Enhanced Federal Tools for Transformational Transport Investments:

Policy Brief

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Metro

Los Angeles County Metropolitan Transportation Authority

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Background

Major surface transportation investment programs can confer multiple benefits: improving mobility, stimulating economic growth, reducing pollution, promoting livability, and generally enhancing the quality of life. *Transformational transportation investments* are those relatively few large-scale capital projects—or series of projects—that not only benefits the direct users but fundamentally improve livability within a wide region. Examples of major transformational transportation projects are the Los Angeles 30/10 Initiative, the Chicago CREATE series of rail improvements, and the proposed ARC (Access to the Region's Core) rail tunnel connecting New Jersey and New York.

This federal policy brief uses the Los Angeles 30/10 Initiative to illustrate how new federal policy enhancements could advance mega-investment programs of regional and national significance. The 30/10 program is a bold initiative to concurrently develop a portfolio of 12 new and discrete but interrelated transit projects in Los Angeles County that, collectively, will fundamentally transform accessibility throughout the region. At the same time, the 30/10 Initiative will generate 160,000 new jobs, reduce vehicle pollution emissions by 568,000 pounds annually (thereby significantly reducing cases of childhood asthma), reduce our dependence on foreign oil by saving 10.3 million gallons of yearly gas consumption, and ease congestion by reducing 208 million vehicle miles traveled per year.

The 30/10 program is so-named because it entails taking the 12 projects previously approved in the region's 30-year long-range capital plan, and completing them within the next decade. A key reason to accelerate the build-out is to take advantage of the current excess capacity in the Southern California construction sector, where the current unemployment rate is over 10 percent. By aggressively accelerating the pace of investment, Metro estimates it can save a minimum of $3.7 billion in construction costs, reducing an approximately $18 billion price tag to about $14 billion.

The U.S. Department of Transportation has identified five strategic goals as priorities for the national transportation system: (1) safety; (2) economic competitiveness; (3) state of good repair; (4) livability; and (5) environmental sustainability. Further, the Department has established, in cooperation with the United States Environmental Protection Agency (EPA) and United States Department of Housing and Urban Development (HUD), a more refined set of "sustainability and livability" objectives: (1) provide more transportation choices; (2) promote equitable, affordable housing; (3) enhance economic competitiveness; (4) support existing communities; (5) coordinate policies and leverage investment; and (6) value what is unique about communities. The 30/10 program of projects incorporates these federal policies and can serve as a national model for other metropolitan areas. As U.S. Department of Transportation Under Secretary for Policy Roy Kienitz stated recently at a Congressional hearing, "The 30/10 program may well be at the vanguard of transit planning and system development; similar programmatic approaches to solving regional transportation challenges are likely coming."

The backbone of the 30/10 program is a new countywide half-cent sales tax—Measure R--approved by two-thirds of the voters in November, 2008. Measure R is expected to generate in excess of $35 billion over the next 30 years. Of these revenues, 35 percent has been designated for constructing new transit capacity. This revenue stream will support $14 billion in accelerated capital investment in the 12 new projects shown in Appendix A. The balance of Measure R proceeds will fund transit operations, select highway capital projects and other surface transportation improvements.

Because of the magnitude, duration and stability of the local commitment, as evidenced through the Measure R dedicated revenue stream, the 30/10 Initiative seeks a federal grant share of only 20 percent. This contrasts sharply with the 50-80 percent federal share typically associated with Federally-assisted transportation projects.

Federal Policy Tools

The federal government has various policy tools at its disposal to encourage investment in targeted sectors:

- Direct grants
- Credit assistance
- Tax incentives
- Regulatory reforms

Together, these tools can be used to design a balanced strategy for advancing major investments.

Although accelerating the timetable for the Measure R projects will reduce the total capital cost from $18 billion to $14 billion, Metro recognizes that it cannot rely upon any one funding source. It would be unrealistic to seek grant funding in the 50 percent range typically associated with FTA's New Starts capital program for all 12 projects. Metro does intend to apply for New Starts and other discretionary grant assistance (e.g., TIGER II or the proposed National Infrastructure Innovation and Finance Fund), but in a limited amount, comprising only about 20 percent (or $2.8 billion) of 30/10's total capital investment. Instead, Metro intends to rely primarily upon bonding against the Measure R revenue stream. Bonds repayable from Measure R revenues will generate nearly 60 percent of capital funding sources. The balance will come from pay-as-you-go spending of Measure R revenues and formula federal, state and local grants.

