U.S. House of Representatives
Committee on Transportation and Infrastructure
Washington, DC 20515

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April 13, 2010

SUMMARY OF SUBJECT MATTER

TO: Members of the Subcommittee on Highways and Transit

FROM: Subcommittee on Highways and Transit Staff

SUBJECT: Hearing on "Using Innovative Financing to Deliver Highway and Transit Projects"

PURPOSE OF THE HEARING

The Subcommittee on Highways and Transit is scheduled to meet on Wednesday, April 14, 2010, at 10:00 a.m., in room 2167 of the Rayburn House Office Building to receive testimony on innovative financing practices in surface transportation project delivery. This hearing is part of the Subcommittee's effort to reauthorize Federal surface transportation programs under the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU) (P.L. 109-59), which would have expired on September 30, 2009, but has been extended through December 31, 2010. This hearing also is being conducted as one of several hearings under the requirements of clauses 2(n), (o), and (p) of Rule XI of the Rules of the House of Representatives. The Subcommittee will hear from the Assistant Secretary for Budget and Programs and Chief Financial Officer of the U.S. Department of Transportation (DOT), the Secretary of the North Carolina Department of Transportation (NCDOT), the General Manager and Chief Executive Officer of Denver's Regional Transportation District (RTD), the Chief Executive Officer of the Los Angeles County Metropolitan Transit Authority (LACMTA), and the President of a consulting firm specializing in the financing of transportation infrastructure projects.

BACKGROUND

Adequate investment in surface transportation infrastructure is critical to the nation's economic growth, competitiveness in the world marketplace, and the quality of life in our communities. Delivering successful transportation projects requires both sustained and reliable levels of funding, as well as access to sufficient financing mechanisms. Traditionally, highway and transit investments have been funded through a combination of Federal, State, and local public funds. Additionally, private funds have been used to augment and leverage public funds for certain

types of transportation projects. Transportation "funding" thus generally refers to the different revenue sources generated at the Federal, State and local levels, including: taxes, fees, user charges, and capturing enhanced property values through special assessments.

Current public investments in funding surface transportation are not adequate to meet the needs of the system. According to DOT's *2008 Status of the Nation's Highways, Bridges, and Transit: Conditions and Performance* report (C&P Report), over the next 20 years, an **additional**:

- $27 billion per year from all levels of government is needed simply to sustain highway conditions and performance;
- $96 billion per year from all levels of government is needed to make all cost-beneficial highway improvements and to eliminate the backlog of bridge deficiencies;
- $2.3 billion per year in capital investment from all levels of government is necessary to maintain the current average transit asset conditions and current transit vehicle occupancy levels; and
- $8.3 billion per year in capital investment from all levels of government is necessary to improve transit conditions and performance.

The significant underinvestment in surface transportation infrastructure identified in the C&P Report confirms the findings of two commissions established by Congress to study future surface transportation policy and financing needs.

- The National Surface Transportation Policy and Revenue Study Commission called for an annual investment level of between $225 and $340 billion – by all levels of government and the private sector – over the next 50 years to upgrade all modes of surface transportation (i.e., highways, bridges, public transit, freight rail, and intercity passenger rail) to a state of good repair.

- Similarly, the National Surface Transportation and Infrastructure Financing Commission (Finance Commission) found that an annual investment of $200 billion by all levels of government was necessary to maintain and improve the nation's highway and transit infrastructure systems. The Finance Commission projects a Federal highway and transit investment gap that totals nearly $400 billion in 2010-2015, growing to about $2.3 trillion through 2035.

Distinct from the sources of transportation funding, transportation "financing" refers to the different financial tools that are used to leverage transportation funding and revenue sources, allowing transportation agencies to raise the up-front costs needed to build projects and expedite the implementation of surface transportation improvements. Thus, financing mechanisms are the tools used to leverage existing funding sources, including a wide variety of bonds, credit enhancements, debt instruments, and loan programs designed to assist transportation agencies in expediting the implementation of transportation improvement.

Due to the nation's recent economic recession, however, many of the previously available funding sources and financing mechanisms used to deliver surface transportation projects have been undermined in a variety of ways. For example, State and local budgets have encountered sharply falling revenues that have negatively impacted the availability of traditional funding sources, such as

sales and property tax revenues. Increases in fuel economy for cars and trucks and a decrease in vehicle miles traveled have reduced the amount of revenue collected through Federal and State taxes on motor fuels. Additionally, the volatility of the U.S. financial markets has limited the ability of the private sector to play an increasing role in either funding or financing surface transportation investments.

