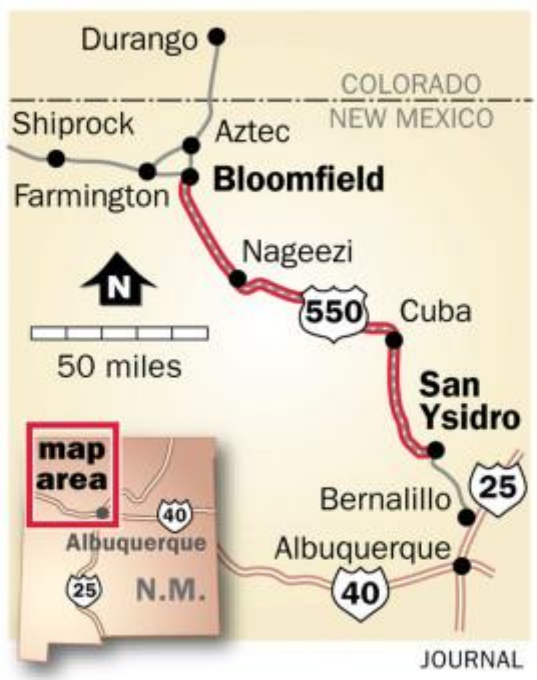
“In general, the department is facing serious obstacles related to highway maintenance,” the analysis said.

“Increased maintenance costs combined with revenue shortfalls have forced officials to decide whether to spend limited funds on good roads so they do not become bad roads or bad roads so they do not become failed roads,” the analysis stated.

The unfunded construction needs across the state include a gap of about $225 million for routine maintenance and $250 million for repairs to structurally deficient bridges, the analysis stated.

More than $390 million in transportation projects from the Gov. Richardson Investment Partnership program have also been deferred for lack of funding, the analysis added.

Asked about a liability cap that is hitting New Mexico in the pocketbook, a Koch Industries spokeswoman told the Journal in an email that the company “continues to meet its long-term contractual obligations. Thank you.”



(Journal)

Future funding

Sen. John Arthur Smith, D-Deming, was critical of the U.S. 550 road widening project from the start, in part, because it broke from traditional road financing practice and relied on future federal funding to pay for the reconstruction and warranty.

"I think that we (legislators) are going to be back here, replaying and rehashing this, when everybody is retired from the highway department," Smith said in a 1999 Journal series on the road project, titled "Four Lane Politics."

Smith, who today chairs the powerful Legislative Finance Committee, said the escalation cap tied to asphalt-related prices wasn't mentioned in the many legislative discussions about the warranty.

The warranty limits Mesa PDC's inflation risk at 3.5 percent per year, with the state on the hook for repair costs above that limit. The inflation index is based on asphalt, fuel and other material and labor costs, according to DOT officials.

It doesn't make sense for the DOT to be footing maintenance costs while the warranty is still in place, Smith said recently, but added that there's little recourse at this point.

"It seems to me the state better go ahead and swallow the pill that Pete Rahn left," he said.

A 2004 LFC report concluded the warranty, which included pavement and structures, "probably wasn't worth" the money. Assuming that Koch invested the money the state paid on the warranty, the company would reap tens of millions of dollars of interest at different rates of return, the LFC reported back then.

However, Rahn, in a recent interview, defended the road project.

“We are getting a very good value for the dollars we are spending because of the warranty that’s in place.”

The state DOT projected back in 1998 that the U.S. 550 warranty would save the state $89 million worth of maintenance on the road.

Under the original plan devised by the Johnson administration, bonds for the U.S. 550 project, including the $62 million warranty, were to be paid off by 2014.

But Richardson’s DOT refinanced the U.S. 550 bond debt, while unveiling a $1.2 billion transportation plan that included the Rail Runner commuter train.

(Journal)

Now the state isn’t projected to pay off the U.S. 550 rebuild until 2024.

Rahn, now chairman of the New Mexico Transportation Commission, which sets policy for the DOT, took some criticism for his role in the U.S. 550 warranty in the last legislative session.

