NJPIRG

New Jersey Public Interest Research Group

Caution on New Jersey Turnpike and Parkway Deal

Six Public Interest Principles for Considering Toll Road Monetization

A deal to "monetize" the New Jersey Turnpike and Garden State Parkway should not be signed if it violates the public interest. No deal should be approved that fails to uphold any of six basic principles: public control, fair value, no deal longer than 30 years, state-of-the-art safety and maintenance standards, complete transparency and accountability, and no budget gimmicks. Here's why:

1. Public Control

Transportation policy has tremendous impacts on New Jerseyans' quality of life, health, and cost of living. It determines the level of traffic congestion and air pollution, the safety and quality of the roads, the many costs of driving and car ownership, and the availability of high-quality and affordable mass transit alternatives. Whether the state or a private operator controls the management of the Turnpike and Parkway has a powerful impact on transportation policy.

Any driver knows how events that take place on one road affect other connecting and alternative routes. Thus, toll levels, maintenance and safety standards, and congestion on the Turnpike and Parkway have a substantial impact on the number of cars using alternative routes, including local roads and mass transit. Decisions about how to operate and manage these roadways have the effect of creating traffic policy for the state. In the wake of the last Turnpike toll hike, for instance, many communities felt the impact of trucks diverted onto local roads. What may seem beneficial from a narrow profit perspective does not necessarily benefit transportation networks in New Jersey more generally. Public control of key toll roads is necessary to ensure a coherent statewide transportation planning and policy making.

Road privatization elsewhere shows that private operators' profit motive produces very different management decisions than government would. Three examples illustrate these potential dangers:

- *Non-Compete Clauses*—Deals in California, Colorado, and to a lesser extent, Indiana, limited the state's ability to improve or expand "competing" roads. In New Jersey, such a clause would cripple the state's ability to conduct effective transportation policy since virtually all major roads compete for cars with the Turnpike and the Parkway.

- *Private Toll Decisions = Broad Private Control of Traffic Management*—If the rules for increasing toll rates under Chicago toll road deal had applied to the Holland Tunnel since its inception, that roadway could presently charge a one-way toll of more than $180. As a practical matter, an operator would be unlikely to charge that price because drivers would instead take alternate routes. The point is that the Chicago toll-increase schedule effectively allows the private operator to charge whatever maximizes its profits. The toll operator can also offer discounts to particular types of motorists or encourage traffic between certain exits, as will maximize profits. Together these powers enable the operator to control toll policy, and thus dictate who drives on the toll roads, and when.

It's well understood that drivers avoid high tolls. That's the principle underlying congestion-pricing policies that increase tolls during peak traffic hours to shift drivers toward mass transit and less crowded times. The principle also creates the appeal for California's so-called "Lexus lanes," on which tolls adjust throughout the day to ensure light enough traffic for speedy travel, at least for those who can afford it.

- *Creates "Tax" on Normal Policy Making*—The Indiana deal also requires the state to pay investors compensation for reduced toll revenue when the state performs construction such as when it might add an exit, build a mass transit line down the median, or bring the road up to state-of-the-art safety standards. This compensation would add significant costs, and potentially state could not afford to do the work it would otherwise perform. As added complication, the exact level of these future payments might be subject to dispute and lawsuits.

  Transportation policy should be made according to what's best for the public, not limited by what kinds of extra payments may have to be made to a private operator.

2. Fair Value

The people of New Jersey need to be sure that the government would receive fair value for a public toll road. But obtaining this long-term value is highly uncertain, especially for a private deal.

Figuring out the fair price for a toll road is a high-stakes guessing game. Expected revenues are based on uncertain predictions about factors such as what future toll rates will be, how many cars and trucks will use the road, what rents can be obtained from service-area vendors and development of future advertising and amenities. The operator's costs similarly depend on a dizzying array of factors such as: what future construction will be done, who will pay for it, how many workers will be employed, and what will be future maintenance and safety standards. All of these factors will themselves be influenced by future trends in transportation and demographics. And any guess about the long-term value of the upfront payment itself depends on correctly predicting the extent to which inflation will erode the value of those dollars and what rate of return investors could have otherwise garnered with the money.

The Indiana and Chicago deals are not encouraging; nor is the way the process played out in Texas. A financial analysis of the Indiana and Chicago deals by NW Financial, a New Jersey investment bank that represents the Turnpike Authority (among others), found that the private investors in those deals would likely recoup their investment in less than 20 years. That analysis is confirmed in at least Indiana's case by the company that won the bid. Macquarie sent investors a presentation asserting an "Anticipated 15 year payback to equity." Given that Indiana's deal is 75 years long, and Chicago's is 99 years, the analysis suggests that governments in these states received far less for their assets than they are worth. In fact, analysis by economist and long-term valuation expert Roger Skurski at Notre Dame University finds that the Indiana Toll Road lease, which sold for $3.85 billion, should have more reasonably been valued at $11.38 billion.

In Texas, the Department of Transportation initially excluded the toll authority from bidding to build and run a new toll road they planned near Dallas. The winning private bid would have generated an estimated 12.5 percent rate of profit on its equity investment and would have required the public to compensate Cintra, the private company, if a "competing roadway" was built within 20 miles. One state senator initiated hearings which led to a temporary moratorium on private deals and the toll authority was allowed to bid. The public authority's bid offered an estimated $2.5 billion in additional present-value funds over the life of the deal on top of the $3.1 billion offer from Cintra, despite the public entity's higher estimated costs for constructing the road.

The danger that our roads could be sold off at fire-sale prices is very real, but we might not even know it for decades.

