A WHITE PAPER
EXPLAINING

The Need for the 2011 Alaska Legislature to Examine the Financial Plans of the Knik Arm Bridge and Toll Authority

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SUMMARY

The Knik Arm Bridge cannot be built unless: (1) the State guarantees repayment of the debt necessary to finance the bridge, (2) that guarantee would need to make up the annual shortfall between toll revenues and expenses, including debt repayment, and (3) the State agrees to spend on the bridge a substantial portion of all federal money available for transportation statewide. The legislature must exercise some oversight on the project because Knik Arm Bridge and Toll Authority (KABATA) intends to issue an RFP for the $700 million to $1 billion dollar first phase of this project. If KABATA proceeds as planned, the State will be exposed to considerable financial liability and transportation projects statewide will be jeopardized.

Using federal and state numbers, the deficits for the first 10 years of Bridge operations will significantly exceed the approximately $25 million per year that Anchorage or Mat Su have averaged over the last decade on total state and federal spending on transportation.

I. Background

The Knik Arm Bridge and Toll Authority, a quasi-independent state agency with a Governor-appointed Board of Directors, has a sole purpose to construct and operate the proposed Knik Arm Bridge. The original federal funds with their small state match, total $114 million. Half of those funds or approximately $61 million remains unspent. Since the federal money was de-earmarked, the State of Alaska can decide how it spends the remaining funds, if those funds do not go to KABATA.

II. Knik Arm Bridge Feasibility

Three recent developments have compromised the financial feasibility of the Knik Arm Bridge and the viability of the public-private partnership:

1. **In November 2010, KABATA was turned down for a federal, low-cost "TIFIA" loan of $279 million, or more than one-third the total project cost of $783 million for Phase 1 of the bridge**. This was junior debt at a below market rate which did not require any debt repayment until five years after the bridge opened. All KABATA financial statements to date have included these low-cost funds for a third of project costs. While KABATA may reapply - assuming the TIFIA program continues – there will be fierce competition for these funds (in 2010, one billion dollars was allocated out of the $12.5 billion requested). Many of the other projects that also had their TIFIA loan applications rejected have positive attributes that the Knik Arm Bridge project lacks: they address significant existing congestion, have private partners willing to assume the downside risk of building for a fixed price or willing to cover debt repayments if there are toll shortfalls, and have accurate, existing (as opposed to projected) traffic and revenue information to demonstrate financial feasibility.

2. **In December 2010, KABATA admitted that the project will need a "state guarantee" to be financed by a private partner.** The March 1, 2010 failed TIFIA letter of interest (essentially a loan application) pledged "annual appropriations of the state legislature" to cover the large (estimated at $40 million/year) expected shortfall between bridge toll revenues and bridge costs including bond repayments. In a private briefing to the Alaska Department of Revenue on March 23, 2010, KABATA staff put forward two financial scenarios: 1) a publicly-financed project with no private partner; and 2) a private partner putting 9% of the money in and receiving an estimated 64% of the money out over 40 years, with the State of Alaska signing a "letter of credit" (labeled as "off balance sheet financing") to, in effect, guarantee bond repayment. While the KABATA Board

did not review the March documents, and has not formally discussed any financials for the Bridge, at KABATA's December, 15, 2010 news conference, KABATA staff admitted they are seeking a "state guarantee."

The federal 3/1/10 application, the March briefing, and the December statement are all tacit admissions that *the private partnership concept is likely dead* in the sense of a private entity willing to assume the downside risk of the project. Quite importantly, previous support for the Knik Arm Bridge by the Anchorage Assembly and AMATS has been contingent on no further state or local monetary support.

3. **Federal transportation officials now are questioning two key elements of the project which KABATA has represented as not affecting the funding of other Alaskan projects**. First, KABATA has said that the proposed Knik Arm Bridge is not subject to state or federal "fiscal constraint" requirements, which is federal bureaucratese that the costs of the project do not need to be considered in long range planning "fiscal constraint" calculations. This means that the project's cost was not counted against other Anchorage projects when the U.S. Department of Transportation (DOT) assessed whether the state and Anchorage had adequate resources to follow through on constructing projects that receive federal planning funds. When AMATS updates the Anchorage Long Range Transportation Plan this year, however, U.S. DOT will require the Knik Arm Bridge to compete with funding for other projects including ALL other Anchorage-area road and safety projects, and demonstrate that there are sufficient resources to construct the projects.

