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ANSWERS TO APRIL 22, 2008 LETTER BASED ON FEBRUARY 2008 DRAFT PUBLIC-PRIVATE PARTNERSHIP RFP

As stated in the cover letter to this document, changes to the procurement process must occur to address the concerns raised by DOT&PF, the Department of Law and the Governor's Office. The February 2008 draft Public-Private Partnership (P3) RFP has not been further developed and does not reflect KABATA's final recommendation.

Since its creation by the Legislature in 2003, KABATA has been diligently working to achieve its legislative mandate of completing the Knik Arm Crossing. At that time, the Knik Arm Crossing had received federal earmarks of $231 million. This level of federal earmark significantly reduced the amount of funding required by the State, either through tolls or from other revenue sources. In this time frame KABATA began undertaking the necessary steps to make the Crossing a reality. The environmental review process was started, and a traffic and revenue report was commissioned.

Due to issues not related to the Crossing, the federal earmarks were removed and the amount ultimately appropriated for the Crossing was reduced to $94 million. Faced with a project cost estimate in excess of $600 million, KABATA began investigating other means of delivering the Knik Arm Crossing. Three scenarios were considered:

- The Crossing could be constructed without tolls, which would require the State to fund approximately $550 to $650 million. As in all State projects, the State would retain all environmental, permit, funding, construction, and operation and maintenance risks and costs over the life of the Crossing.
- The Crossing could be funded using public toll revenue debt issued by KABATA. Our analysis indicated that due to the constraints of the tax-exempt municipal debt markets, there would still be a funding gap of between $100 and $200 million. This gap would need to be funded by the State. In addition to the typical risks associated with a State project, under this scenario the State would assume 100 percent of the toll revenue and toll operations risks.
- The Crossing could be developed utilizing a Public-Private Partnership. KABATA's analysis indicated that under this structure there would likely be no additional upfront funding requirement by the State and, in fact, the State could be paid in excess of $400 million over the proposed life of this arrangement. The private developer would assume most but not all of the risks borne by the State in the two above scenarios.

Based on KABATA's analysis of the alternatives, a decision was made to move forward with the procurement of a P3 contract. Legislative authority for this approach was granted in 2006 and the board resolved to pursue a P3 in November 2006. DOT&PF and the Department of Law worked with KABATA to adopt the innovative procurement procedure necessary for this approach.

While there are many forms of P3 arrangements, the approach selected by KABATA is referred to as a "committed financing," which requires the successful proposer to offer definite pricing and financing with ready and willing sources of debt and equity providing written commitments to fund. Under this approach, the State would still be responsible for certain project-related risks, but would be able to transfer substantial amounts of financing, revenue, construction, operational, and maintenance risk to the successful proposer.

Alternative forms of public-private partnerships include pre-development agreements which result in a process that is very similar to the AGIA process. In this case, a project is awarded and the successful private developer works with the public agency to obtain environmental approvals, permits, and refined construction costs. The final financial aspects of the project are then negotiated after these elements are obtained and a final form of Public Private Agreement (PPA) is negotiated on a sole source basis. If the parties are unable to work out the terms via these negotiations, the public agency can end the negotiations and proceed with a competitive procurement of a public-private agreement. This approach was not chosen for the Knik Arm Crossing specifically because of the mature stage of project development and the desire to capture the maximum financial value of the concession for the State through a competitive auction bid process, which takes most advantage of the advanced state of project development.

Another public-private model that is emerging is the use of an availability payment. Under this model the public sector retains the right to all toll revenue but agrees to pay to a successful bidder a series of payments. The competition for this bid structure is centered on the lowest availability payment bid. The successful bidder is required to construct, operate, and maintain the facility and would be able to raise financing based on the public agency's promise to make availability payments. The public agency takes all the revenue and toll operations risk.

KABATA's selection of a firm, committed-financing public-private model was based on the constraint that, with the exception of the federal monies and state match, the Crossing had to be self-funding. It was KABATA's evaluation that this approach best matched that constraint. This was done recognizing that there were certain risks that the State potentially would need to retain. We recognize that these risks are the center of your inquiry, and we address these below.

At all times KABATA has attempted to protect the interests of the State in accomplishing its legislative mandate, the development of the Knik Arm Crossing. It has always been our understanding that the State's policy directive to KABATA has also been to try to contain the State's risk exposure, to the extent possible, within the parameters of this project, while maximizing value. This constraint was an integral part of the decision to move forward with a committed financing approach, because it was felt that this approach would maximize the upfront payment to the State, provide the greatest ongoing share of toll revenues, and allow the greatest risk transfer from the State.

In order to accomplish this directive, we have made decisions in a reasonable and diligent manner based on the best available advice and data. KABATA is fully aware that reasonable people can come to different conclusions and decisions on any issue. KABATA is also aware that with the passage of time policy objectives can change to meet current realities. Consequently we are looking forward to addressing your concerns and working with DOT&PF to develop solutions that are acceptable to all parties.

For ease of addressing the issues contained in your April 22, 2008 letter we have taken the liberty of organizing your inquiries into 11 areas, and have fashioned our responses around these 11 areas. We accept that we may have either inadvertently omitted or misinterpreted an area of inquiry. If this is the case please let us know and we will be glad to address it.

1. To date KABATA has spent approximately $40 million of public funds developing the Knik Arm Crossing. What were these funds expended on?