By approving the third half-cent sales tax in Los Angeles County, voters have demonstrated their financial commitment to investing in improved regional transit. However, existing financing tools such as tax-exempt bonds and Build America Bonds do not provide sufficient borrowing capacity under today's market conditions and required debt service coverage tests. In order to adhere to the 30/10 capital spending schedule, Metro needs to access both lower cost financing <u>and</u> utilize alternative approaches that will take into account the expected growth in the sales tax revenue stream over time.

The LA 30/10 Initiative seeks federal help in maximizing the effectiveness of its Measure R revenue stream through three specific federal policy enhancements:

1. New Tax-Preferred Bonding Program
2. Streamlined Federal Credit Process (TIFIA-style Direct Loans)
3. Early Systems Work Agreement (ESWA)

This proposal in no way is intended to replace the existing federal assistance program structure. Rather, making these tools available for transformational projects could incentive jurisdictions that are willing to impose taxes on themselves to do so. In this way, the federal government could encourage local investment in green transportation solutions while limiting the federal budgetary commitment.

As an initial step, it is contemplated that a comprehensive framework for seeking these forms of federal assistance would be outlined in a Memorandum of Understanding (MOU), to be entered into between Metro and the US Department of Transportation. This form of agreement, which has been used to advance other multi-faceted transportation programs, would set forth certain shared objectives and planned milestones, recognizing that one or more pieces of federal legislation will need to be enacted before some of the financing commitments can be made. Each of these policy tools is summarized below, along with a preliminary estimate of its scored budgetary cost.

1. Tax Preferred "Transit Improvement Bonds"

Policy Issue*:* Metro seeks to participate in a new tax-preferred bond financing program that would reduce the interest expense of long-term borrowing. The tax incentive would be obtained by modifying the Internal Revenue Code to establish "Transit Improvement Bonds," which would be eligible for refundable federal tax credits. This would provide a much deeper federal subsidy than traditional tax-exempt bonds or Build America Bonds, both of which are issuable today for transit purposes but are insufficient for the 30/10 Initiative. While Congress recently has enacted higher tax subsidies for other sectors, no such program specifically exists for large-scale transit investments.

Policy Precedent*:* Since 1997, Congress has enacted half a dozen separate programs authorizing state and local governments to issue tax-preferred debt at or near zero percent. These programs, totaling in excess of $37 billion, are for purposes such as public education, Gulf and Midwestern disaster recovery, clean renewable energy, forestry conservation and energy conservation. The interest subsidies are designed to provide federal buy-downs of 70 percent to 100 percent of borrowers' interest expense. Each program has a volume cap and maturity limitation associated with it.

Policy Rationale: Given the substantial "spillover" benefits of major public transportation investments—immediate jobs, environmental protection, energy self-sufficiency, safety, sustainable and more livable communities, in addition to increased mobility—a strong argument can be made for providing a new zero-interest long-term bond program for transformational transit investments.

Major transit projects are long-lived assets, financed with municipal bonds maturing over 30 years or more. The existing 100 percent tax credit bond programs generally are for smaller projects. Current tax law sets a bond term of 15-17 years, which limits the present-value of the federal subsidy to 50 percent of debt-financed project costs. However, the long useful life of transit improvements and their substantial positive spillover benefits warrant a longer bond maturity and corresponding higher effective subsidy. It is proposed that the maximum maturity of TIBs be 35 years, similar to many long-term tax-exempt bonds, Build America Bonds and TIFIA loans.

The proposed TIBs structure will allow Metro **to more than *double*** the amount of capital investment supportable by Measure R revenues, compared to conventional tax-exempt bond issuance.

Legislative Ask: Congress should establish a new class of tax-preferred bonds—Transit Improvement Bonds—in an upcoming piece of tax legislation:

- The TIBs program would be volume-capped at $30 billion nationwide, allocated over 5 years.
- Eligible projects would be public transportation projects (or a series of related projects) that:
  (1) significantly reduce emissions of greenhouse gases; (2) have an estimated capital cost in excess of $1 billion; and (3) derive not more than 30 percent of its funding for capital costs from Federal grant funds.
- Proceeds could be used for infrastructure, rolling stock, preliminary engineering and associated environmental work.
- The maximum term of the bonds would be set by the Treasury such that the discounted present value of the maturing principal equaled 20 percent of the amount issued, but not to exceed 35 years
- The federal subsidy would run directly to the issuer to reimburse its interest cost, in the form of direct-pay interest subsidies.
- The Secretary of Transportation would select the qualifying projects / programs based on those with the highest benefit-cost ratios.
- Bonds would be repayable from non-federal sources, such as Measure R.