Compounding the State, local, and private sector funding and financing shortfalls is the lack of a long-term reauthorization of the Federal surface transportation programs. This severely limits the ability of the Federal Government to provide increased funding and innovative financing tools to achieve the needed investments in the nation's surface transportation systems. Addressing the Federal surface transportation funding and financing challenges are critical, and this hearing will focus specifically on innovative financing tools and programs that can assist in successfully delivering highway and transit projects.

Innovative Financing of Surface Transportation Projects

Innovative financing is a broadly defined term that encompasses a combination of specially designed techniques that supplement traditional surface transportation funding and financing methods. Under traditional financing methods, transportation projects are usually completed on a pay-as-you-go basis, meaning that projects have often been built in phases or increments as funds become available over a period of years. By using innovative financing methods, project sponsors can gain immediate access to all of the funds necessary to complete the project and use their traditional funding sources to pay back the debt on the financing instrument over time. It is important to note that most innovative financing tools do not generate new funds in and of themselves. However, they can reduce upfront capital costs, achieve life-cycle cost efficiencies, facilitate the transfer of risk away from the public sector, and expedite the implementation of needed transportation improvements.

The primary objectives of innovative financing mechanisms are to:

- maximize the ability of project sponsors to leverage immediate capital for a project;
- more effectively utilize existing funds;
- move projects into construction more quickly than under traditional financing mechanisms;
- make possible major transportation investments that might not otherwise receive financing; and
- limit the risk to the project sponsor of cost over-runs associated with the project.

Unfortunately, the various types of innovative financing tools are not always easy to access, and often may be difficult to initiate. State and local officials wishing to implement an innovative finance program may face unique challenges that will potentially be different from those faced by other States, due to the varying programs, policies, and political traditions among the States.

The primary barriers to using innovative financing mechanisms are:

- private financial market conditions that may be unpredictable or unstable;
- the lack of statutory authority to use particular mechanisms (e.g., State infrastructure banks);
- limited public agency familiarity with (or capacity to institute) innovative financing tools; and
- projects' inability to generate revenue streams for repayment.

Oftentimes, for certain transportation projects that seek to combine Federal grants with innovative financing methods, the barriers become even greater. According to an October 2009 report by the U.S. Government Accountability Office (GAO), the Federal Transit Administration's (FTA) New Starts project approval process remains a barrier to a greater private sector role in project delivery. The report found that FTA could enhance its efforts to assist project sponsors seeking innovative financing approaches, and specifically recommended that FTA develop guidance, provide technical assistance, and sponsor greater use of financial assessments for New Starts projects whose sponsors seek to utilize alternative financing approaches.

Questions have also been raised about the Federal role in relation to an area of innovative finance that has spurred substantial State and local interest in recent years: public-private partnerships (PPPs) to design, build, finance, and/or operate highways. In a February 2008 report, GAO recommended that DOT develop objective criteria for identifying national public interests in highway PPPs. The same report recommended that DOT play a targeted role in ensuring that these interests are appropriately considered in PPP arrangements.

Despite these barriers, innovative financing mechanisms will continue to play a role in supporting State and local investment in surface transportation. As the Finance Commission stated in its February 2009 final report, innovative financing approaches should not be oversold as a "silver bullet" solution to the nation's increasing transportation investment needs, but they can play an important role in helping public-sector agencies more rapidly advance projects by leveraging future revenue streams.

Federal Policies and Programs to Support Innovative Financing of Surface Transportation

The Federal surface transportation programs have not always been at the forefront of supporting innovative financing tools for the delivery of highway and transit projects. In recent years, however, several new programs and policies have been developed at the Federal level in order to support and encourage innovative financing methods. Following is a detailed discussion of four types of innovative financing methods that are supported at the Federal level: Federal credit assistance programs, innovative bonds, grant anticipation borrowing, and State infrastructure banks.

Federal Credit Assistance Programs

Transportation Infrastructure Finance and Innovation Act (TIFIA)

Enacted as part of the Transportation Equity Act for the 21st Century (TEA 21), the Transportation Infrastructure Finance and Innovation Act of 1998 (TIFIA) established a Federal credit program for eligible transportation projects of national or regional significance. The program's goal is to leverage Federal funds by attracting substantial private and other non-Federal

co-investment in critical improvements to the nation's surface transportation system. TIFIA credit assistance provides improved access to capital markets, flexible repayment terms, and potentially more favorable interest rates than can be found in private capital markets for similar instruments.