   Second, the Phase I cost of constructing the Knik Arm Bridge was estimated at $686 million (National Constructors Group, 2009) or $783 million including financing costs without including any connecting roads outside of the direct bridge connectors. U.S. DOT is now questioning where the funds are for connecting roads, including the Phase 2 connection across Ship Creek to Ingra-Gambell plus bridge and connector road expansion to four lanes "when traffic warrants". Additionally, 2010 Mat-Su Assembly support for the Bridge was contingent on state or federal funds for engineering and design of improvements to the Knik Goose Bay Road, Burma Road, and South Big Lake Road and other public infrastructure in the area.

These three recent developments suggest it is now time for the legislature to provide a hard look at the financial feasibility of the Knik Arm Bridge project. With the granting of a Record of Decision (ROD) in December 2010, KABATA now can move forward and issue a Request for Proposal (RFP) to the two pre-qualified bidding consortia. Whether the terms of the RFP include a state guarantee or whether the legislature rightly insists on the private sector assuming all of the risk of making bond repayments, are issues that should be clarified prior to issuance of the RFP, not after a consortia has responded to the RFP, won a construction contract, the right to receive all toll revenue, and the project is ready to go except for the "details" of a state guarantee.

State financial liability is not a theoretical issue to be sorted out later; in 2010, two TIFIA-funded public-private partnerships went bankrupt leaving their states holding the bag.

- Macquarie, a large Australian-based financial firm and the lead private firm in one of the two pre-qualified bidding consortia for the Knik Arm Bridge, set up an affiliate for San Diego's South Bay Expressway project. In 2010, during its second year of operation when toll revenue of $6/car proved insufficient, the partnership declared Chapter 11 bankruptcy. The State of California has no recourse to the assets of the parent corporation to pay off the project bonds.
- In 2001 a non-profit entity was set up to operate the Greenville, South Carolina Southern Connector tollway. In 2010, the partnership declared a rare Chapter 9 bankruptcy (the bankruptcy code for units of government) on $300 million of bonds when annual toll revenue proved half the projected amount.

Both states now find themselves responsible for unanticipated operations and maintenance costs on the roadways while awaiting the results of a bankruptcy process to sort out who is responsible for debt repayments, the terms of the debt restructuring, and whether the state or creditors will own the roadway asset in the interim.

III. KABATA OPERATING ISSUES

Because KABATA has a Board structure and has advertised the Knik Arm Bridge as a public-private partnership, it has not had the administrative and legislative oversight consistent with other large state projects. Its operations to date are not consistent with other state agencies: KABATA has undertaken large and likely inappropriate lobbying and public relations expenses, used inaccurate population and revenue estimates, and developed financing plans that may not be consistent with its enabling statute.

Consider:

- **Over $1.3 million in large and likely inappropriate lobbying and PR expenses.**

  Since FY08, KABATA has spent $425,000 on lobbying the federal government, up to $250,000 in PR expenditures to MAP Associates, and $508,597 on legal expenses that may include lobbying.[1]

  Because it did not have the in-house, specialized legal expertise necessary, KABATA funds the Alaska Department of Law's contract with William A. Greene who purportedly provides legal expenses in the field of public-private partnerships which cannot be provided by the Department of Law. In 2009, William A. Greene represented KABATA, one quasi-independent branch of AK DOT/PF, in suing another branch of AK DOT/PF and AMATS to redo the process that postponed the Knik Arm Bridge into the long term portion of the Long Range Transportation Plan. William Greene may have provided excellent legal work, but without an audit of those legal expenses, it is not clear if those expenses included lobbying public officials or if state money underwrote other local units of government to join KABATA in its suit against the state and AMATS.

  KABATA also has paid Dittman Associates for a 2009 poll showing that the project had a majority approval if responders were told that the project would be paid by 70-90% private funds. KABATA's 2011 Dittman poll tellingly did not make the same claim that the private sector would pay for the bridge, and instead was silent about how the bridge would be paid for. The recent poll found a majority of Alaskans thought the Bridge would be needed in the near future, but failed to test the issue of cost; that is, it did not ask if the state should finance the project, or guarantee nearly a billion in debt, or how often the respondents would pay a $5, 1 way toll to use the Bridge. KABATA paid for radio ads four years ago supporting the project and in 2010 paid GCI for multiple Channel 1 airings of a 30-minute video (production cost $57,000) which included the KABATA Executive Director saying that all toll roads in the United States pay for themselves (not true – for example, Alaska's single existing toll road, the Whittier Tunnel, has its operations subsidized by the State of Alaska annually, as well as the 2 bankrupt toll roads listed above).

