A Wake-Up Call to Public Sector Toll Agencies

By Daniel L. Dornan, P.E.

This article focuses on recent developments in Texas regarding the disposition of a contract to complete and operate SH 121 as a tolled highway linking two counties north of Dallas. It discusses how traditional financing and development practices used by existing toll agencies—which tend to be very conservative—can hinder their ability to compete with the private sector for projects in their own jurisdictions. This is particularly threatening when larger state transportation agencies establish their own less constrained tolling programs, fortified by the resources of private concessionaires seeking highway development and operating rights in return for the cash flow resulting from future tolls. It also suggests how established toll agencies can effectively compete and thrive within this new environment characterized by alternative project financing and delivery approaches.

Introduction

The United States is at a critical juncture as it confronts the need to rebuild its aging highway systems and provide additional capacity to serve an expanding economy. Recognizing the inadequacy of motor fuel taxes to meet these growing fiscal requirements, federal, state and local governments are investigating alternative sources of funding. Where toll roads were once considered the "ugly ducklings" of the nation's highway system, they are now emerging as "swans" in the search for strategies to address the funding and congestion challenges confronting the nation's highway system.

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A major challenge to expanding the application of direct user pricing (tolling) is that most of the nation's highways are toll-free. They were developed by state agencies unfamiliar with treating users as customers and applying revenue-based financing approaches. One strategy to expedite the transition to user pricing is to tap the experience and resources of established toll agencies to expand their systems and help other state transportation agencies that are beginning to develop their own tolling/pricing programs aimed at managing traffic congestion and generating funds to expand highway capacity. This is the case in Florida, where the state's largest toll agency (Florida's Turnpike Enterprise) is an essential but distinct part of the Florida Department of Transportation (FDOT) that constructively collaborates with various FDOT districts and regional expressway authorities to expand Florida's Intrastate Highway System through the use of its toll revenues.

In contrast to Florida, the adoption of tolling to finance additional highway facilities in Texas has placed the Texas Department of Transportation (TxDOT) and its Texas Turnpike Authority (TTA) subsidiary in competition over highway development rights with the two existing urban toll authorities in the state: the North Texas Tollway Authority (NTTA) in Dallas and the Harris County Toll Road Authority (HCTRA) in Houston. This situation poses a major threat to established toll authorities, commissions, and enterprises that may be called upon to compete with private concessionaires that engage in more aggressive fiscal policies and development practices. This hinders their ability to compete with larger

