TexPIRG

Six Public Interest Principles for Considering Private Toll Roads

Plans for the state of Texas to sign concession deals for privately operated toll roads present a number of dangers for the public interest. Giving long-term control of our roads to a private operator and granting them future toll revenues is a huge commitment that should not be taken lightly. There has been major controversy over this road deal, and over the initial exclusion of the public tollway authority from submitting its own competing bid.

Regardless of whether a deal is with a public or private operator, no concession should be approved that fails to uphold any of six basic principles:

1. Public control
2. Fair value
3. No deal longer than 30 years
4. State-of-the-art safety and maintenance standards
5. Complete transparency and accountability
6. No budget gimmicks

The Governor's proposal for private toll roads violates these principles. For that reason, TexPIRG supports the two-year moratorium on private deals. It may be important for these roads to be built, but that question should be separated from whether the public should rush into a long-term risky deal.

In the future there will likely be discussion of other possible deals with private or public entities. These six principles should guide consideration of any future concessions.

1. Public Control

Transportation policy has tremendous impacts on Texans' 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 roads 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 a toll road 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. For instance, a hike in

toll rates can divert large numbers of trucks onto local roads, creating congestion and air pollution in nearby communities. What may seem beneficial from a narrow profit perspective does not necessarily benefit transportation networks in Texas 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. The proposed Trans-Texas Corridor deal would place restrictions on what kinds of improvements the state could make on nearby roads. It also mandates that the state must build specific feeder roads and entry ramps onto the new private road. These are projects that might tie up scarce resources that the public might other otherwise use for other projects.[*]

- Private Toll Decisions = Broad Private Control of Traffic Management—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.

  Concession agreements lay out schedules for toll increases that can sound reasonable, but compound over time to very high rates. For example Chicago's 99-year toll deal lays out a schedule of permissible rate hikes. If these same increases had applied to New York's Holland Tunnel since its inception, that roadway could presently charge a one-way toll of more than $180. As a practical matter, a toll operator would be unlikely to charge such a high price because drivers would instead take alternate routes. The proposed concession here in Texas would have allowed tolls as high as $14.92 by the 48th year of the deal. The point is that granting toll-setting power to a private entity enables the private operator to largely dictate who drives on the toll roads.

- Creates "Tax" on Normal Policy Making—Private concession deals also require 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.

[*] "The Highwaymen: Even the Losers Win as Texas Rushes to Privatize its Roads," *The Texas Observer*, December 15, 2006.

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 danger that our roads could be sold off at fire-sale prices is very real, but we might not even know it for decades. The people of Texas need to be sure that the government would receive fair value for the future toll revenue it would promise a road operator. 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. A financial analysis by NW Financial investment bank 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 process so far as been equally discouraging. The Texas 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. After public pressure and hearings, the North Texas Tollway Authority (NTTA) was allowed to offer its own bid. Public entities can generally borrow money at a lower rate than private entities, and thus – all things equal – can offer higher payments to the state budget based on the same future toll collections.

Independent Analysis by the investment banking firm NW Financial Group confirms this analysis about Texas.[†] Unpacking the public and private bids, they find that both the NTTA and Cintra anticipate collecting $50 billion in tolls over the life of the deal. But whereas the Cintra deal would provide $3.1 billion in payments to the state over this time, the public authority's deal would yield $5.68 billion. Thus, 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. In plain terms, *Texas would lose over $3 billion by pursuing the private deal.* This comes despite the public authority's plans to invest more money than the private group to actually construct the road.

A private toll road deal would also come with a number of other hidden costs. For instance, not included in the price-tag are large concession payments that have already been paid out to losing bidders for toll road construction. According to papers obtained from the Texas Department of Transportation, two bidders who lost out on constructing a new planned State Highway 130 have already been paid $1.4 million each for submitting bids.[‡] Also not appearing in the ledger for the private deal are the public costs of monitoring and enforcing its terms. The state of Texas would need to be sure that an operator held firm to the terms of a deal, for instance resurfacing the road as often as promised and with high-quality materials. Doing so will require its own bureaucracy and an assortment of lawyers to pour over the fine print and sue the operator if necessary.

3. <u>No Deal Longer Than 30 Years</u>

The Chicago and Indiana lease deals will stretch for multiple generations: 99 years and 75 years respectively. The Governor's proposed deal with Cintra would have stretched for 50 years.

To appreciate how profound future changes will be over these time frames, they must be put in perspective. Consider these epoch-changing milestones: 49 years ago in Dallas, the integrated circuit was first tested, ushering in the semiconductor and the electronic age; and Congress created the interstate highway system in 1956, 51 years ago. Similarly, consider population the massive population changes: in 2006, Texas' population was 23.5 million people, nearly three times the 8.8 million here back in 1956. It's hard to imagine how different our transportation needs would be with three times as many people as today.

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, Texas cannot predict its transportation needs, nor the revenue

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[†] NW Financial Group, LLC, "An Economic Analysis of the Texas SH 121 Toll Road Concession," April 12, 2007. Available also on the Pennsylvania legislative website http://www.pahouse.com/yourturnpike/documents/TexasSH121Final.pdf

[‡] "The Highwaymen: Even the Losers Win as Texas Rushes to Privatize its Roads," *The Texas Observer*, December 15, 2006.

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. Toll roads are vital infrastructure, integral to the daily lives of Texans. So long as the State, directly or through turnpike authorities or other public entities, retains control over these roads, 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. <u>State-of-the-art maintenance and safety standards</u>

Any deal that would grant control of our roads 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 Texas roadways should be approved that did not guarantee that state-of-the-art innovations would continue to be introduced.

5. <u>Complete Transparency and Accountability</u>

Texas' public roadways properly belong to the people of Texas. No deal should happen if Texans 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 Texass past struggles with corruption and pay-to-play contracts. The public must have full confidence in the process for considering a potential deal.

Likewise, Texans 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 Texans for a deal.

6. <u>No Budget Gimmicks</u>

If Texas' future toll-road revenues are to be used as collateral for a private or public deal, 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, only then would investing in long-term capital projects be appropriate.