Senate Rules Committee chair Linda Lopez, D-Albuquerque, wrote Gov. Susana Martinez a letter contending there was a "cloud" on Martinez's appointment of Rahn to the commission in 2011.

Lopez, in the letter, cited the warranty among other issues.

Her letter said she would recommend the committee vote "no" on Rahn's appointment, but the session ended without such a vote.

Rahn, who works for an out-of-state transportation consulting firm but has a home in Placitas, continues to serve in the unpaid commission role.

Warranty limit

Under the warranty, the DOT was to be responsible for non-pavement maintenance along the roadway, such as mowing, metal barrier repairs, striping and signage.

During negotiations on the liability cap, Rahn said the DOT reviewed the cost of asphalt, looking back at the prior 10 years.

"At no time had the overall cost of asphalt increased more than 3.5 percent a year. The only thing that's happened, now with what's gone on with oil prices, which drives asphalt prices, it's increased more than 3 percent," Rahn said. At the time, he said, 3.5 percent seemed to "be a very reasonable number."

But the price of asphalt has since soared.

One year, the state footed nearly half of the overall bill for warranty repairs on the road, which has an average daily traffic of about 5,000 vehicles.

In its pitch for the New Mexico road project, Koch touted a new asphalt technology that would provide longer durability and performance.

With that in mind, Koch originally expected to do only monitoring of the road conditions for almost half the warranty period, with the bulk of warranty expenses occurring in the year 2017, according to a 2007 court case involving federal taxes on the warranty.

Under the warranty, certain minimum acceptable pavement performance criteria has to be met for smoothness, rut depth, cracking, bleeding, raveling, potholes, depressions and shoving.

The roadway gets detailed regular inspections, in which ruts and cracks are measured, filmed on video and chronicled annually in an audit by the state DOT’s office of inspector general.

Pavement cracks on U.S. 550 south of Cuba have been documented as part of the detailed monitoring required under the 20-year performance warranty the state signed more than a decade ago with the contractor, a subsidiary of Koch Industries, Inc., of Kansas. (Dean Hanson/Albuquerque Journal)

After just a few years, road woes began

Once touted by supporters as the most innovative highway project in the country, U.S. 550 from San Ysidro to Bloomfield has had a rocky track record.

Within a few years of completion in 2001, unexpected heaving and other pavement distress began to occur.

The problems were traced to pre-construction soil preparation, and the contractor, a subsidiary of Koch Industries Inc. of Kansas, picked up the cost of repairs under a separate professional services warranty on the design and construction.

But that warranty expired in 2004 and the distress on the road isn't over, according to state Department of Transportation records.

An August 2012 geotechnical report noted new pavement cracking, slumping, dips and humps in the pavement that, again, were attributed to soil problems beneath the roadway.

Of seven identified locations, three have been repaired and the others will be remedied this year, the DOT says.

Of the estimated $622,000 in planned repairs, the DOT's share is expected to be about $226,097, according to DOT records.

Another part of the $62 million warranty covered structures and bridges along the northwest New Mexico road.

That warranty was supposed to continue through April 2012 or when the total repairs hit $4 million. But the monetary cap was reached a year early, in April 2011.

Since then, the DOT has had to pay more than $1.5 million to address the slope failure and soil settlement causing distress to a bridge on U.S. 550 near Cuba, according to state records.

—Colleen Heild

— This article appeared on page A1 of the Albuquerque Journal

AlbuquerqueJournal

State, Construction Firm Bickering Over U.S. 550 Roadwork Warranty

By Colleen Heild
Journal Investigative Reporter
Sunday, August 29, 2004

Less than three years after completion, New Mexico's $296 million highway to Farmington is showing unexpected and troubling signs of distress.

