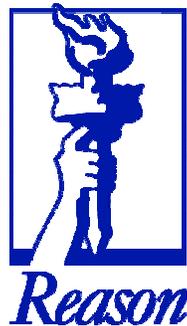


Tolling and Public-Private Partnerships in Texas: Separating Myth from Fact

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Introduction/Overview

The enormous challenge of reducing traffic congestion over the next 35 years, while Texas adds 13 million people, led to enactment of sweeping legislation in 2003 to permit expanded use of tolling and public-private partnerships (PPPs). That law, as strengthened by amendments in 2005, has led to Texas attracting enormous potential private capital investment to expand its highway capacity beyond what would have been considered possible several years ago. The Texas policy has also been cited repeatedly as a model by other states enacting similar enabling legislation since 2003.

Nevertheless, now that major deals are starting to occur, serious questions have arisen about the wisdom of pursuing this path. Are long-term PPPs (called Comprehensive Development Agreements—or CDAs—in Texas) actually sound long-term transportation policy? Could existing public-sector toll agencies raise as much—or perhaps even more—funding for transportation as private toll road companies? Should the state enact a two-year moratorium on CDAs during which time it studies their efficacy? This policy brief aims to answer such questions, as a guide for concerned citizens, media observers, and public officials.

Can Public-Sector Toll Agencies Generate More Value?

Perhaps the most explosive contention in the 2007 Texas toll roads debate is the idea that whatever benefits may be achievable via CDAs can also be delivered by existing public-sector toll agencies such as Harris County Toll Road Authority (HCTRA) and the North Texas Tollway Authority (NTTA). Two variants of this claim have been made. The mild version is that a public authority could raise just as much, financially, as a private lease. That was the finding of the Citigroup/Siebert Report as interpreted by First Southwest Company for Harris County in June 2006.¹ The bolder version of this proposition was put forth by consultant Dennis Enright in his independent study comparing a hypothetical NTTA proposal for the State Highway 121 (SH-121) project with the CDA proposal from Cintra.² In what follows, we will refer to these two reports as the First Southwest report and the Enright report, respectively.

The Enright Report

This report addresses the following question. For a brand-new “greenfield” toll road, could a public-sector toll agency such as NTTA generate more net funds for

¹ First Southwest Company, “Harris County Toll Road Authority Financial Alternatives,” Houston: Harris County Commissioners Court, June 15, 2006.

² Dennis Enright, “Texas Hold'em: Will the State Go ‘All-in’ on Public Private Partnerships (‘CDAs’) and Lose \$2 Billion?” Jersey City, NJ: NW Financial Group, LLC, April 12, 2007.

transportation investment than a CDA such as that proposed for the Dallas-area SH-121? Under the negotiated CDA, Cintra would finance and build the new toll road at its own expense, make a \$2.1 billion up-front payment, make annual lease payments with a net present value of \$700 million, and provide revenue sharing if the toll road exceeds certain traffic and revenue targets. Drawing on a letter from the North Texas Tollway Authority³, Enright makes a comparison between the accepted Cintra proposal and a hypothetical NTTA deal. The latter would borrow against the entire NTTA toll road system, so as to come up with an equal \$2.1 billion up-front payment. Enright goes on to conclude that the public-sector deal could produce nearly twice as much value as Cintra's CDA. This extraordinary claim deserves extraordinary scrutiny.

Enright's conclusion stems from several key elements of his analysis. The first is to assume that toll revenues over the 50-year period would be identical between NTTA and Cintra. This is very likely to be wrong, for two reasons.

1. *Unrealistically aggressive traffic and revenue forecasts:* Enright's analysis is based on a traffic and revenue forecast that is unrealistically aggressive for a public toll agency. Toll agency all-debt financings rely on conservative, investment-grade forecasts. The one produced by Wilbur Smith Associates (WSA) for SH-121 as a public-sector toll road projects \$20.5 billion in nominal revenues over a 50-year period. But Enright uses WSA's alternative toll projection (totaling \$34.7 billion), based on a more aggressive demographic forecast, which he and NTTA guess that Cintra may have used in their proposal. That higher-risk forecast is appropriate for equity investors, who do not need an investment-grade rating to finance such a project. But it's unlikely to pass muster with rating agencies and tax-exempt bond buyers of an agency like NTTA, who expect investment-grade ratings.