To date through April 30, 2008 approximately $41.5 million have been invested by the State to further the development of the Knik Arm Crossing. Approximately $2 million of this total was expended or contractually committed directly by DOT&PF prior to the formation of KABATA.

The bulk of these funds have been expended to complete the necessary environmental reviews and supporting engineering studies. Of the $41.5 million expended to date, 71 percent, or $29.2 million has been spent on these required reviews. As a percentage of total project cost, KABATA has spent approximately 6 percent on environmental, or about half the national average of 12 percent[1]. As you are aware, the environmental review is not a requirement that is unique to a public-private partnership but is one that is required for any federally-funded transportation project as a matter of law, regardless of how it gets delivered.

The balance of the $41.5 million has been used as follows:

- ***General and Administration.*** $5.2 million have been spent since 2003 to run KABATA. This accounts for 13 percent of the total and includes salaries, benefits, office expenses, board of directors' expenses, and associated overhead.
- ***Public-Private Partnership Procurement.*** $3.8 million or 9 percent of the total. This includes legal, engineering, and financial advisory services plus direct expenses associated with preparing and submitting the Request for Proposals, development of a shortlist, drafting

[1] FHWA's ***REPORT TO CONGRESS ON COSTS ASSOCIATED WITH THE ENVIRONMENTAL PROCESS: Impacts of Federal Environmental Requirements on Federal-aid Highway Project Costs*** dated October 25, 2006.

the various procurement documents, developing valuation models, and conducting industry review meetings.

- ***DOT&PF Overhead Charges.*** $1.8 million or 4 percent of the total. Since KABATA is part of DOT&PF, the Knik Arm Crossing pays the same DOT&PF federal overhead rate applied to all similar capital projects funded with Federal-aid or state funds.
- ***Traffic and Revenue Studies.*** $1.4 million or 3 percent of the total. Originally started to support a public financing, these studies have allowed KABATA to evaluate toll elasticity, measure the economic impact of the Crossing, establish a valuation for the Crossing, and model traffic impacts and the need and timing of future capacity.

We recognize that $41.5 million seems like a very large number. We would note that over 90 percent has been spent on work that is not directly related to the current public private partnership procurement. These expenditures are requirements for the Crossing to move forward regardless of delivery method and have been efficiently invested in the project.

2. Correspondence with Proposers requesting acknowledgement that the RFP documents are in final form. In the alternative, provide the current draft RFP documents to DOT&PF and the Department of Law with a cover letter stating KABATA's staff has already negotiated the best terms.

It has always been the documented and certain intention of KABATA that the draft RFP documents, including the February 2008 draft RFP, are not in a final state until there is concurrence with the Governor's Office, DOT&PF, and the Department of Law. The February 2008 draft RFP was never viewed by KABATA as being a take-it-or-leave-it draft. It was submitted for review and concurrence as is the normal process within DOT&PF. Therefore, the procurement cannot be further developed to reflect any final recommendation by KABATA for project delivery until the State's concerns are adequately addressed.

KABATA has involved DOT&PF throughout the development of this Project to date and fully intends continuing to do so. The Commissioner of DOT&PF and/or his designee is a member of the KABATA Board of Directors, has attended virtually all of its meetings and informational sessions, and has been in continuous contact with KABATA's Executive Director. DOT&PF has been included in work plans, budgets, and methods of project development since the beginning, as has the Department of Law. Other DOT&PF personnel have had an open invitation, have been encouraged to participate and have participated in the KAC Project development process as well as development of P3, including attending P3 industry review meetings with the private developers. DOT&PF and Law have had full access to KABATA's Intralinks Procurement Data Site and the various drafts, as they have evolved, of the Public Private Agreement, Instructions to Proposers, and the Technical Provisions since the summer of 2007, as well as full access to and audit of all financial records, external audits, and annual reports of KABATA from its inception.

The RFP documents consist of three basic documents: the Instructions to Proposers, Public Private Agreement, and the Technical Provisions. There are also numerous exhibits to these documents, importantly including a form of Independent Engineer's Agreement and form of Project Trust Agreement, among others. Each of these documents was developed based on similar documents used on other Public-Private Partnerships throughout the United States. They have been modified to fit the specifics of the Knik Arm Crossing and the requirements of Alaska law.

The most recent drafts of these documents were forwarded to DOT&PF, FHWA, and the Department of Law on or about February 26, 2008. There have been no significant modifications to these documents since that time in anticipation of review comments and reconciliation of the concerns raised by the Administration and DOT&PF.

The RFP documents are not in final form. KABATA has always understood that the RFP documents could not be formally released without the appropriate State reviews and authorizations, and including those required from FHWA.

Starting with the initial drafts, these documents have undergone a series of changes. Most of these changes were driven by internal discussions and decisions made by KABATA with input from the Department of Law and DOT&PF. To the extent provided, these documents also attempt to address concerns raised by FHWA.

Further, the draft RFP documents have been modified to reflect changes from issues discovered in the environmental review process. We anticipate that there will continue to be a need to make such modifications until the Record of Decision is entered and the necessary permits are received.

At specific points in the process, drafts of the RFP documents were provided to each of the Proposers for comment. Four separate industry meetings were held with the Proposers, in addition to several conference calls. The main purpose of these meetings and conference calls was to receive comments and answer questions from the Proposers on the RFP documents. In all several hundred comments were offered and considered, but only a selection of which have been incorporated into the February 2008 draft of the RFP documents. The Proposers have not been given these drafts and are not aware of the precise extent to which their many comments have been incorporated into the RFP documents directly or in part.