Documents obtained by the Albuquerque Journal show that problems were noticed in 2002 on drainage, bridges and erosion features of the new U.S. 550, formerly N.M. 44.
In 2003, sections of the 118-mile widened roadway began to crack, dip and heave.
In April of this year, state Department of Transportation crews discovered a crack1 foot wide and 8 feet deep along the shoulder, 10 miles north of San Ysidro.

Records show that "significant progressive deterioration" has been noted at numerous locations along the corridor from San Ysidro to Bloomfield in northwest New Mexico.

"These distresses are not expected as normal wear and tear," stated a DOT report issued earlier this year. "If encountered at one or two locations, they might be attributed to normal variation in construction technique or material. However, they were noted in various stages of progression at numerous locations, seeming to suggest a systemic problem."

The road project, with its controversial performance warranty and financing provisions, was the centerpiece of then-Gov. Gary Johnson's transportation plan in the late 1990s.

Kansas-based Koch Industries Inc., a multibillion-dollar oil and gas conglomerate, was the only bidder on the innovative reconstruction project, which was financed by bonds backed by future federal funding.

The project was touted as a unique public-private partnership in which Koch assumed design/build responsibilities, instead of the state DOT.

The state took out a unique $62 million warranty with Koch to inspect and maintain the new road for up to 20 years.

Though the pavement is warranted for 20 years, structures, such as bridges and culverts, have a 10-year warranty.

With the three-year warranty on the road design and construction management due to expire in November, the condition of the highway has become of increasing concern to transportation officials.

The state began limited geotechnical testing last year to determine the cause of the distress. An independent evaluation is expected soon.

"We don't know how serious the problem is," said state DOT spokesman S.U. Mahesh on Friday. "We have to wait for the results.”

In response to a records request by the Journal, the state DOT produced 94 pages of e-mails, reports and other records that document the problems.

But the agency refused to turn over another 24 records, citing "litigation or anticipated litigation."

Mahesh said Friday his agency is negotiating with the contractor to resolve issues "amicably" but said litigation isn't contemplated at this time.

'State of the art'

The warranty was the first of its kind in the nation, gaining national attention in its promise to save New Mexico taxpayers an estimated $89 million in road maintenance and repair costs over 20 years.

Koch Industries said the improved road— widened from two lanes to four— would be "state of the art" and require "minimum maintenance." The project was completed in November 2001.

Records show that, over the past year, conflicts have developed over warranty coverage, contract provisions and the need for testing beneath the pavement.

State officials also discovered shortcomings in the deal negotiated with Koch in 1998.

"NMDOT is concerned that these distresses ... may represent longterm problems which may be endemic to the project," state DOT warranty engineer Scott McClure said in a May 10 e-mail to Brian McWaters, administrator of the warranty for Mesa PDC, the company Koch created to manage the project.

"Our position is that many of the distresses along U.S. 550 to date, including heaving, settlement, cracking and slope failures, are unusual, unexpected and not anticipated by either party," McClure wrote in a May 20 e-mail.

When contacted by the Journal, McClure referred questions to Mahesh.

But in his e-mail to Mesa PDC, McClure wrote that it was reasonable to suspect inadequate subsurface investigation during construction and/or improper design had contributed to the failures.

"In fact, it could be considered a foregone conclusion, even without the benefit of investigation, that these unexpected failures are attributable to design or construction errors," McClure's e-mail stated.

McClure stated in the e-mail that a subsurface investigation was important before making repairs to "determine the nature, magnitude, and extent of these problems" and to assess the problem for future failure.

But Mesa PDC has consistently denied the need to perform those tests, the e-mail said. And, he wrote in another e-mail, the state didn't require such testing in its contract with the company.

Mesa PDC officials have maintained that "their knowledge and experience with construction and materials used on the project precluded the need to perform testing," according to a warranty compliance report issued by the state DOT in March.

But the state DOT is still responsible for responding to emergency road problems and has a vested interest in avoiding future trouble, McClure said in another e-mail.

So far, the state has spent about $75,000 on testing.

Larry Velasquez, state DOT director of engineering, mentioned structure problems on U.S. 550 at a national pavement warranty symposium in Grand Rapids, Mich., in May 2003, according to symposium records.