2. *Unrealistic projected toll increases:* The other problem with Enright's toll-revenue projection is the assumption that a public toll agency would be able to increase tolls every year for 50 years, as authorized under a CDA with a private company. Political interference in toll-setting has plagued public toll agencies as long as they've been in existence. The only examples we have where a public agency is making regular toll increases are the relatively new E-470 in Denver, the TCA toll roads in Orange County, California, and the 91 Express Lanes, also in Orange County. In the last of these, the Orange County Transportation Authority understands that in order for value pricing to work to keep traffic flowing without congestion, toll rates must be kept at market-clearing levels, via an automatic process. As for E-470 and the TCA toll roads, their toll rates have been regularly increased thus far. But we have no guarantee in any of these cases that the toll road agencies will be allowed, politically, to keep doing this 20, 30, or 40 years from now. Thus far, no public agency has invented a fool-proof mechanism for ensuring the kind of 50-year revenue flow made possible by a legally enforceable CDA.

In fact, there is a long history of political interference with toll-increase plans of public toll agencies. At present, both the Miami-Dade Expressway Authority and the West Virginia Parkways Authority are facing legislative threats to prevent toll increases, and

³ Letter to Sen. John Carona from NTTA Chairman Paul N. Wageman, March 12, 2007.

such actions have occurred in recent years over proposed toll increases on the Delaware River bridges between Pennsylvania and New Jersey, as well as on the Massachusetts Turnpike. The financial markets are well aware of this risk, and take it into account in assessing plans for future toll increases by public toll authorities. In sharp contrast, when the government of Ontario, Canada attempted to prevent toll increases authorized by the long-term concession agreement for the 407ETR toll road in Toronto, the courts upheld the legitimacy of the toll increases. Financial markets noted that, as well.

Another factor leading to Enright's conclusion is his unexplained listing of the net present value of operations and maintenance costs over the 50-year period as being 42% higher for the private firm than for NTTA. By everything we've learned about private-sector service delivery over the years, the default assumption should be that the private sector would be leaner and more efficient than the public sector, not dramatically more costly.

Finally, there's the question of discount rates. In order to make a fair comparison of money flows over time, it is standard practice to use some kind of interest rate to discount future flows to present value. When a firm makes a decision about an investment, a key issue is the value of the resulting cash flows over time. From the firm's standpoint, the interest rate used reflects the level of risk associated with these future funds. An informed investor will select the appropriate rate to use, depending on the nature of the investment.

Here Enright totally misses the mark. As the ultimate beneficiary, representing the public, the "investor" in this case is the Regional Transportation Council (RTC). It has a choice between two "investments": the proposal from Cintra and the hypothetical NTTA deal. Once the CDA is signed, the annual lease payment from Cintra is almost certain. It has the same priority for payment as operating and maintenance costs, and must be paid before debt service, taxes, or dividends to shareholders. But in the hypothetical NTTA deal, RTC's future payments would come only after the payment of operating costs, debt service, and a premium that NTTA will get—and only if there is money left over. A reasonable investor would be more skeptical about the value of these future payments than Cintra's, and would assign a higher discount rate than applied to the Cintra proposal.

But Enright does just the opposite. He uses a 5% discount rate for NTTA, but 6.17% for Cintra, which is his estimate of their respective weighted average cost of capital. This, plus his over-estimation of Cintra's O&M costs, entirely accounts for his conclusion about greater value from the public-sector deal; otherwise (given his assumption of equal toll revenues in the two cases), his analysis would show the two deals producing equal value. But if you also re-do the calculation substituting the more appropriate lower (investment-grade) traffic and revenue forecast for NTTA, then private CDA deal would clearly produce *greater* value.

Besides these basic errors, this kind of comparison leaves out a crucial difference between toll agencies and concession companies: the willingness and ability to take risks. Grandiose plans to "leverage" existing toll agencies assume that conservative rating agencies and their bond-buying customers will sit quietly for massive increases in debt

and adoption of very aggressive traffic forecasts. That's unlikely to happen. Concession deals are not simply the same old, same old. They are a new and important phenomenon for U.S. transportation finance.