KABATA's staff cannot provide a letter stating that the best terms have already been negotiated, for three reasons.

First, the industry meeting process that has occurred has not been a negotiation. KABATA has simply answered Proposer questions and received their comments and has asked questions to try and understand the nature of those comments. KABATA, without assent from the Proposers, made decisions about whether and how to modify the draft RFP documents to reflect their expressed concerns and comments at all times considering what we believed to be in the State's best interest. Again, the Proposers have not been given the February 2008 drafts.

Second, the process that KABATA is currently pursuing anticipates several additional industry meetings, plus the potential to incorporate technical solutions that improve aspects of the Crossing that, for example, reduce risk and/or increase value to the State. This process has been utilized in other states and has proven beneficial.

Third, lenders do not know what their final terms have to be until the private developers finish their RFP due diligence ($5 million to $10 million) near the end of the RFP period, and the private developers do not know what their final terms with the State have to be until they negotiate final terms with the lenders.

More importantly, KABATA is awaiting approval and/or directions from DOT&PF on a number of issues, many of which are contained within your April 22, 2008 letter. The RFP documents can only be considered final, in the sense that they are ready for the formal RFP release or represent the "best deal" at this point, when the State is comfortable with what is embodied within the RFP documents and FHWA has approved them for release. This necessarily implies that since there are aspects of the project with which the State is uncomfortable, then those aspects need to be addressed and satisfactory solutions developed. Once the State is comfortable with the RFP documents, FHWA approval for formal release is also required.

3. Provide an updated risk matrix with discussion of the associated risks of the Knik Arm Crossing, risks associated with Project Delay, and risks associated with the proposed traffic floor.

The February 2008 draft RFP has not been further developed and a draft RFP will not reflect KABATA's final recommendation for project delivery until the State's concerns are adequately addressed. KABATA is not further developing the February 2008 draft RFP and is instituting changes to the procurement to further mitigate risk and resolve the concerns raised by the Governor's Office, DOT&PF, and the Department of Law.

The most current version previously submitted to you and based on the February 2008 draft RFP, of the *Cost Risk Assessment of the Proposed Knik Arm Crossing* is being forwarded under separate cover. The following responses are based on Scenario 2 of the *Cost Risk Assessment of the Proposed Knik Arm Crossing*.

The risk analysis suggests that the estimated cost impacts that could have resulted from Scenario 2 range from zero to $112.8 million. The expected value (i.e., the mean) was $50.5 million. These numbers are shown in Table 1, Cost

Table 1. Cost Impacts (in Millions $)

		Percentile		
Risk	**Mean**	**10%**	**50%**	**90%**
Hazardous Materials	2.2	0.5	1.1	5.6
Governmental Approvals	44.1	0.8	30.6	104.2
Earthquake & Volcano	0.5	0.0	0.0	0.0
Right of Way	4.2	0.0	2.7	11.0
Utility Relocations	0.4	0.0	0.0	0.0
Overall	**50.5**	**3.2**	**38.4**	**112.8**

Impact (in Millions $). This table shows that the most significant potential monetary risk that KABATA and the State would have assumed under the February 2008 draft RFP documents was that associated with delay in obtaining the necessary governmental approvals.

Similarly, the expected results of the risk analysis in terms of schedule show the expected value (i.e., the mean) would have been 10.9 months delay, with a range from 0 to 27 months. Consistent with Table 1 above, Table 2, Schedule Impacts (in Months) illustrates that the most significant schedule risk to KABATA and the State would have been from the obligation to deliver governmental approvals.

Table 2. Schedule Impacts (in Months)

		Percentile		
Risk	**Mean**	**10%**	**50%**	**90%**
Hazardous Materials	1.4	0.5	1.3	2.4
Governmental Approvals	9.5	0.0	6.5	24.8
Earthquake & Volcano	0.0	0.0	0.0	0.0
Right-of-Way	0.5	0.0	0.0	2.7
Utility Relocations	0.1	0.0	0.0	2.0
Overall	**10.9**	**0.0**	**8.6**	**27.0**

Governmental approval risks generally involve delays, mitigation costs, termination, and/or litigation challenging the Letter of Authorization and the U.S. Army Corp of Engineers (USACE) 404 Permit. The February 2008 draft RFP documents classified most of these events as Relief Events and/or Compensation Events depending on the nature of the specific event.

A Relief Event was a specific event which results in material delay or interruption of the developer's ability to perform its obligations under the PPA. The developer was entitled to an extension of contract deadlines, to temporary excuse from performing obligations that it cannot carry out because of the event, and potentially to an extension of the concession term to make up for the adverse economic impact of prolonged delay. The PPA listed 20 specific Relief Events, including delay in obtaining governmental permits timely, and changes in baseline mitigation.

Compensation Events resulted in payments to the selected developer. In most cases these payments would have come from KABATA, although for a few events (tax on toll receipts, imposition of state or local real property taxes on the developer) the economic impact could have been made up through toll rate adjustments or toll surcharges. These payments could have taken several forms. The PPA listed 19 specific Compensation Events including the discovery of pre-existing hazardous materials, imposition of state and local real property taxes on the infrastructure, delay in obtaining governmental permits, and changes in baseline mitigation.

