Last month at a Senate Transportation Committee hearing on SB 79-80, the companion bills to HB 158/159, I said these bills represent a blank check while KABATA said that the state would make "availability payments" to the private partner and that private partner would bear the financial risk of the project.

Since then KABATA again submitted their annual application for a federal loan for 1/3 total project costs. I would like to briefly go over the financial sources and uses of funds from that application that the committee has, to show why this is at least a billion dollar liability to the state and why the state bears the full downside on the project.

Let me list 4 red flags in the document to suggest why you could be going to a bad play whose predictable sad ending you don't want to be around to witness. Any resemblance between my comments on this project and some of the causes of the recent housing bust and financial troubles are not coincidental.

Looking at page 1 of the sources and uses of funds of KABATA's Pro-Forma Plan of Finance you see that the $150 million is committed to the project at financing on day 1 and is not in some sort of reserve fund held for unexpected developments. Also note the $40 million in Capital Accretion Bonds which is a fancy way of saying there are insufficient tolls in the early years to pay interest on those bonds so interest accumulates and is added to the principal. Page 5 shows that the project cannot start to pay making payments on those CAB bonds until 2034 so the project would pay $208 million in accumulated interest to pay off the original $41 million in principal. Let's call a project where the principal amount owed goes up in the early years and not down as the first red flag of negative amortization or negative equity.

Page 6 lists the latest estimate of KABATA's availability payments to the private partner: $3.2 billion over 35 years or $ 3,227,382,614 to be exact, that is money that KABATA estimates they would be obligated to pay to a private partner over the next 35 years. KABATA would get the toll revenue and use it in part to make availability payments to the private partner sufficient to cover Bridge operating costs and the funds for the private partner to pay off the bonds. The private partner will use the KABATA contract to then get the investment credit rating from a rating agency that they need to go to market to sell the bonds.

Those annual availability payments start at $35.7 million in the year the Bridge opens in 2016 and gradually balloon to be $141 million in the year 2051 before all the bonds are finally paid off by the private partner. The states that have gotten into these public private partnership deals usually have a fixed amount of annual payments, like a mortgage. Because there is grossly insufficient toll revenue in the first 10-15 years, KABATA's projects payments grow at 4 % a year for 20 years and then 2% thereafter. Let's call that second warning flag balloon payments.

Page 6 also shows the annual costs for toll collection, a sinking fund to fund capital repairs, O&M costs, and KABATA admin costs. My message is, believe those costs, including the projected availability payments and bond payments; do not believe the projected toll revenue numbers that are needed to cover those costs.

Why not believe the revenue projections?

All KABATA revenue until this month was based on a Mat Su population in 2030 on 250,700; that number is nearly 50% higher than UAA ISER's number of 169,000 in 2030 up from 89,000 today. In December the state demographer projected a Mat Su population in 2034 of 152,456; so KABATA's number four years earlier is 64% higher than the state's demographer.

Because of our objections to the overestimated population, Wilbur Smith has now redone the population and toll numbers reducing them slightly about 20% in the early years and 8 % in the out years; this has the effect of reducing projected toll revenue by 12% in 2030. But KABATA has not released the new toll revenue study – that study is listed as Coming Soon on the KABATA web site – and by conflating regional population with Mat Su population they are hiding the ball in ways that make it hard to review. Wilbur Smith now says this slight alteration of their original 2007 numbers is not warranted for financial decisions. Let's call this third warning flag overoptimistic revenue assumptions or undocumented income.

If you still believe that KABATA's population projections are more accurate than ISER's or the Department of Labor you can today request the Department of Transportation to release their estimate of Mat Su-Anchorage traffic for 2030 at the Old Glenn crossing and Bridge traffic. DOT and AMATS did those numbers for the Highway to Highway project. They have so far repeatedly refused to release those numbers so today we filed a Public Records Act request.

My hunch is DOT numbers are about half what KABATA numbers are so the projected toll revenue to cover availability payments is at least a third but probably still 50% too high.

The reason why projected trip numbers and toll revenue are too low to meet expenses and pay off the bonds is apparent from the map you have before you from KABATA's consultant Wilbur Smith. The map shows that if you are at the corner of Knik Goose Bay Road and the Parks Highway in Wasilla it's 12 minutes faster to downtown Anchorage on the Glenn than if you take the Bridge. You have to be in Big Lake or 7 miles out Knik Goose Bay road before it's a faster trip to downtown Anchorage on the Bridge than the Glenn and you have to be indifferent to paying a $5 one way toll or $2000 a year for a commuter making a round trip. (Experts say tolls usually reduce demand by 25% or folks will drive about 8 miles out of their way to avoid paying one.) And if you are going from Big Lake to the hospitals, the U, or Fort Rich it will still be faster on the Glenn than the Bridge and the Glenn will be toll free.

So if these bills are still approved, what happens next? That gets to the fourth and final warning flag and the most serious one yet: the unlimited government guarantee in HB 159.

As KABATA has described, if these bills pass they will issue the RFP, acquire right of way including people's homes, and award the qualified project to the private firm proposing the lowest availability payments for KABATA. At that point KABATA will sign a contract with the private partner committing KABATA to 35 years of availability payments subject to annual appropriation of the legislature to make up the entirely predictable shortfall in toll revenue. The private partner will then use the KABATA

contract to then get the investment credit rating from a rating agency they need to go to market to sell the bonds to finance construction.