The First Southwest Report

The First Southwest report was aimed at answering a related but slightly different question: Would Harris County be better off selling or leasing the HCTRA toll road system, or could it realize comparable sums for transportation investment by, in effect, refinancing HCTRA? Three separate teams addressed these three alternatives (sale, lease, refinance), using common data on future traffic and possible toll revenues developed by WSA. The Citigroup/Seibert team looked at the refinancing alternative.

An underlying WSA report presented three possible revenue projections for the HCTRA system, for use by all the participants:

- A. Base Case, continuing traditional flat-rate tolls for the entire study period;
- B. Inflation Case, in which toll rates are increased to keep pace with 2.5% annual inflation;
- C. Revenue Maximization Case, in which tolls are reset regularly to whatever level would maximize toll revenue.

Citigroup/Siebert then looked into the extent to which HCTRA could raise more funding from its current asset base (its existing toll roads) by a more aggressive approach to toll increases and more aggressively leveraging (borrowing against) its assets. If HCTRA adopted inflation-indexed tolling (Case B), they projected that it could fund \$8.2 billion in new projects instead of the currently planned \$4.5 billion. And by going to a revenue-maximizing toll policy (Case C), HCTRA could increase this total to \$10.8 billion. But the report notes that those dollar totals *also* assume a decision "to leverage the system aggressively." That would mean reducing the current "coverage ratio" (the ratio of annual revenue to annual debt service), which the report notes would increase the cost of borrowing. The conclusion is that "Leveraging the system aggressively beyond today's levels would allow the County and HCTRA to approximate the present value proceeds of either an Asset Sale or Concession."

The first thing to note is that this is a much less ambitious claim than Enright makes. This analysis concerns only existing toll roads, not the more-costly and higher-risk task of developing brand new ones. Second, its conclusion is that even in this less-demanding challenge, the best the public-sector agency could do is to *equal* what a private-sector approach such as a concession/CDA/lease could do, not exceed it.

After further consideration of PPP alternatives, the report concludes that, under existing laws, "preliminary indications suggest that these [PPP] alternatives would produce an uncertain amount of additional present value benefit, if any, to the value that the County and HCTRA could receive under the aggressive scenarios." In other words, when it comes to existing toll roads such as those belonging to HCTRA, if the public sector were willing and able to adopt an aggressive tolling policy, and stick to it for 50 to 75 years, *and* if it were willing and able to aggressively leverage its assets (i.e., borrow a great deal

more against them, at the likely penalty of a lower bond rating), it could possibly approach the value the County would receive by selling or leasing the system.

As noted previously in the Enright report discussion, neither of those assumptions is warranted. We do not know of any proven mechanism under which a public-sector toll agency can guarantee to investors that it will be able to increase toll rates regularly over a 50+ year period. Claims that an agency could do this will be treated as speculative by the financial markets. Second, as the Citigroup/Siebert report acknowledges, dramatically increasing a public toll agency's borrowing (aggressive leverage) will likely lead to a lowering of its bond rating, which will increase the rate of interest it must pay on its bonds.

Thus, there is little credibility to claims that public-sector toll agencies can generate as much or greater value for transportation investment than private companies operating under CDAs. Long-term toll road concessions (of which CDAs are one example) are not simply a private-sector version of a public-sector toll agency. They are a new and important innovation in U.S. highway finance, with a proven track record in Europe and Australia. They can mobilize more capital for a toll road project than traditional tax-exempt finance (see box), while shifting significant risks from the public sector to investors.

Specific Concerns about CDAs

Citizen groups and concerned legislators have raised a number of concerns about meeting a significant portion of Texas's future highway needs via toll roads developed by private

How CDAs Can Raise More Revenue than Conventional Toll Agency Finance

The first signed CDA is for the extension of the Central Texas Turnpike, SH-130 (Segments 5 and 6). The urban portion of SH 130, in and around Austin, was conventionally toll-financed by the Texas Turnpike Authority. The 40-mile southward extension, to San Antonio, was projected as having lower traffic, and when Texas DOT did their traffic and revenue assessment, they concluded that conventional toll finance could cover, at best, \$600 million of the project's \$1.3 billion cost. When the project was offered as a long-term concession, however, Cintra-Zachry offered to finance the entire \$1.3 billion project. Not only that, they agreed to pay the state a \$25 million up-front concession fee and to share in profits over the 50-year term of the deal.

