Maryland Department of Transportation
Fiscal 2008 Budget Overview

Department of Legislative Services
Office of Policy Analysis
Annapolis, Maryland

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Note: Numbers may not sum to total due to rounding.

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Analysis in Brief

PAYGO Capital Budget Issues

Public-Private Partnerships: In recent years, private markets have been entering the world of transportation finance, representing a paradigm shift in how government finances transportation projects. During the interim, the Department of Legislative Services wrote a research paper on this subject and the potential implications for the State. This issue will provide a summary of that report. The full report is attached as **Appendix 2**.

Local Funding of State Transportation Projects: In the fiscal 2007 through 2012 *Consolidated Transportation Program*, local jurisdictions are contributing $104 million for transportation projects. This contribution of local funding raises a number of issues for the General Assembly to consider in terms of the funding of transportation projects and the role of local jurisdictions.

Proposed Deferral of the General Fund Payment for the InterCounty Connector: In the Governor's allowance, the general fund payment for the InterCounty Connector (ICC) is proposed to be deferred in fiscal 2008 contingent upon the General Assembly passing legislation that would revise the ICC financing plan. There are a number of issues regarding the Governor's plan to defer the general fund payment which will be discussed in this issue.

Recommended Actions

1. Add annual budget bill language pertaining to capital budget changes.

2. Add annual budget bill language on non-transportation expenditures.

3. Add annual budget bill language to establish a position ceiling.

4. Add budget bill language requiring the department to use the Bureau of Revenue Estimates' corporate income tax estimates.

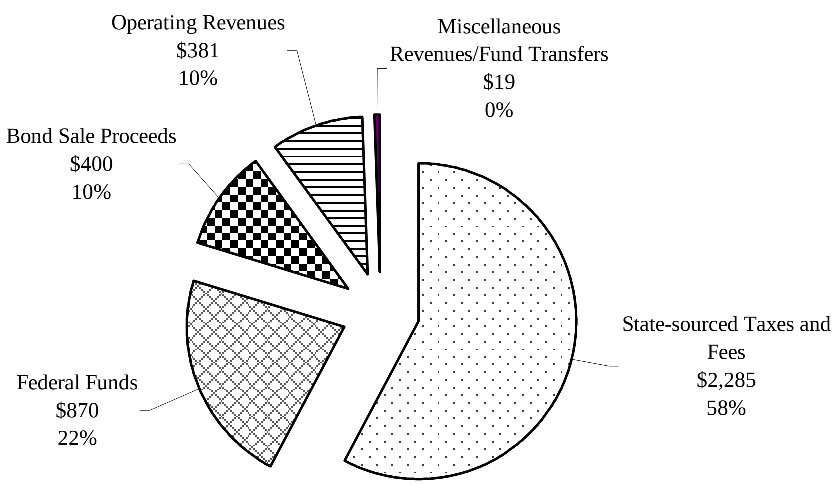
Operating Budget Analysis

The Maryland Department of Transportation (MDOT) is responsible for statewide transportation planning and the development, operation, and maintenance of key elements of the transportation system. It is involved in all modes of transportation within the State, including the construction and maintenance of State roads, regulation and licensing of drivers and vehicles, and operation of bus and rail transit services. In addition, MDOT owns and operates Martin State Airport, the Baltimore/Washington International Thurgood Marshall Airport (BWI Marshall Airport), and terminals in the Helen Delich Bentley Port of Baltimore (Port).

Transportation in Maryland is funded through the Transportation Trust Fund (TTF), a nonlapsing special fund revenue account whose revenue sources include motor fuel tax receipts, titling tax receipts, vehicle registration fees, a portion of the corporate income tax, revenues generated by the individual modes, proceeds from the sale of bonds, and federal highway and transit aid. As illustrated in **Exhibit 1**, State-imposed taxes and fees (including motor fuel, titling, corporate income, rental car taxes, vehicle registration, and miscellaneous motor vehicle fees) comprises the largest single source of revenue, followed by federal funds, bond sale proceeds, operating revenues, fund transfers, and other miscellaneous revenues.