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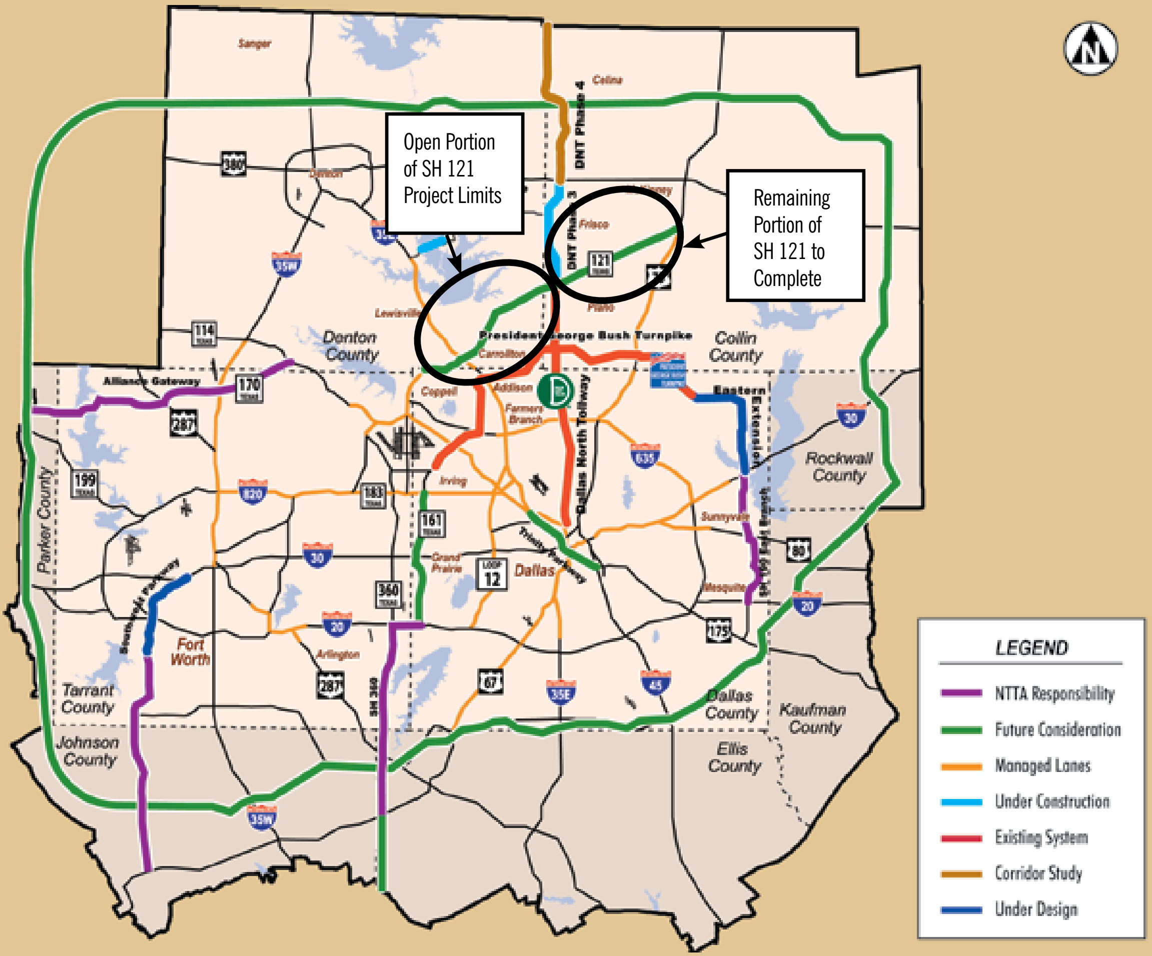
state transportation agencies bolstered by experienced international concessionaires through public-private partnership (PPP) arrangements.

The effects of TxDOT's approach to instituting its own tolling program in competition with the state's two existing toll authorities can be demonstrated by examining the consequences

Exhibit 1 – SH 121 Site Map in Dallas-Fort Worth Region



Source: *Proposal for SH 121 Toll Project*, Presentation to RTC on June 14, 2007, p. 16

of TxDOT's challenge to NTTA over rights to complete and operate the SH 121 toll road north of Dallas.

NTTA's Initial Proposal for SH 121

The North Texas Tollway Authority owns and operates four tolled facilities in the Dallas-Fort Worth region, including the Dallas North Tollway, the President George Bush Turnpike, the Addison Airport Toll Tunnel, and the Mountain Creek Lake Toll Bridge. During the past two years, NTTA and TxDOT have engaged in a virtual "tug-of-war" over the rights to complete and operate SH 121, a major state highway connecting US-75 with I-35 in the northern suburbs of Dallas – an area within the jurisdiction of NTTA for developing and operating tolled highway facilities as shown in Exhibit 1.

In 2005, NTTA expressed a desire to assume responsibility to finish the partially-completed project and subsequently operate all 26 miles of SH 121 as a tolled facility within its area of jurisdiction. Its initial proposal of $515 million included constructing the remaining 12.8-mile portion of SH 121 yet to be built in Collin County and operating only that portion of the highway. This proposal was rejected in February 2006 by the Regional Transportation Commission (RTC) as being inadequate. Simultaneously TxDOT proceeded with its own project procurement process to establish a Comprehensive Development Agreement (CDA)[1] with a concession team that could maximize its return from the facility.

Given TxDOT's broad freedoms granted under the state's PPP-enabling legislation, its financial resources and influence, and the power of private concession teams to leverage its capabilities, NTTA concluded its chances of successfully competing with private concessionaires under TxDOT's CDA procurement process were slim. Therefore NTTA reluctantly dropped out of the competition for the SH 121 project in August 2006, leaving only three private concession teams competing for the project. The winning concession team was selected by TxDOT in February 2007.