Where does this huge difference come from? For one thing, the toll road company was less conservative in its projections of future traffic (and it alone bears the risk of being wrong on this). Second, the longer term (50 years versus the traditional 30-year tax-exempt financing) permits them to take into account longer-term development, new interchanges, and traffic growth. Third, there is clearly a greater willingness and ability by the company to keep toll rates growing in pace with economic growth over the life of the 50-year period. While governments could, in theory, plan to do likewise, political constraints would make this highly unlikely—and the financial markets recognize this and act accordingly. But under the CDA, the toll road company has a legally enforceable contract that permits toll increases, limited by an annual cap, for the duration of the agreement.

companies under CDAs. The concerns are all issues that need to be addressed. This section explains common misconceptions about the principal concerns that have emerged in this debate.

Sky-High Toll Rates

In responding to the challenge of raising many billions of dollars for new highway capacity, the investor-owned toll road companies offer a different approach to tolling than their traditional U.S. public agency counterparts (such as HCTRA and NTTA). Those agencies have traditionally issued toll revenue bonds based on flat-rate tolls, which remain unchanged either for the life of the bonds or for many years. By contrast, the investor-owned companies adjust toll rates regularly by some form of inflation index, often the consumer price index (CPI) or an index of economic growth such as GDP per capita. Thus, higher-than-traditional toll rates are part of the price to be paid for expanded investment in much-needed highway capacity—there is no free lunch.

But in fact, the case for small annual (or biennial) toll increases is quite sound. All of a toll road's costs (other than the initial construction) are affected by inflation: wages, maintenance, construction of additions, etc. Virtually no other business in America keeps its prices flat in dollar terms; instead, if they wish to stay in business, they generally keep their prices in step with inflation. Inflation, and the need for new construction, eventually catches up with public-sector toll agencies. Typically, after 10 or 12 years without a toll increase, they must then overcome political opposition to a 50 or 70% one-time increase, to catch up with current costs. That hits customers hard. It is actually more customer-friendly to enact modest annual increases, of the kind that people expect for most goods and services—which is what investor-owned toll roads do.

Critics of CDAs play a deceptive game, taking advantage of compound interest over a long period of time. For example, they will take a starting-year toll of 30 cents a mile, increase it by an assumed CPI of 3.5% per year and come up with a shocking \$1.63/mile by the 50th year. That sounds like an outrageous amount—until you realize that wages and salaries generally increase faster than the CPI (so the year-50 toll will be more affordable than the starting-year toll), and that a cup of Starbucks, a movie ticket, a plane flight, or a house purchase will likely also increase by the same percentage.

All concession agreements (including CDAs) contain caps on toll rate increases and/or ceilings on the rate of return the toll company can earn. And the annual ceilings are just that: ceilings. The actual amount a company can charge will be only as much as people are willing to pay. If the toll road does not offer fast, reliable trips worth the amount of the toll, people will choose non-tolled alternatives (including the frontage roads the private companies would likely be required to build alongside the toll road, as they have been in CDA agreements to date).

Too-Long Terms

Another oft-heard concern is that 50 years is simply too long a time for the state to contract with a private sector partner for operations and maintenance of a new toll road. Who knows whether cars and trucks on highways will still be our principal means of

moving goods and people 50 years from now? But that uncertainty about the future is equally true of the public sector and the private sector. In a long-term CDA, the investor-owned company takes on the risk that its toll road might have less value in the future. Its investors are willing to bet that the roadway's value will increase over time, but they cannot know that, any more than Texas DOT or a regional planning agency can know what transportation will be like 50 years in the future.

For this reason, concession agreements such as CDAs typically contain provisions for amendment, in ways deemed fair to both parties. And because negotiating such changes does not always go smoothly, they also include provisions for negotiating and arbitrating disputes, and using objective third parties to make fair valuation estimates.

To be sure, concession agreements can be for shorter terms than 50 years. In Europe in the 1970s, many plain-vanilla rural toll road concessions were for 30 or 35 years. Even today in Australia, many urban toll road projects are being done under 35-year concessions, though the government does the land acquisition, environmental clearance, and preliminary design, thereby reducing the costs which must be financed out of toll revenues. More complex toll projects today in Europe have much longer concession terms—e.g., 70 years for the \$2 billion A86 West tunnel near Paris and 78 years for the Millau Viaduct in France, the world's highest toll bridge.