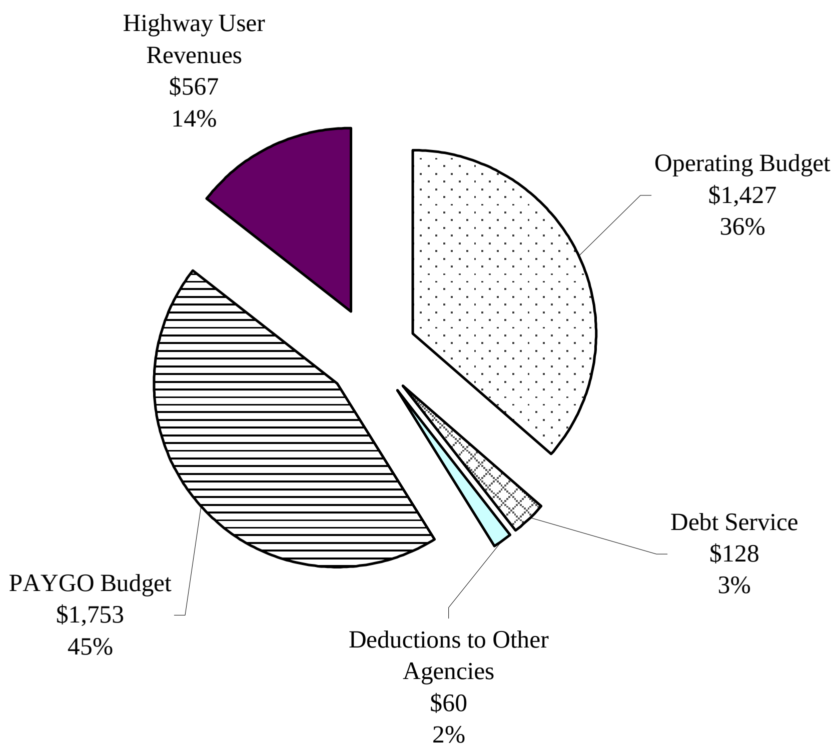
Exhibit 2 illustrates fiscal 2008 spending for MDOT. The PAYGO capital program, at $1.8 billion, represents nearly one-half of the MDOT budget. Over one-third of the budget is allocated for the operations of the various modal administrations. Highway user revenues, representing a portion of tax and fee revenue that is divided amongst local jurisdictions, comprise 15% of the budget. The remainder of revenue is allocated for debt service on Consolidated Transportation Bonds (CTBs).

Exhibit 1
Fiscal 2008 Transportation Trust Fund Revenue by Source
Total Revenue: $4.0 Billion
($ in Millions)



Source: Maryland Department of Transportation

Exhibit 2
Fiscal 2008 Transportation Trust Fund Uses
Total Spending: $4.0 Billion
($ in Millions)



Source: Maryland Department of Transportation

Fiscal 2007 Actions

Proposed Deficiency

The fiscal 2008 budget includes 13 deficiencies for MDOT for a total of $55.4 million. The deficiencies are:

- $23.5 million for 5 deficiencies (one for each mode) for fuel and utilities;

- $12.2 million to the Maryland Transit Administration (MTA) for union contract increases;
- $9.0 million to MTA for bus operations;
- $4.2 million to MTA's Mobility Program due to increased ridership;
- $2.6 million to the Maryland Aviation Administration (MAA) for insurance and security expenses;
- $1.8 million to MTA for maintenance expenses;
- $1.2 million to the Motor Vehicle Administration (MVA) for credit card fees, the Vehicle Emissions Inspection Program contract, and Limited English Proficiency services;
- $0.8 million to the Maryland Port Administration (MPA) for overtime payments to the Maryland Transportation Authority (MdTA) Police for cruise ship operations; and
- $121,000 to MVA to provide funds for 20 temporary employee positions.

Governor's Proposed Budget

Exhibit 3 categorizes the fiscal 2008 Governor's budget by operating and PAYGO capital budgets for each modal administration, debt service, and local highway user grants. The fiscal 2008 allowance increases $218.1 million (6.0%) over the fiscal 2007 working appropriation. Without the health insurance costs decline due to one-time savings, the allowance would have increased $250.1 million (6.9%). The majority of the increase comes from special funds, which increase $168.1 million (5.9%), largely due to operating budget increases. The remainder of the increase comes from federal funds, which increase $50.0 million (6.1 %).

Operating Programs

The fiscal 2008 operating program increases by $100.0 million (7.5%) over the fiscal 2007 working appropriation. However, without the health insurance costs decline due to one-time savings, the allowance would have increased $125.3 million (9.6%). The largest percentage changes are observed at MTA, which increases $46.0 million (9.8%); the Washington Metropolitan Area Transit Authority (WMATA), up $16.7 million (9.6%); and MPA, which climbs $8.6 million (8.8%).