  An LB&A audit could determine if KABATA PR, lobbying, and legal expenses have provided objective and appropriate public information at a reasonable cost comparable to other Alaska DOT & PF projects. With KABATA seeking for the state to fund the project or a guarantee on state bonds, the Bridge is now a public project and the legislature can determine if the scale of public resources devoted to selling the project are appropriate for a project that the legislature will be asked to fund the project directly or through annually appropriated state debt service payments.

- **Inaccurate Population and Toll Revenue Estimates - Probably at Least 50% Too High.**

  All of KABATA's financial estimates of project toll revenues to date, assume a Mat-Su population in 2030 of 250,700 compared to UAA ISER's 2009 estimate of 169,000 in 2030. ISER's 169,000 number is now being used to analyze the Glenn/Seward Highway-to-Highway project. For the Mat-Su to grow from around 89,000 today to 250,000 by 2030 would require the Borough to add the equivalent of the city of Palmer, the Borough's second largest city, to the Borough <u>every</u> year for 20 years. Because the KABATA population estimate for Mat-Su is approximately 50% higher than the ISER estimate, the projected toll revenue is approximately 50% higher. Even ISER's 2009 population forecast included the assumption that some form of a natural gas pipeline would be built by about 2020. However, in December 2010, the US Energy Information Administration indicated that the pipeline

[1] Source: State of Alaska Checkbook and www.opensecrets.org.

will not be feasible, based on estimated gas prices, for at least another 20 years, thus a conservative new toll revenue forecasts would need to be based on NOT having the population influx that was predicted as coming from the gas pipeline.

After public-driven discussions at the KABATA Board meetings and the AMATS Technical Committee, in December 2010, KABATA has agreed to hire Wilbur Smith Associates to redo the population and traffic information in the next few months. Because accurate traffic population estimates are critical in determining accurate toll revenue, if the legislature is asked to provide a state guarantee, the legislature should independently review the technical accuracy of the revised traffic and revenue projections including their underlying assumptions and KABATA's overall financial plan.

The new Wilbur Smith analysis needs to include the effect of a $5 or more one way car toll, or $2000 or more annually for a resident commuting 200 days/year, on lowering demand to use the bridge. Presently residents have to live approximately 7 miles west or southwest of Wasilla near Big Lake or along the Knik Goose Bay Road for the bridge to provide a shorter trip to Anchorage than using the Glenn Highway. Residents of Palmer and Wasilla will continue to use the Glenn. Likewise, the new analysis needs to account for increased telecommuting as gas prices rise along with existing and likely future carpool and vanpool incentives and use.

- **KABATA's current plan for financing the project with a state guarantee may not be consistent with its enabling statute and its mission may better be handled by folding KABATA into Alaska DOT& PF.**

KABATA's enabling statute and its amendments gives it authority to issue bonds for up to $500 million plus issuance costs (19.75.211(c)) *without creating a debt or liability to the state* (19.75.221(g)) at a rate not to exceed 11% or a rate over 125% of the Bond Buyers Index (19.75.211(a)). At that 125%, the bonds likely would have to earn an investment grade in order to be sold. The statute basically assumes that the project only would go forward without pledging the state's credit rating because toll revenues would be sufficient to pay off the bonds, or that a private partner with adequate capitalization would take the downside risk of toll shortfalls to pay off the bonds.

Neither is the case. With KABATA now seeking a state guarantee of the bonds or a publicly financed project, which in effect exposes the state to equal liability, *the Knik Arm Bridge is now a public project.*

Bridge deficits of significantly more than $25 million/year will dwarf other transportation priorities.

Prior to the discovery of the population error and the loss of a low interest TIFIA loan for one-third of the project costs, an independent financial analysis using KABATA and Wilbur Smith numbers on costs and the Federal DOT estimates of revenue, showed that the bridge deficits for the first ten years of the bridge would be about $24 million year or roughly the same amount that Anchorage and Mat Su have each received each year on average in the last decade for all federal and state transportation funding. That includes road construction and maintenance, public transportation, and bikeways (see www.knikbridgefacts.org for spreadsheet). While interest rates have declined slightly since that analysis, the more significant loss of the TIFIA loan and expected population revision downward is certain to make revised Bridge finances significantly worse.

IV. CONCLUSION

With KABATA having now received a federal Record of Decision, it can move forward on an RFP. Because the project is now seeking a state guarantee and/or state funding, it is essential that the legislature review the financial feasibility of the project in 2011, examine KABATA's budget and operations, publically review the conditions of any RFP before it is issued, and determine if the bridge is the best continued use of Alaska's limited transportation funds.