Agreements less than 50 years can certainly be negotiated for many projects—but the impact of a reduced number of years during which investors can recover their investment will be significantly lower revenue to the public sector, whether in up-front concession fees, annual lease payments, or future revenue sharing (or all three). Here is one quantitative example. Credit Suisse in 2006 did a valuation analysis of a possible long-term lease of the Illinois Tollway System, at the request of a legislative body.⁴ They reviewed a large number of scenarios, with different assumptions about toll rate increases, traffic growth, and length of term. One pair of scenarios differed only by the length of the concession. For a 25-year term, the valuation ranged from \$1.6 to \$2.2 billion. By changing only the number of years, to 75 years, the valuation changed to between \$5.8 and \$8.4 billion. In other words, the additional 50 years led to 3.6 to 3.8 times as much net proceeds to the public sector.

Loss of Control of Highways

There has been much concern about the state losing control of its highways. Roads built using long-term concessions such as CDAs are not privately owned; the state still owns the roadway and protects the public interest through negotiating and enforcing the terms of the concession contract. When drafting this long-term contract (the CDA), the government must comprehensively protect taxpayers and road users by demanding full accountability.

⁴ Credit Suisse, "Illinois Tollway System: Preliminary Valuation Analysis," Illinois Senate, Powerpoint presentation, August 29, 2006 (available at www.jschoenberg.org/tollway/Illinois_Presentation_Final.pdf).

Concession agreements are typically several hundred pages long, and may incorporate other documents (e.g., detailed highway performance standards) by reference. The public interest is protected by incorporating detailed provisions and requirements into the agreement to cover such issues as:

- Who pays for future expansions and reconstruction;
- How decisions on the scope and timing of those projects will be reached;
- What performance will be required of the toll road and the toll road company;
- How the contract can be amended without unfairness to either party;
- How to deal with failures to comply with the agreement;
- Provisions for early termination of the agreement;
- What protections, if any, will be provided to the company from state-funded competing routes (see below);
- How to determine the value of the toll road, in case of early termination; and,
- What the limits on toll rates or rate of return will be.

The first two CDAs developed thus far in Texas cover these points and many more. All the terms of a CDA are enforceable via the judicial process.

The alternative to using the private sector (via CDAs) to develop lots of new toll road capacity would be to greatly expand Texas DOT and local toll road agencies to do such projects. But as discussed previously in this paper, those agencies cannot raise as much money as toll road companies can, and they tend to be less efficient and less innovative than toll road companies.

Non-Compete Provisions

Nearly all toll roads—both public-sector and private-sector—request and obtain some degree of protection from unlimited competition from taxpayer-provided “free” roads. Otherwise, if the government could build unlimited amounts of high-quality freeway right next to the toll road, it would be very difficult if not impossible to sell the toll revenue bonds. (Would you buy such bonds?)

The question is one of striking the right balance between the benefits of large new investment in needed highway projects (from new toll road capacity) and protection of the public’s interest in mobility and having a choice between presumably higher-quality (hence, worth paying to use) roadway service and lower-quality but inexpensive roadway service. Modern day “competing facilities” provisions seek to attain this balance. They seldom, if ever, ban all “free road” additions near the toll road. And they usually provide for compensation for reduced traffic, rather than forbidding public-sector roadway additions.

In the case of the CDA for SH-121 in Dallas, the agreement defines a “competing facilities zone” on either side of the toll road. Certain additions of taxpayer-funded highway capacity within this zone would be subject to compensation, if the toll road company can demonstrate reduced traffic and revenue from those new roads. But *excluded* from such compensation are:

- All portions of major freeways, including I-35E, I-635, President George Bush Turnpike, U.S. 75, and U.S. 380;
- All limited-access highway lanes;
- All projects in the 2006-08 State Transportation Improvement Plan;
- All projects in the state's Unified Transportation Program;
- All projects in the NCTCOG Mobility 2025 Plan;
- All projects in the NCTCOG Mobility 2030 Plan.