"The DOT should have been more involved with quality control," he was quoted as telling the group.

Rain blamed

McWaters, who works for Koch Performance Roads Inc., said in a recent interview that some of the distress has occurred as a result of the heavy rains earlier this year.

He said there is no threat to the traveling public.

"In retrospect," McWaters said, "we may go do some analysis to see if there is anything that caused it that's out of our control that should have been in somebody else's control, for example.

"But we haven't gotten there yet. We're just trying to fix the road and get it fixed up."

The state teamed up with Koch after Johnson made the widening project his top road building priority in 1997.

Pete Rahn, then highway secretary, said the project was pushed ahead of others to improve traffic safety and enhance economic development in the Farmington-area.

Mesa PDC didn't actually build the highway but oversaw the work of contractors selected through a state competitive bid process.

Under the transportation department's traditional pay-as-you-go road building, the 118-mile project would have taken up to 27 years to build, Rahn has said. It took Koch three years, under the innovative financing.

An article published by the Heartland Institute, a non-profit public policy organization based in Chicago, stated that the most significant aspect of the contract was the warranty.

"One key factor in the project's success is that the state is not telling Koch how to build the road. Avoiding micromanagement allows the contractor to use innovative practices often not available to the public sector," the institute stated.

The project won more than a half-dozen awards from national industry and transportation groups.

And it is still on the national radar.

Federal transportation officials are "very interested in this project and its implications for performance warranties nationwide," McClure wrote in one e-mail.

Eric Worrell, an engineer with the Federal Highway Administration, told McClure in a May 18 e-mail that he recalled that the federal highway administration "always understood that Mesa PDC intended to provide quality construction and quality maintenance.

"Disregard for geotechnical investigations, which occurred prior to construction, may have been partly responsible for the failures occurring today," Worrell said.

"Public safety is now a concern. To continue on the same track, that is to do repairs without proper subsurface investigation, would be irresponsible."

His e-mail stated that his office supported "proper subsurface investigations and hopes that Mesa PDC will reconsider their position. Considering the extent of national interest in this project ... it seems that it would be in Mesa's best interest to re-establish the spirit of partnership that once existed with NMDOT."

Failure 'alarming'

Mesa PDC has acknowledged responsibility for fixing the 8-foot-deep crack that led to emergency repairs earlier this year, McClure said in an e-mail.

"The sudden and progressive failure at this site is alarming, and we should be asking ourselves whether the potential for similar failure exists at other structures," McClure stated.

But McClure added that Mesa PDC "elected not to participate in a full investigation" of what happened.

"Unfortunately, the warranty did not anticipate these types of failures, and the requirement for testing is conspicuously absent," he wrote.

Mesa PDC has hired subcontractors for major repair work.

But those contracts, McClure stated, didn't include testing provisions "so the Department risks the potential for perpetuating the conditions giving rise to the original failures throughout the warranty phase."

In mid-July, McClure notified Mesa PDC of a number of sinkholes identified along the right of way in the northbound direction of U.S. 550 a few miles from the site of the crack.

Mesa PDC responded that the sinkholes weren't covered by the warranty because they happened suddenly. McWaters' response said the state could pay to fill them in, but that cost wouldn't be reimbursed by Mesa.

McWaters said Mesa PDC has spent about $140,000 on repairs since the road project was completed, and more are on the way.

What's in warranty

According to the March warranty compliance report:

- In August 2002, the damage to the drainage, bridges and erosion features was considered "substantial."
- McClure requested an audit of the contractor's financial records in March 2003, questioning the validity of charges Mesa PDC was making against the warranty.
- Inspections of the roadway's bridges and other major structures were completed a month beyond the contracted deadline in 2003. The state sent a letter to Mesa PDC last December, advising that such information was of "critical value both in advising the motoring public of potential traffic hazards and delays, and in affording Department personnel the opportunity to observe these inspections."