So the "finance risk" that the private partner is bearing is not the finance risk of a shortfall in toll revenue to pay off the bonds or make availability payments – that's the real risk the state will be bearing -- it is the quote "finance risk" that the State of Alaska will stop making the larger and growing availability payments to the private partner you see on page 6 that total $3.2 billion. That's not what I call a "finance risk" in any standard meaning of the term.

What KABATA has been saying since 2003 and I paraphrase, "If this project does not make financial sense to the private sector partner, then they won't support it and the bridge will not be built." The private sector does not want to touch this project if they have to assume the financial risks. That is why bills were introduced in 2008 to make sure that KABATA's RFP had public and legislative scrutiny before it was issued to prospective partners.

But the bills before you change the rules of the game from KABATA's original statute. HB 158 and HB 159 makes KABATA'S bonds, if they issue debt directly, or the availability payments contract to the private partner who would then issue bonds, "obligations of the state" ; that commitment also was in its March 1 federal application which pledged state funds to cover the toll shortfall "subject to annual appropriation."

Then there's an interesting $3 billion difference between this year's pro forma seeking the federal loan and last year's application for the same loan. On March 1 2010 when KABATA submitted its application to the federal government for the same loan program as this year, KABATA's estimate of the cumulative availability payments KABATA would make to the private partner was $6.3 billion over 55 years compared to availability payments of the $3.2 billion over 35 years you see in this year's application. That's a $3 billion discrepancy which can only be explained in part by the $150 million in this year's application from the state, shortening the time period to pay off the bonds, and dropping the private partner return from over $3 billion in last year's application to $924 million in this year. By this year's pro forma spread sheet the private sector return labeled "net cash flow" is an estimated 12% a year compounded, a high return given the state guarantee of the availability payments subject to annual appropriations.

You should not trust numbers that move around this much.

Making KABATA bonds or the "availability payment" contract guaranteed by the state is the blank check which the legislature is now being asked to sign. Future legislatures would then have the hard choice between appropriating funds from other sources to make up the difference between toll revenue and Bridge costs or letting KABATA go bankrupt on the bonds it issued or default on its availability payment contract to the private partner. As you can see on page 3 those projected availability payments are not small; they get up to $50 million in 2019 and over $100 million in 2038.

So what would happen if the state legislature refused to appropriate the funds to make those availability payments?

Now we have to use the B word, bankruptcy.

Last year in its second year of operation, San Diego's South Bay tollway went bankrupt. Macquarie, one of the two pre-selected private partners for the Knik Bridge project, was the private partner who defaulted on the bonds. The problem was the Macquarie sub who had the contract with the state was an LLC and creditors had no recourse to the assets of the parent corporation to pay off the bonds. So now the state of California is on the hook for the unbudgeted O&M costs and everyone's in bankruptcy court to see if the debt can be restructured and who will take control of the asset. Also last year, the Southern connector tollway another public-private partnership in Greenville, SC went bankrupt, leading to a rare Chapter 9 bankruptcy for a unit of government.

So if the state fails to make availability payments, the credit rating of KABATA, a state agency, is toast. More importantly, other state agencies like AIDEA, AHFC or the Municipal Bond Bank all issue debt in their own name but creditors count on the "moral obligation" of the state to make good on the bonds in case revenue from the project is insufficient. So the credit rating of these agencies would then also suffer as would the state's new high Aaa credit rating. If a new Red Dog deal came along could AIDEA get financing at reasonable rates to get the deal done? How would financing for local government projects through the Municipal Bond Bank or housing projects through AHFC be affected? How much more interest rates would the state pay on its GO bonds if KABATA defaulted on availability payments?

Last April when I went to the KABATA Board meeting and criticized the incompleteness of similar spreadsheets, I handed out the first detailed sources and uses of funds document the Board had seen.

There are good people on the KABATA Board but they are naturally focused on building a Bridge; they are not focused on what the real toll revenue of the Bridge will be, what other uses the state may have for 3 or 6 billion dollars in the future, or the impact this project will have on the state's credit rating. When the Board came to Juneau last month and met for an hour it did not discuss any financial spreadsheets on the project or what would be in the March 1 federal loan application. Rather they discussed the need to lobby public officials on the project and add a PR position to their operating budget.

So, to sum up, these bills before you completely change the rules of the game without KABATA accurately telling you what the costs of the new game are to the state and how this new game binds future legislatures. The original and amended legislation creating KABATA let them issue $500 million in bonds but they could not "create a debt or liability to the state", (19.75.221 (g) and those bonds had to be at no more than 125% of the Bond Investment Index or basically at investment grade. But toll numbers on this deal are so bad this deal can't earn an investment grade without your guarantee so HB 158/159 lets KABATA have $150 million in general funds and now issue $600 million in bonds or have a contract for availability payments and both would now be obligations of the state subject to annual appropriations.

Balloon payments, loans which over time increase and not lower the amount owed or negative equity, undocumented income or overly optimistic revenue estimates, an unlimited government guarantee, and the need to borrow $150 million from the parent to make the mortgage er availability payments in the

early years and for the parent, the state of Alaska, to co-sign the whole loan – we've seen this play before in the housing market and it's ended badly. As Yogi Berra said, it will be déjà vue all over again.

Thank you for listening. Be glad to take any questions.

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