Exhibit 3
Transportation Budget Overview
Fiscal 2006-2008

	2006 Actual	2007 Working	2008 Allowance	2007-08 Change	2007-08 % Change
Operating Programs					
Secretary's Office	$64,528,053	$78,015,773	$75,127,918	-$2,887,855	-3.7%
WMATA	167,041,076	174,503,000	191,185,195	16,682,195	9.6%
Highway Administration	203,728,087	197,610,335	210,744,439	13,134,104	6.6%
Port Administration	95,422,864	97,699,551	106,302,268	8,602,717	8.8%
Motor Vehicle Administration	133,666,252	140,085,935	146,018,329	5,932,394	4.2%
Transit Administration	470,452,772	467,541,452	513,533,920	45,992,468	9.8%
Aviation Administration	166,707,172	171,041,584	183,585,617	12,544,033	7.3%
Subtotal	***$1,301,546,276***	***$1,326,497,630***	***$1,426,497,686***	***$100,000,056***	***7.5%***
Debt Service	**$141,217,092**	**$119,944,998**	**$128,318,800**	**$8,373,802**	**7.0%**
Local Highway User Grants	**$512,631,402**	**$584,911,158**	**$566,782,241**	**-$18,128,917**	**-3.1%**
Capital					
Secretary's Office	$22,864,607	$37,353,195	$20,362,758	-$16,990,437	-45.5%
WMATA	70,856,936	70,982,000	80,261,000	9,279,000	13.1%
Highway Administration	1,100,615,858	1,041,038,718	1,106,278,085	65,239,367	6.3%
Port Administration	72,973,897	130,926,486	123,858,294	-7,068,192	-5.4%
Motor Vehicle Administration	14,438,396	24,411,068	34,340,577	9,929,509	40.7%
Transit Administration	239,689,947	240,534,000	308,056,000	67,522,000	28.1%
Aviation Administration	68,886,291	80,235,538	80,172,009	-63,529	-0.1%
Subtotal	***$1,590,325,932***	***$1,625,481,005***	***$1,753,328,723***	***$127,847,718***	***7.9%***
Total of All Funds					
Special Fund	$2,685,275,051	$2,837,297,315	$3,005,427,089	$168,129,774	5.9%
Federal Fund	860,445,651	819,537,476	869,500,361	49,962,885	6.1%
Grand Total	**$3,545,720,702**	**$3,656,834,791**	**$3,874,927,450**	**$218,092,659**	**6.0%**

WMATA: Washington Metropolitan Area Transit Authority

Source: Maryland State Budget

The increase for MTA is largely driven by rising fuel expenditures caused by increasing prices and increases in a number of transit service contracts, such as paratransit Mobility, Maryland Rail Commuter (MARC), and commuter bus services. The operating subsidy for WMATA increased due to operating expenditures, such as personnel and fuel expenses, rising faster than the growth of operating revenues. The increase at MPA is primarily the result of increases for stevedoring costs, additional security, and the debt service payment for the Certificates of Participation (COPs) used to construct the new paper shed at South Locust Point terminal.

Personnel

As **Exhibit 4** shows, the fiscal 2008 allowance contains 9,096.5 regular positions, an increase of 76.0 positions (0.8%), over the fiscal 2007 working appropriation. Contractual full-time equivalents (FTE) increase in the fiscal 2008 allowance by 6.5 FTEs (3.7%), for a total of 182.4 FTEs.

The regular positions increase includes 63 operating positions and 13 capital positions. The largest operating position increases are at MTA (50 positions), MVA (8 positions), and the State Highway Administration (SHA) (5 positions). The 50 new operating positions at MTA are for:

- 30 bus operators to replace positions that were transferred to the Mobility paratransit program to meet the rising demand for service;
- 15 contractual positions that are being converted to regular full-time positions for the Mobility paratransit program;
- 4 bus maintenance positions; and
- 1 office clerk.

The new operating positions at MVA are for eight customer service agent positions at the Gaithersburg branch office. SHA's five new operating positions will increase patrol coverage in the Baltimore and Washington metropolitan areas for the Coordinated Highway Action Response Team.

The 13 new positions in the capital program are spread across all modes to create a compliance-focused Environmental Management program. This new program is the result of two events that occurred in 2005. The first was direction from the Secretary of the Maryland Department of the Environment that agencies should assess their environmental compliance. The second was agreements negotiated with the federal Environmental Protection Agency regarding environmental compliance at the modal administrations of MDOT. Two compliance oversight positions have been filled at the Secretary's Office (TSO), and one at MTA, with existing positions. The 13 additional positions included in the fiscal 2008 allowance are divided among the modes as follows: SHA (4), TSO (3), MTA (3), and 1 each at MPA, MVA, and MAA.