Through TIFIA, DOT provides Federal credit assistance to highway, transit, rail, and intermodal freight projects, including seaports. The amount of TIFIA assistance may not exceed 33 percent of total project costs. The program targets only large projects – generally those costing more than $50 million. Both public and private project sponsors may apply for TIFIA assistance, but all prospective borrowers must demonstrate that the proposed project is consistent with State and local transportation plans.

The TIFIA program offers three types of financial assistance: secured loans, loan guarantees, and standby lines of credit. Secured loans are direct Federal loans to project sponsors. Loan guarantees provide full-faith-and-credit guarantees by the Federal Government to institutional investors that make loans for projects. Standby lines of credit represent secondary sources of funding in the form of contingent Federal loans that, if needed, supplement project revenues during the first ten years of project operations.

To fund TIFIA, SAFETEA-LU and the recent extension of SAFETEA-LU have provided $122 million in contract authority from the Highway Trust Fund for each of fiscal years 2005 through 2010 to pay the subsidy cost and administrative expenses of credit assistance. As of February 2010, the TIFIA program had approved $7.8 billion in credit assistance to 23 projects representing more than $29 billion in total infrastructure investment. Of these, 14 are highway projects, three are transit projects, and six are intermodal in nature.

Railroad Rehabilitation and Improvement Financing (RRIF)

The Railroad Rehabilitation and Improvement Financing (RRIF) Program provides direct Federal loans and loan guarantees to finance development of railroad infrastructure, which in the transit industry can benefit commuter rail. The RRIF program was reauthorized in TEA 21 and amended by SAFETEA-LU. Under this program, the Federal Railroad Administrator is authorized to provide up to $35 billion in direct loans and loan guarantees for projects. Direct loans can fund up to 100 percent of a railroad project with repayment periods of up to 35 years and interest rates equal to the cost of borrowing to the government. Since its enactment, the RRIF program has executed 25 loan agreements worth nearly $1 billion, of which $224.6 million – or about 22 percent of the total – have benefited public transit projects.

Innovative Bonds

Private Activity Bonds

Private Activity Bonds (PABs) allow private entities to use tax-exempt debt based on the investment purpose of the bond proceeds and subject to a series of limitations. The interest earned on most bonds issued by State and local governments is exempt from Federal taxation. However, Federal law limits tax-exempt financing of facilities used in conjunction with private activities. PABs are designed to provide the same Federal tax exemption for some private investments in infrastructure.

Congress has specified certain private activities that can be financed with tax-exempt bonds (also referred to as "qualified" private activity bonds). These activities include airport, water and sewer projects, and as of 2005, highway and surface freight transfer facilities. In general, qualified private activity bonds are subject to a number of restrictions, including annual State-by-State limitations on the volume of such bonds that can be issued.

SAFETEA-LU amended section 142 of the Internal Revenue Code to add highways and freight transfer facilities to the types of privately developed and operated projects for which qualified private activity bonds may be issued. This change allowed private activity on these types of projects, while maintaining the tax-exempt status of the bonds. This allows projects with private-sector financial participation to obtain lower financing rates, which helps eliminate one barrier to private-sector transportation investment. SAFETEA-LU limits the total amount of such private activity bonds to $15 billion and directs the Secretary of Transportation to allocate this amount among qualified highway or surface freight transfer facilities. As of January 2010, PAB allocations approved by DOT total about $6.3 billion for seven projects.

Build America Bonds

Traditionally, tax-exempt bonds provide a critical source of capital for State and local governments, but the recent financial crisis sharply reduced their ability to finance new projects. In response, Congress created within the American Recovery and Reinvestment Act (P.L. 111-5) (Recovery Act) (and extended in the Hiring Incentives to Restore Employment Act) a new innovative financing tool: Build America Bonds (BABs). These bonds, which allow a new direct Federal payment subsidy, are taxable bonds issued by State and local governments that give them access to the conventional corporate debt markets. At the election of the State and local governments, the Treasury Department makes a direct payment to the State or local governmental issuer in an amount equal to 35 percent of the interest payment on the BAB. As a result of this Federal subsidy payment, State and local governments will have lower net borrowing costs and be able to reach more sources of borrowing than with more traditional tax-exempt or tax credit bonds. Since April 2009, State and local governments issued a total of $28.5 billion in BABs to be used for highway and transit projects across the nation.