To repeat, the toll road company, under the provisions of the CDA, has no right to prohibit *any* future road development. Its only remedy is compensation, if it can prove loss of revenue. And that remedy *only* applies to a narrow category of road projects *other* than the major projects listed above. Moreover, symmetrically with the company's right to compensation for loss of revenue, the agreement also gives Texas DOT the right to extra toll revenues attributable to positive impacts on the toll road from Texas DOT's own roadway improvements.

It is true that a 50-year CDA extends farther into the future than typical metro area long-range transportation plans. But the reality is (to take the SH 121 example, again) that by 2030, the area near SH 121 will be so built out as to make it extremely costly for anyone—public or private—to add new highways beyond those already planned. An example of such an area is the land near the Chicago Skyway, a toll bridge which the city leased for 99 years. The concession agreement in this case includes no protections from competition, since the area is so heavily developed as to make new roadways extremely unlikely.

To be sure, as with length of terms, some CDAs could be negotiated with little or no protections from competition. But that would further increase the toll road company's risk, and would presumably decrease the amount of revenue it could commit to sharing with the public sector.

Foreign Firms Controlling Our Highways

In the last several years, the financial markets have discovered U.S. infrastructure as an important new asset class. Potential investors include pension funds, insurance companies, and various specialized equity investors. In response, governments (including Texas) have passed enabling legislation, to permit toll road companies—funded by the financial markets—to develop and operate toll roads. When a public-sector agency seeks to find well-qualified firms to build, operate, and maintain toll roads for a long period of time, to do a responsible job, it must seek out the best-qualified firms. That means firms with a demonstrated track record of solid performance at building, operating, and maintaining toll roads.

The fact is, because of the long U.S. tradition of public-sector toll agencies, *there is no domestic toll road industry in the United States today*. By contrast, in Europe and Australia, such industries have been allowed to develop, and now possess world-class expertise in these tasks. That is why most of the important toll road concession deals in the United States (and in Canada) thus far have involved companies from places like

Australia, France, Italy, and Spain, all of which have thriving private-sector toll road industries. (A growing number of such deals do involve U.S. partners, e.g. Cintra/Zachry in Texas and Fluor/Transurban in Virginia.)

Those countries are all strong political and military allies of the United States. And by making long-term investments in immovable transportation infrastructure, they are showing very serious confidence in the legal and political environment of the United States. Ask yourself if you would tie up a billion dollars for 50 years in an immovable toll road in (name your choice of developing countries). Probably not, since the legal and political risks (as well as inflation risks) would seem far too high. Long-term investments in much-needed transportation infrastructure, by companies domiciled in long-time U.S. allies, should be welcomed every bit as much as investments by Japanese auto companies and Korean electronics companies.

Seizure of Land

A completely understandable concern relates to the involuntary purchase of private property to obtain the right of way needed for a new road. The U.S. Constitution permits this to be done by the state, but only upon payment of just compensation. Some opponents of CDAs have claimed that the enabling legislation permits Texas DOT to delegate this power to toll road companies. That is absolutely not true. This power of eminent domain remains solely with the state, where it belongs. Since the right of way for toll roads developed under CDAs will always be state-owned, only the state will acquire such land, where necessary, using eminent domain.

Private companies have a strong interest in limiting the amount of eminent domain used on their projects, and the bad publicity, lawsuits, delays, and public opposition that go along with it. On a proposal for HOT lanes on the Beltway in northern Virginia, the private firm re-designed the additional capacity desired by Virginia DOT to drastically reduce potential public-use land takings.

Obscene Profits/Guaranteed Profits

Some participants in the Texas debate on CDAs have decried such agreements for guaranteeing a toll road company a 12.5% return on its investment. In fact, the Texas agreements, like those in other states, *do not guarantee any return on investment*. In fact, one of the major risks that is being assumed by such companies is the risk that traffic and revenue may be far below their projections. New (“greenfield”) toll roads have a history of underperforming their forecasts, especially in their early “ramp-up” years. Recessions in the U.S. or regional economy can depress driving and revenues; so can the failure of projected real estate development to occur within the expected time frame. Numbers like 12.5% are only estimates of what such a company might be able to achieve if all goes well over many years of toll road operation.