In early 2007 the Texas legislature considered legislation to place a two-year moratorium on long-term concession-based PPPs due to growing public and political concerns with the way TxDOT was implementing major highway expansion projects by using Comprehensive Development Agree-

1 CDAs provide a framework for the conceptual, preliminary, and final planning of a project, and for financing, building, operating and maintaining surface transportation facilities through collaborative efforts between TxDOT and private developers. CDAs can involve the developer performing some or all of these functions on a project-by-project basis, another development team producing the facility, or TxDOT delivering the project using more traditional approaches.

ments (CDAs) with major international concessionaires. After intense negotiations with the Governor and TxDOT, Texas Toll Law SB 792 was enacted in early June. The new law:

- Provides local toll authorities with the first option to build toll projects in their jurisdictions and may use state right of way as needed.
- Provides NTTA and HCTRA the authority to enter into PPPs through CDAs.
- Requires local toll authorities and TxDOT to agree on certain business terms, such as toll rates, and to perform a market valuation study of all proposed projects to determine the road's total value.
- Allows local toll authorities to propose to build needed state roads and finance them through toll revenues.
- Modifies CDAs by limiting them to 50 years, mandating that future buyback provisions be stipulated in the CDA, preventing competing tax-funded roads from being built within four miles of a CDA tolled facility, and requiring CDA toll revenues be used only for other projects in the region where they are collected.
- Places a two-year moratorium on some CDAs, exempting those CDAs planned to be executed in the next two years.
- Allows TxDOT to issue $3 billion in bonds against future gas tax revenue to be used as TxDOT state equity for state toll roads. (PWF – June 2007, Vol. 217 - p.9)

NTTA's Second Proposal for SH 121

As the provisions of SB 792 emerged, particularly the one granting local toll authorities the first option to build toll roads in their jurisdictions, several state senators and the RTC invited the NTTA Board was invited to submit a second proposal for the SH 121. This postponed the signing of the concession agreement between TxDOT and the apparent high-bidder for the SH 121 project, the Cintra-JPMorgan

Exhibit 2 – Comparison of Cintra-JPMorgan and NTTA Bids for SH 121

Key Elements of Competing Proposals	Cintra-JPMorgan	NTTA
Up-Front Payment to TxDOT	$2.15 billion	$2.5 billion
NPV of Payments over 50 Years	$716 million	$833 million
Total NPV of Financial Proposal	$2.87 billion	$3.33 billion

Source: Public Works Financing Newsletter, Vol. 217, June 2007, p.7

concession team. In April 2007, the NTTA Board authorized staff to develop a proposal for SH 121. NTTA submitted its proposal for the project in May 2007.

As shown in Exhibit 2, the NTTA proposal was financially more favorable than the winning concession team's earlier proposal. While the Cintra-JPMorgan proposal offered $2.15 billion in upfront cash plus a Net Present Value (NPV) of $716 million in payments over the 50-year term of the contract, the NTTA proposal offered an up-front payment of $2.5 billion plus a NPV of $833 million over 50 years.

The RTC voted 27 to 10 to endorse the NTTA proposal on June 18th based on the results shown in Exhibit 2 and other considerations. On June 28th, the Texas Transportation Commission (TTC) also gave its conditional approval to the NTTA proposal by a vote of 4 to 1.

By competing head-on with the Cintra-JPMorgan concession team, NTTA's Board Chairman Paul Wageman noted: "We certainly are committed to being the toll provider for the region." (PWF, June 2007, Vol. 217, P. 9) However, it took the challenge of the concessionaire's bid and the legislature's intervention to enable and encourage NTTA leadership to become more aggressive and make a substantial offer to retain their leadership position for developing and operating toll facilities in the Dallas-Fort Worth region.

Lessons Learned from NTTA's Pursuit of SH 121

Over the years, NTTA has been viewed as one of the nation's premier toll agencies, in part due to its conservative expansion plans and traditional financial practices. These conservative approaches were promoted by bond rating agencies which sought to minimize risks to the authority's bondholders, with the result being a higher bond rating. However, this conservatism placed the authority at a competitive disadvantage by allowing more aggressive private sector concession teams sponsored by TxDOT to take the lead on gaining the rights to complete and operate facilities within its jurisdiction, such as SH 121.