Estimated Budgetary Score: Los Angeles would be seeking approximately $6.0 billion of volume cap allocation, with an estimated budget cost (10-year tax expenditure) of from $1.6 - $2.0 billion (27 to 33 percent of the face amount of bonds issued).

2. Federal Credit Assistance (TIFIA Loans)

***Policy Issue**:* Metro seeks the ability to obtain a program-wide front-end commitment from USDOT to provide up to $2.5 billion of TIFIA-like flexible financing for the 30/10 program. An upfront TIFIA financing commitment would allow Metro to reduce interest cost, diversify its funding sources and more effectively borrow against future Measure R revenues. However, Metro requires an upfront credit commitment to ensure that all 12 projects can be accommodated within the Measure R revenue stream, and at a pre-determined rate to eliminate interest rate risk. The current TIFIA program has two major shortcomings: (i) it lacks sufficient budget authority for a program the scale of 30/10; and (ii) it cannot obligate funds (and lock in interest rates) until each project is ready-to-go.

Policy Precedent: There has been one multi-project capital program that has received a TIFIA financing commitment to date: The Washington Metropolitan Area Transit Authority 1998 capital improvement program (CIP) received a loan guarantee to help it satisfy certain WMATA-specific procurement rules. However, that CIP represented a series of small capital renewal projects, such as system-wide escalator replacements, which didn't have the level of environmental and other procedural steps associated with major new transit projects such as the 30/10 Initiative.

Policy Rationale: The TIFIA statutory and regulatory requirements were oriented towards *project-specific* applications. In many cases, the revenue streams have been project-generated (such as tolls), making it imperative that all project requirements were met before funds were obligated. Because the Measure R repayment source is *program-wide* and independent of the performance of the financed projects, it should be possible to relax several of the TIFIA preconditions for obligating funds without increasing credit risk to the federal government. In fact, Metro would like to retain the flexibility to apply TIFIA loan proceeds to any of the 12 projects, depending upon project readiness and market conditions over the next decade. However, no loan proceeds would be *disbursed* for a project until all of the relevant federal requirements under the TIFIA program were satisfied.

***Legislative Ask**:* The TIFIA statute and program regulations would be modified to enable USDOT to make an <u>upfront</u> credit commitment (at an earlier stage of project development) for a mega-program of related projects that satisfy national infrastructure investment goals).

- USDOT would have explicit authority to make an upfront credit commitment for a qualifying program of eligible, related public transportation projects that: (1) significantly reduce emissions of greenhouse gases; (2) have an estimated capital cost in excess of $1 billion; and
  (3) derive not more than 30 percent of its funding for capital costs from Federal grant funds.
- In order to obtain an upfront credit commitment, the qualifying program must demonstrate that a majority of the non-federal funding is committed and sufficient to repay the federal credit assistance. The senior obligations backed from that revenue source must obtain a formal investment-grade rating.
- USDOT would make an upfront credit commitment in the form of a Master Credit (Loan) Agreement (MCA). Upon execution, the MCA would establish the interest rate and other

basic terms and conditions under which subsequent project-specific loan draws would occur. The terms and structure would be similar to USDOT's current conditions for TIFIA loans. The required subsidy funding would be obligated at the time of execution of the MCA.

- Pursuant to the MCA, loan draws for individual projects within the overall program would be conditioned upon those projects satisfying the usual project-specific requirements (e.g., final environmental and other approvals, detailed cost estimates, etc.)
- Congress would appropriate $2 billion of additional funds through 2015, which should be sufficient to pay the subsidy cost (loss reserve) of the 30/10 TIFIA loan request, as well as support other project sponsors' pending requests.

Estimated Budgetary Score: The 30/10 Program likely will require about $250 million (10 percent of the face amount of credit assistance) to fund the subsidy cost of the requested $2.5 billion loan commitment.