The February 2008 draft RFP documents established a selection process that provided an incentive to the Proposers to submit technical solutions that minimize the risk of delay in obtaining governmental permits. The technical solutions that could have helped mitigate these risks would only have been known with certainty when proposals were submitted.

On February 13, 2008 at a meeting in Juneau we provided you with a matrix summarizing the various risks that were associated with financing, constructing and operating this Crossing, and the allocation of those risks between KABATA and the successful proposer as had been contemplated in the February 2008 draft PPA, including how KABATA would have proposed to manage those risks.

The risk analysis contained within the Cost Risk Assessment of the proposed Knik Arm Crossing did not include an analysis of the risks associated with the proposed traffic floor during the first ten years of operations of the Crossing. The traffic floor mechanism was not intended to improve the successful proposer's financial position and did not provide a return on the proposer's equity. The intent was to stabilize and thus reduce the lenders' perceived risk during the first ten years. This would have had the effect of reducing financing costs and provide value to the State. Based on the concerns raised, the economic value of including a traffic floor provision should be compared to the cost of the risks created by that floor.

As set forth in the February 2008 draft RFP documents, the traffic floor was set at 75 percent of projected traffic in year one. The projected traffic used for this calculation was the lower of KABATA's or the successful proposer's traffic projections. The floor fell by one percentage point each succeeding year through the tenth year, when the traffic floor equaled 66 percent of the applicable projection. No floor was provided after the tenth year – the presumed end of traffic ramp-up. Under those terms and using the best current data, the developer assumed from 94 to 87 percent of traffic and revenue risk, depending on the year. Table 3, Traffic Floor Calculations assumes that the traffic floor was based on KABATA's traffic forecast.

Table 3. Traffic Floor Calculations

	Wilbur Smith Associates' Forecast				Annual	
Year	**PV**	**CV**	**PVE**	**PVE**	**Floor %**	**Floor**
2012	7,400	1,000	11,000	4,015,000	75%	3,011,250
2013	11,000	1,500	16,400	5,986,000	74%	4,429,640
2014	14,300	2,000	21,500	7,847,500	73%	5,728,675
2015	17,000	2,300	25,280	9,227,200	72%	6,643,584
2016	17,900	2,400	26,540	9,687,100	71%	6,877,841
2017	18,800	2,600	28,160	10,278,400	70%	7,194,880
2018	19,800	2,700	29,520	10,774,800	69%	7,434,612
2019	20,900	2,800	30,980	11,307,700	68%	7,689,236
2020	22,000	3,000	32,800	11,972,000	67%	8,021,240
2021	23,100	3,100	34,260	12,504,900	66%	8,253,234

If the actual traffic was less than the traffic floor, then KABATA would have been obligated for the toll value of the difference between actual annual traffic and the floor for that particular year. Conversely, if the traffic would have exceeded the traffic floor, KABATA would have received "traffic credit" to offset potential traffic deficits that might have occurred in future years and to reimburse KABATA for any payments that might have been made in previous years during the ten-year period. The numbers contained in Table 3 above are based on annual traffic levels in passenger vehicle equivalents (PVE). PVE converts commercial vehicles to the equivalent of passenger vehicle counts using a 3.6 conversion factor, and is higher than Average Daily Traffic, or ADT. Table 4, Probable and Floor ADT, shows the relatively low levels of ADT that would have been needed to meet the traffic floor. To calculate round trips, simply divide ADT by two.

Table 4, Probable and Floor ADT

Year	Probable Case ADT	Floor %	Floor ADT
2013	8,400	75%	6,300
2014	12,500	74%	9,250
2015	16,300	73%	11,899
2016	19,300	72%	13,896
2017	20,300	71%	14,413
2018	21,400	70%	14,980
2019	22,500	69%	15,525
2020	23,700	68%	16,116
2021	25,000	67%	16,750
2022	26,200	66%	17,292

Your April 22, 2008 letter specifically requested us to provide the potential cost to KABATA should traffic levels have fallen to 75 percent, 50 percent, and 25 percent of the projected level. At 75 percent of the projected level, the traffic floor cost to KABATA would have been zero. Estimates for what the 50 percent and 25 percent cases could have been are set forth in Table 5, Traffic Floor Payments. The Differential Columns shown on this table reflect the annual difference between the reduced traffic levels and the annual traffic floor in PVE, not ADT, for each of the 10 years. The Payment column reflects the annual payment, based on what the expected reduction in toll revenue attributable to the Differential might have been.

Table 5 has not been adjusted to reflect the statistical probability of occurrence. We are in the process of defining the statistical distribution for the traffic floor risk. Using the best preliminary data we have for the statistical distribution indicates the probability that traffic volumes would have exceeded the traffic floor (the level at which no traffic floor payments would have been made) varied from 93.5 percent to 87.2 percent over the ten-year ramp-up period. This indicates that, with an approximately 90 percent confidence level, no payments would have been made under the traffic floor guarantee. Similarly, the probability that traffic would have exceeded 50 percent of projected values varied from 99.9 percent to 98.8 percent over the same period, and that it would have exceeded 25 percent of projected values varied from 99.9997 percent to 99.97 percent over the same period. This indicates that the probability of payments under the traffic floor at the 50 percent and 25 percent levels would have been less than or equal to about 1 percent. Final results of this statistical analysis of the traffic floor will be provided to you once they are completed.