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Prompted by the Texas Legislature's initiative to moderate the state's PPP-enabled highway development program, NTTA's leadership realized they had more to gain than lose by actively participating in the program within their area of jurisdiction. With its system-wide revenues and expertise to leverage, NTTA discovered it could successfully compete or partner with private concession firms to pursue SH 121 and other opportunities as the projects' public sponsor.

What are the key implications of the NTTA SH 121 case for other U.S. tolling agencies?

- **Many established toll agencies have not effectively leveraged their financial capacity due to a number of factors. The reasons include:**
  - Institutional complacency;
  - Perpetuation of outdated financial, technical, and business practices that are less cost-effective than the innovative approaches used by those in the concession community;
  - Opposition or reluctance by their politically-appointed boards of directors or state legislative bodies to embrace efforts to increase toll rates to properly fund preservation and expansion programs; and
  - Restrictions imposed by the municipal tax-exempt bond markets and their insistence on high coverage ratios that force significant financial resources to lie unused. These resources could be put to better use developing needed transportation infrastructure and introducing more cost-effective technologies.
- **Established toll entities need to embrace innovative approaches that more fully leverage their experience and financial capabilities. These include:**
  - Indexing toll rates for inflation;
  - Raising toll rates to cover the rapidly rising costs of highway construction;
  - Significantly lowering debt coverage ratios to free up otherwise idle financial resources;

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- Using system-wide revenues on a portfolio basis; and
- Using more innovative financing and financial sources (such as pension funds with lower cost and longer repayment terms) instead of traditional tax-exempt revenue bonds.

public tolling entities from realizing their full potential.

- **Experienced toll agencies can attain an even stronger position by selectively collaborating with private firms experienced in the application of cost-effective business best practices for project finance, development, operations, and/or preservation, including concessionaires that have honed their skills on large-scale projects around the world.**

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- **The NTTA experience with SH 121 should be a wake up call to other toll agencies that their future will also be threatened unless they adopt more cost-effective approaches to finance, deliver, and operate highway infrastructure.**
  - This will create a more level playing field for competing with larger state transportation agencies and sophisticated concession operators and financial firms.
  - Otherwise, established toll agencies in the U.S. may find themselves cut off from expansion projects needed to improve transportation mobility in their regions and outbid by private-sector competitors unconstrained by the limitations that have prevented
- **Optimal results can be achieved when the various parties to the competition recognize their respective capabilities and needs and develop prudent partnering arrangements that expedite the provision of needed transportation infrastructure.** These parties include regional and local tolling entities, state and local transportation agencies, and private providers of project delivery and financial services.

Conclusions

The NTTA-TxDOT struggle over SH 121 demonstrates that sufficiently threatened toll agencies can become more creative in their project delivery and financing approaches to meet and beat the competition. This requires removing outdated policy constraints to provide a more level playing field with state transportation agencies and private concessionaires that are less burdened by such constraints.

While many advocates of public-private partnerships decry the reversal of the CDA procurement process in Texas for SH 121 as an attack on PPPs, these developments actually benefit the consideration of PPPs by providing a more deliberate and balanced approach that protects both the public and private interests that underlie such partnership arrangements.

The success of NTTA to gain qualified approval to finance and develop SH 121 near Dallas suggests that other existing toll agencies in the U.S. have the financial and institutional capacity to match and even beat sophisticated competition for developing or operating tolled facilities in the regions they serve—if they are willing to adopt project development and financing approaches that significantly leverage their existing system resources, financial cash flow, toll revenue potential, and institutional knowledge of toll pricing and customer service.

The NTTA SH 121 case provides a wake-up call to action for established toll authorities, commissions, and enterprises across the country to use their inherent financial and institutional capabilities to compete with, and when appropriate, collaborate with private and/or public partners to develop additional highway infrastructure necessary to promote the economic vitality of the nation. This will ultimately transform the image of established toll agencies from "ugly ducklings" to "swans" of highway finance and development.

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