3. Early Systems Work Agreement (ESWA)

Policy Issue: Traditionally, the Federal Transit Administration has funded new rail transit capacity projects through its New Start process. This detailed procedure—designed for fiscal control and project management purposes—entails a series of statutorily-mandated evaluations, ratings, and steps that can take several years to complete, ultimately culminating in a Full Funding Grant Agreement ("FFGA"). The FFGA , entered into by the transit agency and FTA, provides a schedule for the provision of Federal New Start funds, subject to appropriation by Congress , over a multiple year period for the development and construction of the New Start project. FTA also has the authority to enter into Early System Work Agreements (ESWA) for New Start projects under which FTA authorizes certain activities to be undertaken within a budget, and allows funds to be expended as they become available through appropriations for elements of the permitted activities. Thus, FTA can authorize construction activities, real estate acquisition, utility relocation, professional services (final design, construction management, permitting), and procurement of system elements for which specifications are decided (such as tunnel boring equipment and rolling stock) to be undertaken under the ESWA. The ESWA also provides for pre-award authority – enabling the transit agency to expend local funds for subsequent reimbursement in later Federal grants. The ESWA is a precursor to the FFGA and in essence allows the project to move forward prior to the FFGA.

Policy Precedent: Two major investments which have benefited from ESWAs are: (1) Access to the Region's Core ("ARC"), NJ, involving a $1.3 billion ESWA of which $395 million in New Starts funding was provided in the FY 2010 and 2011 budgets; and Phase 1 of the Second Avenue Subway, NY (FY 2008 budget included $200 million; its ESWA was entered into in January 2007).

Policy Rationale: Under the current statute, FTA is permitted to authorize certain activities for large capital investments to be undertaken, in advance of the Full Funding Grant Agreement. The Early Systems Work Agreement provides the authority to proceed with specified activities, including construction and procurements, and commits Federal New Start funds for those activities. An ESWA enables a project to maintain its budget and schedule. A transit agency with an ESWA may proceed with multiple activities, while using federal funds in advance of securing an FFGA – an extended process that can consume well over a year to complete once a Record of Decision is issued under NEPA.

Legislative Ask: Specific language in the President's budget for Fiscal Year 2012 providing ESWAs for LA Metro's Westside Subway Extension and Regional Connector projects, and including $400 million in New Start funds for those ESWAs.

Conclusion

In order to accommodate the 30/10 Initiative within the Measure R revenue stream, Metro has developed a series of distinct but interrelated federal policy measures that would enable it to accomplish the goals of accelerating $18 billion of capital investment in the next decade at a cost of $14 billion. These are summarized below:

30/10 Initiative – Estimated Funding Sources: 2010-2019

($ in billions)

Financing Mechanism	**Capital Sources (Upfront Proceeds)**	**Type of Federal Assistance**	**Est'd. Federal Budget Score (1)**	**Pledged Metro Resources (2)**
New Federal Assistance				
Transit Improvement Bonds (TIB)	$6.0	Tax Incentive	$1.6-$2.0	$6.2
Federal Credit Assistance (TIFIA)	2.5	Federal Loan	$0.3	4.3
Additional Federal Grants (TIGER II, NIIFF)	0.9	Federal Grant	$0.9	---
Subtotal—New Federal Sources	*$9.4*		*$2.8 -$3.1*	*$10.5*
Existing Federal/Other Sources				
Anticipated New Starts Grants	$1.7	Federal Grant	$1.7	---
Other Fed. Formula (CMAQ, etc.)	0.2	Federal Grant	0.2	---
Other State/Local (Non-Measure R)	1.3	n/a	---	2.5
Measure R Pay-as-You-Go Funding and Interest Earnings	1.4	n/a	---	2.4
Subtotal—Existing Federal/Local Sources	*$4.6*		*$1.9*	*$4.9*
30/10 Initiative Total	**$14.0**		**$4.6 - $5.0**	**$15.4**

(1) Estimated federal outlays and tax expenditures over the 10/year budget window/construction period (2010-2019).
(2) Estimated expenditures of non-federal funds to cover capital costs and debt service from 2010-2039; plus other Metro resources committed to the 30/10 Initiative.

Significantly, Metro is seeking New Starts and other discretionary grant assistance for only about 20 percent ($2.8 billion) of capital costs. Nearly 60 percent of capital sources are bonds or loans secured by Measure R revenues.

Metro believes the best approach would be modifying or establishing nationwide programs, rather than one-offs for Los Angeles. Metro would compete against other major project applicants for allocation by the Secretary of both TIFIA credit assistance and Transit Improvement Bond volume cap for financing its 30/10 program.

If Metro were successful in receiving its requested assistance, the estimated federal budget cost of these requests would total **$4.6 -$5.0** billion over the next decade— just 33 to 36 percent of the total capital investment of **$14.0** billion. Metro would pledge local resources totaling **$15.4** billion to pay debt service on the TIFIA loans and Transit Improvement Bonds and fund pay-as-you-go outlays.