Table 5. Traffic Floor Payments

	50% Projections		**25% Projections**	
Year	**Differential**	**Payment**	**Differential**	**Payment**
2012	(1,003,750)	($5,018,750)	(2,007,500)	(10,037,500)
2013	(1,436,640)	($7,369,963)	(2,933,140)	(15,047,008)
2014	(1,804,925)	($9,475,856)	(3,766,800)	(19,775,700)
2015	(2,029,984)	($10,921,314)	(4,336,784)	(23,331,898)
2016	(2,034,291)	($11,229,286)	(4,456,066)	(24,597,484)
2017	(2,055,680)	($11,635,149)	(4,625,280)	(26,179,085)
2018	(2,047,212)	($11,873,830)	(4,740,912)	(27,497,290)
2019	(2,035,386)	($12,090,193)	(4,862,311)	(28,882,127)
2020	(2,035,240)	($12,394,612)	(5,028,240)	(30,621,982)
2021	(2,000,784)	($12,484,892)	(5,127,009)	(31,992,536)

4. Provide a discussion about when and under what circumstances KABATA would cancel the procurement or the PPA due to liabilities arising from delays or conditions imposed by environmental permits.

Within the RFP documents, there were four time periods where cancellation due to problems with environmental permits would have entailed different costs to KABATA and the State.

As drafted, the RFP documents provided KABATA an unlimited right to cancel the procurement anytime up to award of the PPA. KABATA would have cancelled the procurement if it had become apparent that either the cost of mitigation required to obtain environmental approvals or the impact of potential delays on the project costs would have exceeded the Upfront Concession Payment. Upon cancellation of the procurement each of the Proposers would have been owed a pro-rata portion of the stipend. In the event that either Proposer submitted a non-responsive proposal, as defined in the RFP documents, and then KABATA cancelled the procurement, KABATA could have rejected that proposal and would have owed no stipend to the Proposer despite cancellation.

An essential part of a responsive proposal was that it contains a binding offer to enter into the PPA on the terms presented in the RFP. Both Proposers would have been submitting offers under the same PPA and RFP terms. This would have included agreeing to the conditions of NTP1, NTP2 and NTP3 and to the payment of the minimum upfront and annual concession payments, among many others. While there was room for KABATA, if it chose, to further negotiate the PPA between selection and final award, failure of the selected Proposer to agree to the PPA would have resulted in its proposal bond and/or letter of credit being called.

The draft PPA established three separate notices to proceed after the PPA would have been executed. NTP1 would have occurred when the final terms and conditions of the PPA were agreed to by all parties, including the Department of Law and DOT&PF, and the successful Proposer closed its financing and paid to KABATA the required upfront payment. After NTP1 was issued, the developer would have prepared the elements of a comprehensive project management plan pertaining to project design, right-of-way acquisition, utility relocation and construction. The project management plan would have required KABATA's and FHWA's approval.

Once the developer had received these approvals, KABATA would have issued NTP2. The draft PPA sets forth a number of items which the successful proposer could have undertaken after KABATA issued NTP2, including design and engineering, right-of-way acquisition, utility adjustments, obtaining governmental approvals, field and site investigations, data collection and analysis, site clearing, grubbing and staking, demolition of structures and related grading and filling, and mobilization. Should KABATA have cancelled the procurement during this period it would have had to essentially pay for the work done and pay for the costs necessary to undo the debt and equity financing, including the cost of closing the financing and any accrued and unpaid interest expense. As the PPA was drafted, the expended equity would have been paid back with interest at the London Interbank Offer Rate (LIBOR). This was one of several provisions which the proposers have objected to. Both were requesting greater compensation for equity.

The issuance of NTP3 would have authorized the successful proposer to move forward with all remaining activities necessary to complete the Crossing. It was anticipated that KABATA would not have issued NTP3 until it had obtained the NOAA Letter of Authorization and the USACE 404 Permit. Consequently, after NTP3, KABATA's permitting risk would have been almost non-existent.

Termination of the project after NTP3 would have been due to defaults by either the successful developer or defaults on the part of the State or KABATA. KABATA did have the right to terminate the project for convenience. The formulas for compensation upon termination after NTP3 were contained in Exhibit 24 of the PPA.

5. Discuss the potential of multiple risk events occurring consecutively.

The *Cost Risk Assessment of the Proposed Knik Arm Crossing* prepared by HDR/HLB Decision Economics, Inc. accounts for the occurrence of multiple risk events through Monte Carlo simulation of combinations of risk events. Monte Carlo analysis investigates outcomes that depend on multiple possible input values by performing many simulations of sets of the input values, each set of input values producing an output value. In our case the input values are the costs and/or delays due to, for example, obtaining permits, litigation, earthquakes and so forth. Each unique set of inputs produces a possible outcome. The inputs are simulated (i.e., produced) by randomly generating values for each input from their respective population of possible values. Each of the inputs is described by a type of statistical distribution (e.g., the normal distribution), and the frequency of obtaining any particular simulated value reflects the likelihood of that value occurring as described by its statistical distribution.