- The state served notice on the Mesa PDC of non-compliance in May 2003 for failure to deliver a contractually required report regarding vehicle counts on the road. Mesa had complained about the data the state furnished for the report.
- A state analysis found a number of potential problems with pavement inspection techniques.
- After the "progressive distresses" on the roadway in 2003, McClure asked Mesa PDC to consider supplementing its automated annual inspections with more frequent visual inspections. Mesa PDC isn't contractually obligated to do so, and the request was denied.
- The warranties could expire earlier than the 10-and 20-year caps, depending on vehicle counts and funds expended for repairs. Bridges, culverts and drainage features are warranted for a liability cap of $4 million, while the pavement is warranted for up to $110 million.

Since the road was completed, Mesa PDC has charged more than $1 million against the caps, most of that stemming from performance bond costs. State lawyers advised such costs weren't a legitimate warranty expenditure. Mesa PDC disputed that finding.

In a phone interview from his Wichita office, McWaters said Mesa PDC does regular visual inspections of the road and is complying with the warranty.

"If there's anything that is within the shoulders that we built, then we'll pay for it," he added.

He said it is "difficult to tell" if some of the problems that have surfaced stem from the construction of the road.

Soil settlement has been noted in the area of the new outside lanes added during the widening of the two-lane highway, he said. That can cause cracks and heaving.

"The pavement is performing to expectations," he said. "We have some settlement ... but the road itself is doing very well."

He said his company is helping the states of Virginia and Missouri with road projects.

Matter of opinion

New Mexico DOT District Six engineer Larry Maynard, whose district encompasses the new section of U.S. 550, said that, after recent rains, his office started receiving complaints from motorists about the road.

A month ago, he and his staff documented 17 locations that need preventive maintenance work "to keep them from becoming an emergency."

"We don't have any reason to believe that there's any major problems on the roadway at this time," he said. "Even with the cost of the warranty, it's still a very good buy on the road."

Mahesh said Friday that Maynard's comment on the warranty is a personal opinion. "The official statement from the department on the warranty is we don't know if it's a good deal or not. It's way too early to say."

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Private Toll Road Backed By $430 Million in Federal Funds Goes Bust

By Angie Schmitt

Oct 18, 2016

From the beginning, there were plenty of reasons to suspect that Texas 130 — a private toll road between San Antonio and Austin — was a bad idea.

For one thing, the state of Texas looked into extending the highway in 2006 and concluded it wouldn't generate nearly enough toll revenue to pay for construction.

Nevertheless, when two private firms, Cintra and Zachry Corp., decided to take the project on in 2008, the state of Texas and federal officials were happy to help. Cintra and Zachry put together a deal to build the $1.35 billion freeway. They lined up $430 million in federally-backed TIFIA loans, and promised to share toll revenues with the state of Texas and pay $25 million upfront.

Today, four years after the road opened, it is bankrupt. Katherine Blunt at the San Antonio Express-News has done some Pulitzer-worthy reporting about Texas 130 and the questions raised by similar toll road projects. Here are a few of the highlights of her report:

- At the time the road went bankrupt, traffic volume was just 30 percent of what consulting firm AECOM predicted. But AECOM — which has been sued for fraud in similar cases — and its subsidiary Maunsell have refused to disclose detailed traffic projections, saying they are proprietary. Both the Texas Attorney General and U.S. DOT have backed the company, allowing AECOM to withhold its justification for the project from the Express-News.
- Cintra and Zachry put up $197 million — about 14 percent of the cost. But that stake was packaged and sold to investors (in the case of the Zachary Corp., to three investment funds overseen by a Australian firm). Since some construction contracts went to Ferrovial, Cintra's parent company, the firm may have managed to make money even though the road did not.
- The highway appears to have exacerbated flooding problems for the community of Lockhart. One resident told the Express-News that she now has to tie her propane tank to a tree to keep it from floating away when it rains.
- Construction quality was not good. Just two years after the road was complete, an inspection found 160 pavement defects, though some of those have since been repaired.

