BN Private Toll Road Investors Shift Financial Risk to Taxpayers
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By David Mildenberg

Nov. 27 (Bloomberg) -- Companies that build private toll roads are pressing states to assume more financial risk of traffic not meeting expectations, a change that benefits the operators while threatening to increase taxpayer costs.

Illinois and Indiana are among states offering set payments instead of the right to keep toll revenue, the standard financing method in the past. A similar approach is being used in Florida to expand highways in Fort Lauderdale and Orlando, and by the Port Authority of New York and New Jersey for a bridge to Staten Island.

The new financing arrangement decreases the risk for operators, which include Madrid-based Ferrovial SA and Sydney-based Macquarie Atlas Roads Group, after at least 11 private U.S. toll projects since 1995 have struggled financially due to traffic not meeting projections.

"We are seeing more of that because investors are a bit skittish about the U.S. market," said Richard Geddes, director of Cornell University's Program in Infrastructure Policy in Ithaca, New York. "If it's a new road, there is a lot of risk on how many vans, trucks, motorcycles and other vehicles will end up paying the tolls."

States are agreeing to make regular payments, often on a monthly or annual basis, provided toll-road operators build and maintain projects according to the contracts they negotiated.

Under the arrangements, states receive toll revenue and have to augment it with money from their operating budgets should traffic fail to generate enough to cover costs. The terms typically call for the states to take over the roads after several decades.

'Less Risky'

There are at least six unannounced toll-road projects under discussion in which states would make fixed payments, said Peter Raymond, U.S. leader of capital projects and infrastructure at PricewaterhouseCoopers LLP in Washington, which consults for companies building the roads.

"For the financial community, it makes it much less risky and less costly," Raymond said. "It makes it easier for the concessionaires to get the deal done."

Congress in June agreed to expand loans used mostly to finance toll-road construction. The Transportation Infrastructure Finance and Innovation Act, or TIFIA, which leverages federal money with local spending, was increased to $1 billion a year from $122 million.

Overoptimistic Projections

Private toll roads were common in the U.S. in the 1800s, and most of them were eventually taken over by the government or shut down. For much of the past century, states and regional agencies built toll roads by selling tax-exempt bonds.

As road funding diminished and lawmakers objected to raising taxes, governments began searching for ways to finance roads.

The first private road in modern years, called the Dulles Greenway, opened in 1995 in the Virginia suburbs of Washington. Initial traffic on the 14-mile Greenway was less than forecast, forcing a refinancing in 1999.

Other privately backed roads in California, Colorado Illinois, Indiana, South Carolina, Virginia and Texas have had bankruptcies, restructurings, credit downgrades or less traffic than projected. In some cases, anticipated development near the roads didn't materialize.

Thirty-three states allow private ownership of highways, according to the Denver-based National Conference of State Legislatures.

Vehicle forecasts done by consultants for states and investors have long proven overly optimistic. The first-year revenue of 26 public and private toll roads that opened between 1986 and 2004 averaged one-third less than projected, according to a 2009 analysis of federal data by Robert Bain, a transportation consultant.

Less Travel

"You never see a consulting report be negative or else they won't be able to sell the bonds," said Howard Cure, managing director of municipal bond research at Evercore Wealth Management LLC in New York.

Inflated projections are coinciding with a decline in U.S. driving. U.S. miles traveled peaked in 2007 with 3.03 trillion, and then declined 2.5 percent through 2012, according to the Federal Highway Administration.

The operator of the southern leg of State Highway 130, a toll road near Austin, Texas, had the credit rating on $1.18 billion of its bank and U.S. government debt cut in October to the third-lowest junk level after missing initial revenue forecasts by 55 percent since opening in 2012. Moody's Investors Service said there is a "high likelihood" of a payment default next year.

Texas Project

A unit of Ferrovial is the majority owner of the Texas project. The company, and other private investors, who won leases through bidding, bet toll revenues would exceed costs.

States face tough decisions over whether to lock into long-term obligations given the history of private toll roads, said Gabriel Roth, a retired traffic consultant who has worked for the World Bank as a transportation economist.

"It's a very good idea to have private people provide roads, but the condition in which the state pays up if there is no traffic is a disaster," Roth said.

TIFIA loans to private road operators offer below-market rates -- 3.87 percent as of Nov. 22 -- with 35-year terms and deferred payments. The deals often include an equity investment, bank loans and bonds issued through state public finance agencies.

Florida Roads

In Florida, the state agreed in 2009 to pay private investors $66 million annually over 30 years for redesigning an interstate near Fort Lauderdale and adding toll lanes. The investors are also receiving initial payments of as much as $686 million linked to completing the project on time. Florida plans to use toll revenue and its annual transportation budget to make the payments.

Florida could not have finished the project until the late 2020s without private investment from Madrid-based Actividades de Construccion y Servicios SA, and TIAA-CREF, a New York-based retirement-plan investment manager, said Paul Lampley, a construction project manager for the Florida Department of Transportation. The toll lanes are scheduled to open in March.

Using a private partner could inflate costs by $13 million beyond what it would cost the state to complete the project, or result in savings of as much as $244 million, depending on which financial assumptions are used, according to the Florida Transportation Department.

Illiana Expressway

"With the financial crisis going on in 2008 and 2009, this structure made the deal close, despite all the turmoil," said Leon Corbett, project finance manager at the Florida Transportation Department. Investors overwhelmingly supported receiving fixed payments rather than take on more risk tied to toll revenue, he said.

Illinois and Indiana want private investors to build a new toll road through farmland about 45 miles (72 kilometers) south of downtown Chicago.

Governors Pat Quinn of Illinois, a Democrat, and Republican Mike Pence of Indiana, say the road, called the Illiana Expressway, would boost economic growth and relieve traffic congestion in Chicago's south suburbs and northern Indiana.

The two states sought investors to accept toll revenue generated by the road. Investors instead insisted the states provide fixed payments over several decades, regardless of how much traffic the road attracts, according to two people whose employers are involved in the negotiations. Both asked not to be named because the discussions were private.

Illinois Deal

Paris Ervin, a spokeswoman for the Illinois Transportation Department, didn't respond to questions about investors' demands for fixed payments. Will Wingfield, a spokesman for the Indiana Transportation Department, said the state received feedback from toll-road operators and declined to comment on what they said.

Illinois is offering potential bidders as much as $200 million in upfront payments, and both states say they will make fixed payments for 35 years. The road is forecast to cost $1.3 billion to build with the states spending as much as $360 million for land and engineering.

Toll revenues will be sufficient to cover payments to a private operator, said Ervin. The states haven't said how much the fixed payments will total.

Illiana's tolls won't cover its costs for many years, if ever, because the road won't save truckers enough time to merit detours from nearby Interstate 80, said Robert Poole, director of transportation policy at the Reason Foundation, a free-market research group in Los Angeles. He said he based his view on publications he has read about the road.

Some states, like Texas, don't allow fixed payments to private toll-road operators. State lawmakers rejected a bill this year to make that possible.

"I've spent time over the past decade trying to build a firewall between taxpayers and these types of investments," said Lois Kolkhorst, a Republican state representative in Texas, who led opposition to allowing the state make fixed payments for toll roads. "Don't make taxpayers pay for mistakes."

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