For example, in the risk analysis the cost of the Governmental Approval Risk (i.e., permit risk) associated with "Litigation causing injunction after obtaining the 404 permit" is described by a PERT distribution with a 10^{th}-percentile value of \$35,000, an expected value of \$200,000, and a 90^{th}-percentile value of \$400,000 and there is a 40 percent probability this event (i.e., this litigation) will occur. Our analysis used simulations of 10,000 sets of inputs, therefore in about 40 percent of those 10,000 simulations a litigation cost value taken from the above PERT distribution will be randomly generated for combination with the randomly generated costs for the other types of risks in order to arrive at an Overall (total) Risk cost. Delay costs associated with this litigation risk are also randomly generated and calculated for inclusion in the Overall Cost. In this way, our Monte Carlo analysis simulated 10,000 different possible combinations of risk events. The method captured all risk event combinations with greater than a 1/10,000 chance of occurring, thereby addressing the possibility of several risk events occurring in combination.

With respect to risk associated with low traffic volumes, any traffic floor risk cost would have occurred after construction. The *Cost Risk Assessment of the Proposed Knik Arm Crossing* covers through the construction phase of the project. We are in the process of defining the statistical distribution for the traffic volume. However, until we finalize the statistical distribution for the traffic volume we cannot characterize the combination of a traffic floor risk cost with the other possible risk events.

With respect to risk associated with the Ingra/Gambell Extension, please see the response to inquiry No. 9.

6. Discuss the availability and timing of project revenue to offset potential liabilities.

There are five basic revenue sources to the State under the February 2008 draft of the RFP documents. These four sources are:

- ***Upfront Concession Payment.*** As drafted the RFP documents require an Initial Concession Payment of approximately $37 million. Approximately $25 million of this amount is required to be paid into the project Trust prior to the issuance of NTP1 after repayment of certain State non-participating funds expended and transaction related costs of KABATA. The draft RFP documents also provide for the successful proposer to offer an amount in excess of the Initial Concession Payment. These funds would also be deposited in the Project Trust.
- ***Annual Concession Payment.*** The draft RFP documents require the successful proposer to make a minimum Annual Concession Payment into the Project Trust. This payment starts at $3.3 million and increases at an annual inflation rate based on a rolling 3-year CPI formula. The first payment is due on the date specified in the PPA as the date by which the Crossing must be open for traffic and collecting tolls. Successive year payments are due on January 1 of the applicable year. The draft RFP documents also provide for the successful proposer to offer additional annual compensation amounts, which can be either fixed, not necessarily uniform, annual amounts or an amount based on traffic, or a combination of both. The Annual Concession Payment is paid to the Project Trust.
- ***Revenue Sharing.*** The successful Proposer's offer will be based on specific traffic projections and a contractually specified toll rate schedule. While the toll rate schedule is determined by contract, the actual traffic levels will be determined by factors largely outside of the control of either KABATA or the successful Proposer. The revenue sharing provisions of the February 2008 draft RFP documents specify that the State receives a percentage of the positive difference between the projected and actual revenues at an increasing rate if traffic, and consequently revenue, exceeds projections. The first traffic band was established at a level which KABATA estimated was necessary for the developer to pay debt service and costs and earn a reasonable return. Above that band, the State's share increases from 25 percent to 75 percent in incremental traffic bands as this difference increases. The successful proposer is required to deposit the revenue sharing amount in the Project Trust 15 days after the end of each calendar year. These payments are subject to audit and subsequent adjustments.

- ***Refinancing Gain.*** The draft RFP documents require that the successful Proposer provide KABATA with the financial model upon which its bid was based. This Base Case Financial Model will include the successful Proposer's plans for refinancing the Crossing during the term of the concession. Should the successful Proposer complete a refinancing that is not contained within or varies from the Base Case Financial Model, and then the State would have the right to 50 percent of any gain from that unplanned refinancing after the developer earns its base case rate of return. Certain technical transactions are exempt from this provision. KABATA's share of refinancing gain is paid into the Project Trust.
- ***Rights to Future Tolls.*** As the years of operation pass and traffic becomes established over the Crossing, 100 percent of future tolls beyond the end of the term of the agreement may be used by KABATA as assets to secure debt.

Table 6 is a projection of project revenues totaling approximately $418 million, made up of a $37 million Upfront Concession Payment and Annual Concession Payments projected to total $381 million. These projections of revenue to the State have assumed concession award in 2009 and do not include estimates of amounts that proposers may offer above the minimums for concession payments, revenue sharing amounts, or any gains from refinancing. Quantifying these payments is speculative until KABATA actually receives proposals or until after the Crossing is open to traffic. The Annual Concession Payment begins at $3.3 million in the opening year and increases annually based on a 3-year rolling average CPI, assumed to be 2.5 percent. As drafted in the February 2008 RFP documents these amounts are the minimum that is required for a proposal to be considered responsive. A significant part (85 percent) of the evaluation of the proposals is anticipated to be the amount each proposer offers above these minimums. KABATA's financial modeling indicates that there may be an additional $100 million or more in value which the proposers may offer through some combination of upfront payment and/or increased annual payments.