Texas 130 is the third private toll road that received TIFIA funding to have declared bankruptcy or be restructured.

In another case, the "Pocahontas Parkway" in Virginia, the toll road received a $150 million TIFIA loan. The full balance of the federal loan was transferred to the new owner, DBi Services, in May 2014, after original owner Transurban surrendered the road in a “defacto bankruptcy” in 2013.

In San Diego, the South Bay Expressway borrowed $172 million backed by TIFIA, the Express-News reports. The balance of that loan was written down in bankruptcy to $93 million. In return, the federal government was given a 32 ownership stake.

As for Texas 130, it remains to be seen how much of the $430 million in TIFIA funds will be recovered. When pressed by the Express-News, U.S. DOT refused to comment.

Given the checkered track record of private toll roads, it might be worth considering a simple fix: Better independent vetting of traffic projections. Firms hired to produce traffic projections have a history of inflating the numbers. They have a financial incentive to do so, because it often leads to future business.

Robert Bain, an expert on toll road finance and traffic projection voodoo, has recommended “independent peer reviews” of traffic forecasts for private roads [PDF]. The TIFIA program could minimize losses by subjecting deals to more independent scrutiny before making an investment.

BISNOW
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Infrastructure P3s: Not All They're Cracked Up To Be

June 10, 2018

Melissa Oyler and Jarred Schenke

During his tenure as commissioner with the Texas Department of Transportation, Ted Houghton oversaw the rollout of $20B of road work. Private companies helped foot the bill in some of them. These public-private partnerships — P3s — seemed like a dream come true.

One project burst the bubble. The private operator behind a $1B highway partnership went bankrupt, making Houghton realize involving the private sector in a public project is not a panacea to the nation’s infrastructure issue.

“I don’t think one size fits all,” Houghton said.

Pixabay / Pexels

When President Donald Trump announced his plan to fix the nation's infrastructure, he decided P3s were the magical solution. The president has said he will use P3s to turn $200B of public dollars into $1 trillion of investment, building up infrastructure without emptying public coffers.

Trump has been a vocal fan of P3 arrangements, which pair public entities with private investors, to create new infrastructure projects. Finding capital is easy when governments use private money, Trump said: Someone else will pay for it.

P3s typically are presented as innovative, cost-saving and a way for municipalities to get the latest and greatest infrastructure without cutting corners. Often, that is indeed the case. But examples are stacking up around the country that cities and states are jumping into partnerships too fast, inviting hardships that come with handing over control to someone else.

Everything Comes With A Cost

Our aging roads, bridges and transit are rapidly deteriorating; in 2017, the American Society of Civil Engineers scored the United States' infrastructure a D+ on its annual report card.

Public resources are stretched thin, increasingly pushing the U.S. toward P3s to improve and build new infrastructure. In 2004, P3s were responsible for $1.4B of infrastructure, according to a report by AIG. By 2009, that number rose to $6.7B. AIG projects some $15B in projects will be underway in 2018. More than 20 states are using P3s for major infrastructure projects, according to a PwC report, including a nearly $4B project at New York's LaGuardia airport to redevelop and operate Terminal B.

P3s offer flexibility to a city, state or federal entity that may want to farm out parts of major infrastructure investments. They can close a funding hole. They can provide expertise.

For private companies, working with federal and state governments makes financial sense. Getting access to government financing is extremely attractive, Cornell University City and Regional Planning Department professor Mildred Warner said.

“Public financing is always cheaper because we have the municipal bond market,” Warner said. Even cities with bad credit ratings can, by and large, get better credit terms on a bond than private companies.

But P3s can make things messy: When a project doesn’t go as planned, private companies and governmental entities can end up pointing fingers at each other when it comes time to pay the bill.

“The first thing that’s really important to remember is that everything costs money,” In The Public Interest Executive Director Donald Cohen said. “If you want to build a road or bridge or water system, you actually have to pay for it. The problem is not finding the money to build things — the problem is paying it back.”