Grant Anticipation Borrowing

Bonds repaid with future Federal funds are commonly referred to as Grant Anticipation Revenue Vehicles (GARVEEs) for highway projects or Grant Anticipation Notes (GANs) for transit. GARVEEs and GANs allow public agencies to pay debt service and other bond-related expenses with future Federal and/or State funding. The broad use of GARVEEs and GANs were made possible by the National Highway System Designation Act of 1995 (P.L. 104-59) (NHS Act), which modified the Federal reimbursement and eligibility process as necessary to permit borrowing against future funds.

As of December 2008, 20 States, Puerto Rico, and the Virgin Islands had issued GARVEE bonds for approved Federal-aid highway projects totaling nearly $9.3 billion. According to FTA, over $3.2 billion worth of GANs have been issued by transit agencies since 1997. Because of the smaller size and relatively non-predictable nature of the Federal transit grant programs, transit agencies have found it difficult to issue long-term GANs without pledging additional resources to

secure debt service. And unlike GARVEE bonds, GANs do not include debt-related financing costs such as interest and issuance costs.

State Infrastructure Banks

A State Infrastructure Bank (SIB) is a revolving fund mechanism for financing a wide variety of highway and transit projects through loans and credit enhancement. SIBs are intended to complement the traditional Federal-aid highway and transit programs by supporting certain projects with dedicated repayment streams that can be financed in whole or in part with loans, or that can benefit from the provision of credit enhancements. As loans are repaid or the financial exposure implied by a credit enhancement expires, the SIB initial capital is replenished and can be used to support a new cycle of projects.

Section 350 of the NHS Act authorized DOT to establish the SIB Pilot Program. Specifically, DOT was authorized to select up to 10 States to participate in the initial pilot program and to enter into cooperative agreements with the Federal Highway Administration (FHWA) and/or the FTA for the capitalization of SIBs with a portion of their Federal-aid highway funds. The DOT and Related Agencies Appropriations Act, 1997 (P.L. 104-205) opened SIB participation to 38 States and the Commonwealth of Puerto Rico and appropriated $150 million in Federal General Funds for SIB capitalization. Under this authority, 32 States and Puerto Rico established SIBs. SAFETEA-LU made the pilot program permanent and expanded it to allow all States and territories to capitalize SIBs with a portion of their apportioned highway formula funding. By the end of December 2008, these SIBs had collectively issued more than $6.2 billion in loan agreements.

Innovative Financing in the Surface Transportation Authorization Act

The Surface Transportation Authorization Act (STAA) (H.R. ___), which the Subcommittee on Highways and Transit reported to the full Committee in June 2009, includes a variety of provisions related to innovative financing of highway and transit projects. STAA would reauthorize the TIFIA and SIB programs, and would increase the proportion of a TIFIA project that could receive Federal assistance (up from 33 to 49 percent of total project cost). STAA would also authorize metropolitan planning organizations (MPOs) to use funding under the newly-created Metropolitan Mobility and Access (MMA) program to capitalize Metropolitan Infrastructure Banks (MIBs), which would operate very similarly to SIBs. Only MPOs receiving MMA funding would be authorized to establish MIBs. The Committee intends to include in the STAA provisions authorizing the establishment of a National Infrastructure Bank within DOT. The Bank will be administered by the Office of Intermodalism, and will operate like a larger version of the existing TIFIA program, with additional authorities. The Bank will focus on providing assistance to projects under three programs: (1) the newly-created Metropolitan Mobility and Access program; (2) Projects of National Significance; and (3) high-speed rail corridors.

PREVIOUS COMMITTEE ACTION

On both May 8, 2008 and June 10, 2008, the Committee on Transportation and Infrastructure held a hearing to examine methods for financing investment in our nation's infrastructure, including roads, bridges, public transportation, aviation, ports, waterways, and wastewater treatment infrastructure.

On February 13, 2007, the Subcommittee on Highways and Transit held a hearing on innovative financing under PPP arrangements. The hearing examined how the public interest should be protected when PPPs are used to provide innovative financing for infrastructure investment, and whether the model legislation developed by the FHWA provides adequate safeguards for the public interest.

WITNESSES

The Honorable Chris Bertram
Assistant Secretary for Budget and Programs and Chief Financial Officer
U.S. Department of Transportation

The Honorable Eugene A. Conti
Secretary
North Carolina Department of Transportation

Mr. Phillip A. Washington
General Manager and Chief Executive Officer
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Mr. Arthur T. Leahy
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