Table 6. Projected KABATA Concession Revenue by Year

Year	KABATA Revenue	Year	KABATA Revenue	Year	KABATA Revenue
2009	$ 37,000,000	2029	$ 4,783,673	2049	$ 7,838,606
2010	$ -	2030	$ 4,903,265	2050	$ 8,043,571
2011	$ -	2031	$ 5,025,847	2051	$ 8,235,435
2012	$ -	2032	$ 5,151,493	2052	$ 8,441,321
2013	$ -	2033	$ 5,280,280	2053	$ 8,652,354
2014	$ 3,302,962	2034	$ 5,412,287	2054	$ 8,868,663
2015	$ 3,385,536	2035	$ 5,547,594	2055	$ 9,090,380
2016	$ 3,470,174	2036	$ 5,686,284	2056	$ 9,317,639
2017	$ 3,556,928	2037	$ 5,828,441	2057	$ 9,550,580
2018	$ 3,645,852	2038	$ 5,974,152	2058	$ 9,789,344
2019	$ 3,736,998	2039	$ 6,123,506	2059	$ 10,034,078
2020	$ 3,830,423	2040	$ 6,276,594	2060	$ 10,284,930
2021	$ 3,926,183	2041	$ 6,433,509	2061	$ 10,542,053
2022	$ 4,024,338	2042	$ 6,594,347	2062	$ 10,805,605
2023	$ 4,124,947	2043	$ 6,759,205	2063	$ 11,075,745
2024	$ 4,228,070	2044	$ 6,928,185	2064	$ 11,352,638
2025	$ 4,333,772	2045	$ 7,101,390	2065	$ 11,636,454
2026	$ 4,442,116	2046	$ 7,278,925	2066	$ 11,927,366
2027	$ 4,553,169	2047	$ 7,460,898	2067	$ 12,225,550
2028	$ 4,666,998	2048	$ 7,647,420	2068	$ 12,531,189

Again, these projections of revenue to the State do not include estimates of amounts that Proposers may offer above the minimums for concession payments, revenue sharing amounts, or any gains from refinancing.

It is anticipated that the entire amount of the State's share of revenues would be available to offset KABATA's potential liabilities. However, the Project Trust Agreement anticipates that a portion of the State's revenue share would be used to fund KABATA's ongoing budget.

One of the reasons for the use of a committed-financing approach is the ability of the State to obtain the highest monetary offer through what essentially amounts to a competitive auction process. The Proposers compete to see how much of the revenues they can give to the State, thus increasing the amount of project-generated funds available to fund potential liabilities or build future project extensions. This competitive auction process has proven to be successful in other states and is the reason it is essential to maintain at least two proposer teams for the RFP competition.

7. Discuss the State's share of project revenues and who has control of these funds.

The various sources of revenue to the State are discussed above. These sources are the Upfront Concession Payment, the Annual Concession Payment, Revenue Sharing, Refinancing Gain sharing, and Rights to Future Tolls.

All project revenues are deposited into a Project Trust administered by a qualified Trustee. There are multiple accounts established within the Project Trust, including accounts for revenue owed to the State. The draft of the Project Trust Agreement provides that funds contained within those accounts and which are beneficial to KABATA can only be released based upon a certificate from KABATA and subject to the provisions and restrictions contained within the Project Trust Agreement.

The February 2008 draft RFP documents utilize the Project Trust Agreement as a form of security to the successful proposer and other stakeholders that KABATA will have funds available to meet its contractual and other obligations. In general these funds are only available to meet KABATA's operating expenses, contingent liabilities, and provide funding for future expansions beyond those required of the successful proposer. This structure was set up in part based on the constraint to have the Crossing be self-funding. Additionally, both of the Proposers want clear assurances that KABATA could fund its obligations under the PPA.

There are other configurations of how KABATA's funds, which are held in the Project Trust, can be released. If project funding is provided by private or public lenders regardless of whether financing is P3, bonds or other debt such as State loans, lenders and bondholders will require restrictions on the use of project revenue to secure repayment of debt. The use of federal-aid funds subject the Project to a required federal 23 USC §129 toll agreement limiting the use of excess project revenues to eligible 23 USC federal-aid projects. A minimal change would have the certificate come from DOT&PF as opposed to KABATA. To the extent lender's trust restrictions have been met, any excess funds could then be made available to the State for other eligible Title 23 projects or as a payback mechanism for a State funded reserve account.

8. Provide a detailed Project cost estimate, inflated to projected years of expenditure assuming construction starts in each of 2011, 2013, and 2015.

KABATA's current financial modeling assumes that construction will begin in early 2009. The modeling was based on a total project cost of $667 million. This includes all costs to complete a tolled facility including construction costs, engineering fees, toll equipment, right-of-way, project management, etc. These costs are based on a PND study completed in March 2006 and were modified to reflect a 66-foot (four lane) wide bridge deck (instead of 44-foot).That modification increased PND's baseline estimate by nearly $59 million. The PND study estimated the costs of the Crossing in 2006 dollars, and those costs were inflated at a 4 percent per annum rate compounded quarterly to year of expenditure to arrive at the $667 million. For purposes of its financial modeling, KABATA assumed that the project would be awarded in late 2008 or early 2009 and that 2009 would be the first construction season.

Per your letter, we have also made estimates of construction costs assuming that construction would not start until each of 2011, 2013, and 2015. The estimated inflated project costs are $715 million, $767 million, and $824 million respectively. The details of these estimates are included in Exhibit 2 along with the base case forecast project cost of $667 million. For purposes of the effects on financial feasibility, note that the base toll would also be increasing starting in 2012.