Cohen’s company, In The Public Interest, is a nonprofit research and policy center on privatization and contracting. When companies offer up private funding for a public project, they are often expecting a higher rate of return on their investment, he said.

Individual citizens, ultimately, are paying the bills, Cohen said. “There’s only one source of infrastructure money in America: That’s you and me. That’s either through taxes, tolls or fees," he said. When private companies are getting better rates of returns, the profits go to a private company instead of to a public everyone. "Why do we give them 10% rate of return when we could give them 3%? Things cost money — that money comes from us."

Money is not the only factor; P3s also involve sharing or giving away control. They often include noncompete clauses, such as prohibiting governments from upgrading surrounding roads so that drivers won't have the choice between a P3-funded road — which often collect tolls — and an upgraded public road. Additionally, compensation clauses require governments to pay the private companies if upgrades are done.

"P3 proponents say 'cheaper, better, faster,'" Cohen said. "It may be a little faster, depending on how the money is raised. But cheaper? We ask: 'What are you going to spend less money on?' And better: Maybe private companies have innovative ideas and can do things better — well, let's just hire them. But don't give it to them for 70 years."

Risk 1: Bankruptcy

P3s aren't a financial slam dunk. The federal highway department analyzed 28 P3 highway projects between 1992 and 2016 — four fell into bankruptcy, and another five had to refinance existing debt and in some cases even extend the amount of time the private companies received funding or tolls to justify costs.

For Texas and Houghton, the P3 magic soured when it came to a 40-mile stretch of highway called Pickle Parkway (or more officially, Texas State Route 130) that connects Interstate 35 in San Antonio to Georgetown, north of Austin. The highway was built with a $1B joint venture between Cintra and Zachry American

Infrastructure, which footed the bill and in return would collect tolls on stretches of the highway for 50 years.

In 2016, though, that JV filed for bankruptcy. Traffic use on the toll road segment of SH 130 was 60% below the private company's expectations, and the two parties lost their $210M investment, according to a 2016 U.S. Department of Transportation report.

"I think most of us know that project was flawed from the beginning," Houghton said. "Just some bad decisions were made in the location of that southern piece."

While the road remains open, the toll funds are going to the joint venture's creditors, parked with them for the duration of the original lease agreement, or at least until the bankruptcy is resolved. Neither the public nor the private entity behind it is making a dime.

Risk 2: Lack Of Control

During a time of recession and desperate measures, Chicago sold all of its parking meters to a private company — for $1B less than they were worth — after thinking about it for four days and without involving the public.

In late 2008, Mayor Richard Daley came in on a Tuesday with a proposal via a press conference: a consortium of Morgan Stanley, a sovereign wealth fund from the Middle East and a national parking company offered $1.2B upfront in exchange for control of the city's 36,000 parking meters for 75 years.

"This is 2009, and cities are having a hard time because it's the worst of the recession," In the Public Interest's Cohen said.

Two days later, City Council met to vote on the deal, with many members complaining they had not had enough time to scrutinize the proposal. Despite this concern, members voted to accept the deal. City leaders later realized they got taken by about $1B, Cohen said. If the city decides to eliminate parking spots in the future, it has to purchase them back. That can include temporarily, such as for weekend street festivals, or permanently to create mass transit or bike lanes.

Cohen called the arrangement unbelievably stupid. “Everyone in the country hates this deal,” he said. “Who knows if we’re going to be driving in 70 years? We’ve basically contractually obligated the public, the city, into keeping them whole for this contract.”

Drivers protested the deal by parking on side streets. Parking rates went up, and the meters couldn’t handle the additional quarters required, so drivers were ticketed. Meters were vandalized, and the city sent workers out to pay for them to be fixed, although it should have been the role of the private company, the Chicago Reader reported.

Despite all this, nothing can be done to change the deal the city made, and the future of urban planning in the city has been impacted as a result.