One simple way to think about a fair price is to compare a private toll road deal to more standard ways that governments sometimes monetize future revenues such as tolls or long-term legal settlements. Securitization is one such method. Securitization is a financing approach that sells to investors the right to collect a specific amount from a future revenue stream, in exchange for an upfront lump sum. Securitization deals generally last for shorter time periods, such as 15 years, and avoid the risk of an outside investor making windfall profits from aggressive toll hikes or manipulating traffic flow. Securitization would leave the Turnpike Authority in charge of the roads, avoiding all of the risks from lost public control inherent with a private operator and making future cost changes irrelevant to the price calculation, because the investors would not assume any.

Testimony before the Assembly Transportation committee by securitization expert Peter Humphreys[1] made clear that securitizing the existing annual toll revenue of $700 million for a 15-year period would result in an estimated upfront payment of $8.4 billion. Senator Lesniak's bill to authorize privatization of our toll roads contemplates $20 billion from a deal five times longer, the same 75-year length as the Indiana deal. Repeated securitization deals without changing the existing toll rates for the same 75-year time frame would therefore produce a total revenue of a nominal $42 billion. That's much more than the $20 billion suggested by the Lesniak bill, even considering that the dollar amounts are not strictly comparable.

On the one hand the securitization figure is somewhat overstated because much of the revenues would be paid at a later date. On the other hand, if the future toll hikes contemplated in the Lesniak deal were also securitized, the securitization figure would be much higher. Regardless of the exact numbers, the disparate figures fairly illustrate the potential for a private deal to underprice the long-term value of the toll roads by many billions of dollars.

3. No Deal Longer Than 30 Years

The Chicago and Indiana lease deals will stretch for multiple generations: 99 years and 75 years respectively. Senator Lesniak introduced a bill that would allow a 75-year deal in New Jersey. Private investors prefer deals at least 55 years long, because that length allows them to qualify for favorable tax treatment.

To appreciate how profound future changes will be over these time frames, they must be put in perspective. Consider these transportation-related milestones: Henry Ford introduced the Model T in 1908, 99 years ago; the George Washington Bridge opened in 1931, 76 years ago; the New Jersey Turnpike opened its first section in 1951, and Congress created the interstate highway system in 1956, 51 years ago. Similarly, consider population changes during these time periods: in 1910, New Jersey's population was 1.9 million; by 1950, we'd grown to 4.1 million. As of 2000, the Garden State contained 8.4 million people, nearly five times as many as in 1910. It's hard to imagine how different our transportation needs would be with five times as many people.

From these markers, it's clear that massive, unforeseeable changes will likely take place for transportation technology, networks, demographics, and the distribution of population over time frames like those in Chicago and Indiana and being considered here. In the face of such uncertainties, New Jersey cannot predict its transportation needs, nor the revenue potential of the its toll roads, well enough to negotiate a deal that fairly allocates risks, dictates policy, or sets a fair price.

Beyond the uncertainties inherent in a multi-generational time frame, an additional issue of good-government arises: disenfranchisement of future generations of voters. The Turnpike and Parkway are vital infrastructure, integral to the daily lives of New Jerseyans. So long as the State, directly or through the Turnpike Authority, retains control over the Turnpike and Parkway, voters have the ability to hold decision-makers accountable. Turning over control of the roads to private investors eliminates that accountability and binds future voters to present-day decisions. Doing so for several generations of voters is simply anti-democratic.

4. State-of-the-art maintenance and safety standards

The New Jersey Turnpike has been innovative throughout its history. Many of its design and safety choices have been replicated throughout the country and world. It is also recognized as having traffic management and danger warning systems that are among the best in the world. Similarly, the Garden State Parkway is consistently one of America's safest roads.

Any deal that would surrender control of our Turnpike and Parkway to a private operator would have to ensure continuation of the highest available standards. Indiana's deal, for example, would not guarantee this performance. Under that deal, the state of Indiana can require the operator to meet generally applicable safety standards, but must pay a hefty premium to implement higher quality. In other words, if Indiana intends to bring its Toll Road up to state-of-the-art standards, it must pay dearly. In addition to the cost of construction or performing the maintenance, Indiana would be required to pay compensation to the private operator for any loss of revenues caused by the construction or imposition of new standards.

No deal for the Turnpike and Parkway should be approved that did not guarantee that state-of-the-art innovations would continue to be introduced.

5. Complete Transparency and Accountability

The Turnpike and Parkway belong to the people of New Jersey. No deal should happen if New Jerseyans have not had the opportunity to review, question and comment upon it. That requires full disclosure of the deal's terms, and any related contracts and subcontracts, at least six months before a deal is done, plus public hearings. This commitment to transparency is doubly important given New Jersey's past struggles with corruption and pay-to-play contracts. The public must have full confidence in the process for considering a potential deal.

Likewise, New Jerseyans need to be able to hold their representatives accountable for their decision to approve (or not approve) a deal. The Legislature must vote on the final terms of any potential deal. True accountability requires that both the Legislative and Executive Branches answer to New Jerseyans for a deal.

6. No Budget Gimmicks

New Jersey has an ignoble history of finding short term, one-shot "solutions" to long-term budget problems. The most recent time that the state received a large infusion of outside cash—the Tobacco Settlement securitization—it spent the money without solving our budget problems. That scenario cannot be repeated with monetizing our toll roads.

If New Jersey's toll roads are monetized, the proceeds must be used to fund transportation, including mass transit, for at least as long as the deal lasts, and to reduce the state's structural deficit by paying down debt. If proceeds remain after those needs are met, then investing in long-term capital projects is appropriate.

Peter Humphreys is a partner at the law firm of McDermott, Will & Emery, where he heads the securitization practice. McDermott, Will & Emery is the 13th largest law firm in the country.