9. Discuss how the Project addresses Ingra-Gambell.

The February 2008 draft PPA does not create an obligation on the part of either the successful proposer or KABATA to construct the Ingra-Gambell Extension. KABATA's formal commitment to construct Ingra-Gambell Extension is in the Agreement by and between KABATA and DOT&PF dated September 2006. KABATA's intention has been to utilize those funds in the Project Trust for which it is the beneficiary to fund all or some portion of the Ingra-Gambell Extension. KABATA also has tolling authority and the ability to pledge its toll and/or concession revenue to finance all or a portion of Ingra-Gambell Extension as necessary. The draft Project Trust Agreement specifically authorizes the use of these funds on the Ingra-Gambell Extension and for an expansion of the Port MacKenzie Road from two to four lanes.

KABATA's analysis of the Ingra-Gambell Extension indicates that for approximately 12 years the existing A/C Connector will be able to provide sufficient capacity to handle the projected traffic utilizing the Crossing. Our traffic and revenue modeling assumes that the Ingra-Gambell Extension is open for traffic in 2023 as shown in the AMATS LRTP.

Ingra-Gambell Extension delivery could potentially be accelerated regardless of traffic-based need through some combination of higher tolls for the Crossing, an incremental toll for using the

Ingra-Gambell Extension and/or the A/C Connector, and/or the investment of additional State or Federal funds. In the event that it is determined that it is in the State's best interest to deliver Ingra-Gambell Extension sooner than 2023, there may be opportunities to commit future concession revenue to other projects, such as the proposed Highway-to-Highway Connector in Anchorage. We look forward to exploring the pros and cons of these options through further dialogue with DOT&PF.

10. Provide detailed monthly statements for KABATA for the last twelve months, and projected monthly expenditures for the next 12 months.

Detailed monthly expenditures for the Knik Arm Crossing for fiscal 2008 and 2009 are attached as Exhibit 1. Fiscal 2008 includes actual expenditures for the ten months ended April 30, 2008 and estimates for May and June. It is presented on an accrual basis and includes approximately $1 million of incurred expenditures that were not yet recorded in AKSAS through April 30, 2008. Fiscal 2009 is a forecast by month that includes projected KABATA operating costs and capital costs associated with completing a ROD, pursuing permitting activities to mitigate risks, continuing public and stakeholder outreach, and evaluating opportunities to partner with the Municipality of Anchorage and DOT&PF to accelerate the delivery of the Ingra-Gambell viaduct.

Potential expenditures related to certain activities such as procurement-related costs, right-of-way acquisition, utility work, etc. are not included in the baseline forecast for fiscal 2009, but would be incremental to that forecast should these project activities be pursued.

11. Engage and educate the public and the Legislature about the project.

KABATA has demonstrated its commitment to an open and transparent process by engaging in extensive public and stakeholder outreach since the inception of the project. Over the course of the Project we have met with Chambers of Commerce, Rotary Clubs, local governments, Community Councils, members of the Legislature, and many other groups. For example, we have held 10 meetings and also exchanged extensive correspondence with the Government Hill Community Council. We have also conducted 4 other Community Council meetings, 8 non-governmental organization meetings, 16 meetings with various community groups, 6 formal public open house presentations and public hearings, 5 other public information meetings, a 63-day comment period on Draft EIS, 2 public surveys, and 49 other meetings with government agencies, interested groups and individuals plus government agency outreach to 23 cooperating and participating government agencies through 6 interagency group meetings, 39 individual or small group interagency meetings and 11 native tribal meetings. Also, extensive comments were received and addressed under the NEPA process, and have been reflected in the Final EIS.

In addition to the above meetings, for the Section 106 process we have held 17 meetings in the last two months with the Government Hill Community Council, the Municipality of Anchorage, the State Historic Preservation Office, and several other stakeholders. KABATA has also made extensive documents and information available through its Web site including studies and field research reports, informational presentations, project documents, the Draft and Final EIS, surveys, open houses and public hearings, Board minutes, annual reports, comment forms, schedules and EIS activities.,

Another measure of our commitment to public outreach is the public support we continue to receive. The Anchorage and Wasilla Chambers of Commerce have both passed resolutions supporting the project and the Alaska State Chamber adopted a position of support based on public outreach to these bodies. Two past public opinion polls indicate close to two-thirds of Anchorage Metropolitan Statistical Area (Anchorage plus Mat-Su) residents support the project. Those polls were more recently validated by the Wilbur Smith Associates' stated preference survey, which, though not a formal poll, indicated 70 percent support.

A complete listing of the above meetings associated with the NEPA process, a Speakers Bureau List, and other outreach activities are available at http://www.knikarmbridge.com/project_docs.html

The open and transparent public outreach will continue as we go forward to mitigate the risks of concern and deliver the value of the Knik Arm Crossing to Alaskans.

Summary

As noted at the beginning of this response, KABATA had been proceeding under the constraint that project costs needed to be contained within the Project. The interpretation of that directive was that DOT&PF would not provide any funding for the Project other then the federal monies already committed and the associated State match. Another constraint was the objective of keeping tolls low. The approach we have taken was to deliver the maximum value of the project within those constraints. However, we also recognize that this approach required the assumption by the State and DOT&PF of certain risks. A review of the Febraury 2008 draft RFP by DOT&PF, Department of Law, and the Governor's Office has raised concerns about those risks. Without addressing these concerns, it is premature to further develop the procurement at this time. Our resources are directed at completing the environmental review process, obtaining necessary permits and addressing the concerns of the Administration and local government. Acceptable terms for Project delivery mitigating those concerns with an acceptable risk profile are available through close coordination with DOT&PF and the Administration.