“As urban planners, we like things like bike lanes. But when the city puts in a bike lane but displaces a parking meter, it has to pay for that. So it forgoes things that are better for the environment,” College of Urban Planning and Public Affairs Professor, Director of Graduate Studies Urban Planning and Policy Rachel Weber said. “I hear from urban planning, they’ll hit a wall. They’ll think they’ve got everyone in the room involved in the transportation plan [but] they don’t own the rights to these formerly public spaces. It just ties their hands.”

“We believe that’s an assault on democracy,” Cohen said. “That limits our ability to make decisions.”

Risk 3: Long-Term Commitments

Since 2009, about half of new P3s have used “availability payments,” which are regular payments made from the government to the private consortium once a piece of infrastructure is available for use, according to a report from In The Public Interest.

In an availability P3, the private consortium often designs, builds and finances construction, then operates and maintains the asset for the life of the contract. Typically this is around 30 years or longer.

The governmental entity may provide payments during construction and then annual availability payments upon completion.

Traditional P3s use a revenue stream, including tolls, to pay back a private debt. Availability payment P3s can allow for infrastructure with no revenue stream to be built.

This commits governments to multiyear budgeting obligations, and Cohen said considerations should be made for contingent liabilities, compensation clauses, early termination payments and availability payment escalation clauses.

“Bottom line, the contracts lock in government budgets for decades — it's a risk,” Cohen said.

Risk 4: Demand Risk

If user fee revenue falls below a certain level, some P3s require the government to pay the private partner, as an insurance of sorts. If the forecast is more optimistic than the demand, trouble will lie ahead.

“Some sharing of the demand risk between the private partner and taxpayers is a good thing in theory, but the challenge in practice is finding the right balance,” Kellogg School of Management at Northwestern University IBM Professor of Regulation & Competitive Practices professor David Besanko said.

Smaller communities may not generate enough vehicle traffic to feed toll boxes for private companies to reap enough revenue to cover debt service. Houghton said for private companies to minimize risk, they look to invest in big projects in big cities.

“That restricts it to a very small group of cities that can take advantage of P3s,” Houghton said. “So what happens to the rest of the state or the rest of the country in the non-urban areas?”

Houghton saw that risk materialize firsthand when it came to the Texas project.

“We knew at the time … that the project was just wildly expensive, and we didn’t have the money to do it, but the private sector said they would,” Houghton said. “Most of the roads, by a long shot, don’t have enough revenue to sustain the debt and maintenance. The developer miscalculated.”

As Awareness Increases, Popularity Declines

Love them or hate them, P3s may start to fall out of favor. Besanko said Trump’s lowering of personal income tax rates and corporate income tax rates makes the tax-exempt feature of municipal bonds slightly less attractive.

“Municipal bonds are very attractive as vehicles when marginal personal income tax rates and corporate income tax rates are high. Then the tax deduction is very valuable,” he said. “But now that the personal income tax rates at the top have been lowered somewhat and the corporate income tax rate has been lowered a lot, the value of the tax exemption for municipal bonds is now lower than it otherwise would have been.”

In a 2016 report, the U.S. Department of Transportation indicated that there may be some problems rounding up interest from private parties to join P3s.

“Private sector developers appear to have little to no appetite for participating in other greenfield highway concessions unless their public sector project sponsors fund a significant portion of their cost,” officials said in the report.

Even Trump himself has seemed to back off the strategy, telling the Wall Street Journal that P3s are “more trouble than they’re worth.”

Still, he hasn't announced an alternate plan, leaving the P3-heavy plan in place, and it, colliding with his tax cuts, might pull private companies out of the infrastructure game and put the burden of these projects back more on governmental shoulders.

“So, I think that’s going to create a little bit of a headwind — how much of one I don't know for sure, it's hard to tell; it might not be much — but I think it will create a headwind to publicly finance infrastructure projects,” Besanko said. “There’s nothing in the Trump infrastructure plan that really is working to provide additional positive incentives for a more private capital.”

“I think the majority of transportation projects will not be P3. They just don't pencil out. They just don't work,” Houghton said.