December 24, 2009

Comment on Docket No. FHWA-2009-0123 regarding TIFIA eligibility criteria and offset of subsidy costs

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This letter regards proposed changes to the USDOT's programs created by the Transportation Infrastructure Finance and Innovation Act of 1998 (TIFIA). We support the proposed adjustments in weighting criteria and would shirt them further. We also support requirements to offset the subsidy cost of directly operating the program and the federal government's risk-insuring costs associated with the issuance of TIFIA credit. However, we are concerned that allowing applicants to pre-pay for the federal government to mitigate or insure their financing risks may encourage and obscure excessive risk taking in the future. The comments address these three issues in turn.

1. Weighting of selection criteria for TIFIA financing applications

Comments on the three eligibility criteria with the greatest proposed weight are listed below in the order that they are listed in the docket.

First, we applaud the inclusion of livability issues as part of the criterion for establishing which applications qualify as projects of national or regional significance. These important considerations as they have been outlined by USDOT communications over the past year recognize the vital connections between transportation policy, safety, housing, and future growth patterns and infrastructure costs. These are major areas of policy innovation and are important considerations, for instance, in emergent models of private participation in high speed rail. Likewise, forward looking developers are interested in various ways of financing future public transportation expansion through "value capture" mechanisms that leverage the future increases in property values proximate to new public transportation routes. We recommend even greater weight be placed on this criterion.

Second, we question the continuing top-tier weight placed on attracting private financing. The TIFIA program is meant to encourage innovative financing in order to advance transportation goals. To the degree that private investment can advance the public interest in ways that are unavailable under traditional financing, these benefits should be incorporated within other selection criteria. There is, however, no justification for creating an institutionalized program bias toward greater private financing. This is especially true when private participation entails higher costs of capital. Indeed, it is clear that, without subsidies, the debt and equity costs of private capital will tend to be higher than traditional financing. As testimony given by the Government Accountability Office regarding toll roads has concluded, “there is no ‘free’ money in public-private partnerships and it is likely that tolls on a privately operated highway will increase to a greater extent than they would on a publicly operated toll road (GAO-08-44). We recommend that this criterion be amended to apply only to the degree of innovation or that it be eliminated altogether.

Finally, we applaud the inclusion of environmental sustainability as a criterion. It is commendable that the proposed regulation recognizes the need to better maintain transportation assets in a state of good repair and to better consider future life-cycle costs. The new criteria also create an institutional recognition of the fact that: transportation is responsible for the large majority of our nation’s dependence on oil and is a major contributor to emissions of global warming. For these reasons, we support an increase of the weight of this selection criterion and recommend against reducing its weight.

2. Introduction of user fees to offset the cost of operating the TIFIA program

We support the introduction of fees to offset subsidy costs. The chief argument for private participation in transportation infrastructure financing is to save money. Following that logic, private financing should not require subsidies of any kind. The U.S. Department of Transportation is therefore completely justified in identifying these uncompensated subsidies as counter to the intent of the program. Applicant fees should be introduced and be maintained as an ongoing feature of TIFIA regardless of whether, as at present, available TIFIA credit requests exceed available resources.

Likewise, it makes sense for applicants to cover the full costs currently subsidized by the Department of Transportation for covering reserve requirements, lines of credit and measures taken to reduce the risk of private investors. Investors are accustomed to paying substantial fees to private banks or other investment vehicles for covering these kinds of costs. We note that a common justification for public private partnerships is that they will shift the burden of risk off the public. It is counter to this goal, therefore, to introduce measures that reassure private investors by placing greater risk on the public – such as to delay the date at which TIFIA funds need be repaid in case of default or to make TIFIA debt less senior than the debt or equity of private investors. If American taxpayers are to be saddled with these kinds of potential costly risks, they should be well compensated.

The proposed structure of the new rules would properly addresses the subsidy issue by creating user fees that would be proportional to the level of the subsidy. Given the complex nature of public-private partnerships and the need for highly skilled analyses of financial and legal questions related to individual applications, we expect that proper administration of the TIFIA program will require a substantial budget. Public-private partnership agreements entail, as the text of the docket states, complex financial structures and extended negotiations. It would serve the public poorly if U.S. DOT staff felt that they were unable to fully analyze or robustly negotiate future arrangements. Recent studies by the Government Accountability Office show that government entities lack adequate capacity to research, negotiate, monitor and enforce public-private partnership agreements (GAO-08-44). The creation of this pilot program will be a step toward addressing that lack of capacity.

Another benefit of introducing user fees will be to diversify the TIFIA program's own revenue sources. Congress has been unable to agree on fiscally sustainable funding structures for transportation. Federal transportation programs have more recently depended on temporary extenders financed by the General Fund in order to sustain operations. Given such uncertainty, the user fees will offset the risk of budgetary shortfalls that could create lapses in the U.S. DOT's monitoring and enforcement of its TIFIA agreements.

We understand the rationale for setting these fees based on historical costs of administering the program. However, we hope that historically-based funding levels would not lock in potential shortcomings that resulted from the U.S.DOT's past inability to monitor and enforce these arrangements. Ideally, the fees should cover the cost of resources to properly administering this program, not merely the costs that have been incurred in the past. We make this point as a general comment rather than one that is based on an evaluation of the adequacy of the program's available resources in the past.

Finally, we hope that these fees will only be used to cover the costs of administering, monitoring, and enforcing the program rather than diverted into other TIFIA-related activities. In the past, the office has engaged in substantial outreach to investors and promoted a particular template of "model legislation" in state legislation for public-private partnerships. We hope that funds from future TIFIA user fees will not be used for such activities.

3. Concerns over pre-payment of fees to cover risks

We are concerned about potential unintended consequences that could result from allowing applicants to pre-pay the TIFIA program upfront for the cost of financial risks. It is not yet clear how this proposed feature would operate, how applicants would pay based on historical risks, and how applicants' fees would be adjusted according to the risk of their project. Unless fee structures are arranged to penalize applicants that submit riskier proposals, then government-provided backstops against risk will encourage applicants to assume greater risks. Risks will be disregarded when they are bourn by somebody else. This is the well-known tendency toward “moral hazard” as it is called by economists.

Recent financial troubles at the Federal Home Loan Mortgage Corporation (FHLMC) and The Federal National Mortgage Association (FNMA) demonstrate these potential problems. Both Freddie Mac and Fannie Mae, as they are commonly called, sought to leverage greater private sector investment for the housing market.. Their participation in innovative financing and their creation of financial instruments were widely seen as providing unwarranted assurance to other investors that the mortgages they helped to finance were financially safe. Similar troubles could arise if applicants with excessively risky financing arrangements were able to pay up-front for risk protection and a seal of financial backing from TIFIA.

We point out moreover, that this is a problem compounded by basing the fees on historical costs. If risks have been low in the past, but the new program encourages higher risks, then the elevated risk will not be reflected in fees meant to offset full subsidy costs.

Lastly, we notice that the notice does not outline a process for follow-up evaluation of the program before a potential decision might occur to extend the changes. We believe that there should be such a follow-up comment period and that particular consideration should be given to the potential problem of encouraging excessively risky financing.

Thank you for your consideration.