And what if such a firm did succeed in achieving a return in the low double digits? Would that be “obscene”? Here one cannot ignore the relevant global market for infrastructure investments. The money that Texas has been (so far) attracting to invest in toll roads could equally well be invested in other states, other countries, and other types

of infrastructure (port terminals, airports, electric transmission lines, etc.), and rates of return in the low double digits are expected in infrastructure in developed countries. If governments in a particular jurisdiction decide that competitive rates of return will not be allowed, much of that capital will go elsewhere—to other jurisdictions and other types of infrastructure.

Buyout Provisions

Every concession agreement needs provisions dealing with “termination for convenience”—the ability to end the agreement before its expiration date. Such terms need to be fair to both parties. Some versions of the proposed moratorium would change the provisions now being used by Texas DOT, so as to prohibit a buyout formula from being based on the market value of the concession. The fair market value of a long-term concession agreement is the net present value of its net revenues over the remaining years of its term.

This was exactly the method used to arrive at a mutually acceptable value when the Orange County Transportation Authority repurchased the 91 Express Lanes from the toll road company that had developed this project, terminating the concession with 28 years remaining. The third-party valuation study was based on the net present value of projected net revenue over those years. Any buyout at less than fair market value is a form of expropriation. Including such a provision in the law regulating CDAs would have very negative consequences, since toll road companies would be unlikely to enter into long-term deals that involve billions of dollars if much of the value of such a deal could be recaptured by the state at a fraction of its value.

Consequences of a Moratorium

A proposed two-year moratorium would have a number of consequences. To begin with, a moratorium until September 2009, enacted in May 2007, would actually last nearly two and a half years, not just two. It is naïve to think that today’s flurry of private-sector activity in Texas would freeze-frame, to resume business-as-usual 28 months later.

A moratorium on CDA projects would be seen by the private sector as very negative for future investments in Texas. The uncertainty as to what kinds of PPP agreements will be permitted when the moratorium ends will motivate companies to turn their attention to other fast-growing states with workable PPP toll road concession laws already on their books (e.g., Florida, Georgia, Utah, Virginia, Washington) or those that seem close to enacting such laws (e.g., Arizona, California, Nevada, Tennessee). Thus, marketing and project-development offices in Texas will not likely be maintained for 28 months to see what happens. Those people and the underlying expenditures will go where the action is.

That means that even if a workable revision of the current CDA law emerges after 28 months, there will be a further delay as companies return to Texas and set up new offices. So what we are realistically looking at is at least a 36-month delay. What can we expect will be the consequences of waiting three more years to develop projects suitable for undertaking as CDA toll roads?

- Construction cost inflation over the next three years could add between 15% and 30% to the cost of projects, making them harder to finance and requiring higher toll rates.
- Much-needed congestion relief in Austin, Dallas, Houston, San Antonio, and other metro areas will be pushed three years further into the future, costing motorists, truckers, and regional economies many billions more in wasted time and lost productivity.
- Interest rates in 2011 are likely to be higher than today's historically low rates of interest. That means higher financing costs for toll road projects—which again means either higher toll rates, less net revenue to the public sector, or both.

In short, a moratorium on CDAs would be very costly for mobility in Texas. Thus, it is hard to take seriously the claims of some moratorium supporters that they are not opposed to either tolling or PPPs; they just want to ensure that the public interest is protected. We have tried to demonstrate in this paper that the concerns being raised about CDAs and the public interest are already being addressed in the kinds of agreements Texas DOT has been negotiating. A policy-maker who understands this must therefore weigh the serious harm that a de-facto three-year moratorium will do.

Conclusion

Those who want to kill PPPs in Texas, and perhaps to kill toll financing along with them, are understandably supporting the proposed moratorium. But those who understand the necessity of toll finance for meeting the state's congestion-reduction and highway expansion needs, and who understand the advantages the private sector brings to the table, should oppose any moratorium. It would be bad public policy that would seriously undermine the goal of reducing congestion and improving mobility for all Texans.

About the Author

Robert W. Poole, Jr. is Director of Transportation Studies and founder of Reason Foundation, a nonpartisan, nonprofit think tank based in Los Angeles. He has advised the U.S., California, and Florida departments of transportation, and served 18 months as a member of California's Commission on Transportation Investment. He has also advised the last four White Houses on various transportation policy issues. In the field of surface transportation, Poole has advised the Federal Highway Administration, the Federal Transit Administration, the White House Office of Policy Development, National Economic Council, Government Accountability Office, and state DOTs in numerous states.