Exhibit 4
MDOT Regular and Contractual Full-time Equivalents
Fiscal 2006-2008

	2006 Actual	2007 Working	2008 Allowance	2007-08 Change	2007-08 % Change
Regular FTEs					
Secretary's Office	333.0	332.0	335.0	3.0	0.9%
State Highway Administration	3,222.0	3,232.0	3,241.0	9.0	0.3%
Maryland Port Administration	292.0	292.0	293.0	1.0	0.3%
Motor Vehicle Administration	1,612.5	1,612.5	1,621.5	9.0	0.6%
Maryland Transit Administration	3,009.0	3,009.0	3,062.0	53.0	1.8%
Maryland Aviation Administration	543.0	543.0	544.0	1.0	0.2%
Grand Total	**9,011.5**	**9,020.5**	**9,096.5**	**76.0**	**0.8%**
Contract FTEs					
Secretary's Office	5.1	4.5	6.0	1.5	33.3%
State Highway Administration	9.4	22.0	22.0	0.0	0.0%
Maryland Port Administration	1.2	1.5	1.5	0.0	0.0%
Motor Vehicle Administration	89.9	98.4	118.4	20.0	20.3%
Maryland Transit Administration	33.0	48.0	33.0	-15.0	-31.3%
Maryland Aviation Administration	2.0	1.5	1.5	0.0	0.0%
Grand Total	**140.5**	**175.9**	**182.4**	**6.5**	**3.7%**

Source: Maryland State Budget

The largest contractual FTE changes are at MVA and MTA. The loss of 15 contractual FTEs at MTA reflects the conversion of these positions to regular positions. The increase of 20 FTEs at MVA is to implement legislation passed during the 2006 session and to investigate the use of fraudulent documents to obtain driver's licenses or identification cards.

Debt Service

The budgeted fiscal 2008 debt service payment is $128.3 million, an increase of $8.4 million over the fiscal 2007 working appropriation. The increase in debt service is largely due to principal and interest payments for prior and planned CTB issuances.

At the end of fiscal 2008, total CTB debt outstanding is expected to total $1.45 billion, which remains below the statutory cap of $2.0 billion. Additional discussion of debt service trends and issues can be found in the MDOT Debt Service Requirements analysis, budget code J00A04.

Local Highway User Revenues

Local highway user revenues (HUR) are derived from a portion of tax and fee revenues that are deposited in the Gasoline and Motor Vehicle Revenue Account (GMVRA) and subsequently distributed among the TTF, Baltimore City, counties, and municipalities. Local distributions are based on vehicle registrations and road mileage. The fiscal 2008 allowance for HUR shows a decrease of $18.1 million from the fiscal 2007 working appropriation; however, the fiscal 2007 appropriation does not reflect the downward revision in highway user revenues. Based on the current revenue forecast, the local share of fiscal 2007 highway user revenues will be $30 million less than the working appropriation. Growth in fiscal 2008 is estimated to be $11 million.

Transportation Trust Fund Overview

The Transportation Trust Fund is a non-lapsing special fund that provides funding for MDOT. It consists of tax and fee revenues, operating revenues, and fund transfers. MDOT issues bonds backed by TTF revenues and invests the TTF fund balance to generate investment income. The Maryland Port Administration, Maryland Transit Administration, Motor Vehicle Administration, and Maryland Aviation Administration generate operating revenues that cover a portion of their operating expenditures. Capital expenditures and remaining operating expenditures are supported by other TTF revenues.

The tax and fee revenues are motor fuel taxes, rental car sales taxes, titling taxes, vehicle registration fees, a portion of the corporate income tax, and other miscellaneous motor vehicle fees. A portion of these revenues are credited to the GMVRA. Thirty percent of the GMVRA revenues are distributed to local jurisdictions, and the remainder is retained by the TTF. The funds retained by the TTF support the capital program, debt service, and operating costs.

Fiscal 2006 Transportation Trust Fund Revenue Closeout

Exhibit 5 shows that the TTF's fiscal 2006 end of the year cash fund balance totaled $235 million, which exceeded expectations by $135 million. Total revenues of $2.84 billion were $37 million less than anticipated. Titling tax revenues came in $23 million lower after a strong first quarter due to manufacturer rebates. Auto sales for the remainder of the year lagged due to increasing interest rates and rising gas prices. In addition, $35 million in revenue assumed from the sale of the World Trade Center in fiscal 2006 did not occur.

Actual expenditures in fiscal 2006 came in significantly lower than anticipated, more than offsetting the lower revenues. Capital expenditures were $157 million less than projected due to unexpected federal fund attainment, roughly $13 million, as well as cash flow changes in ongoing projects. For more detail, see the capital overview. In addition, operating expenditures were $9 million lower than anticipated.

Fiscal 2007 Revenues Revised Downward

Revenues for fiscal 2007 have been revised downward from the January 2006 forecast. **Exhibit 6** compares the January 2006 estimates for titling, corporate, and motor fuel taxes to the January 2007 estimate. In total these revenues were revised downward by $112 million, with titling tax revenues being revised downward by $58 million, corporate income tax revenues by $32 million, and motor fuel tax revenues by $22 million, representing the first major downward revision in revenues since the recession of the early 1990s. Compared to fiscal 2006 revenues, the revised estimate for titling is down $4 million (0.06%), corporate income is down $22 million (10.90%), and motor fuel is up $7 million (1.00%).

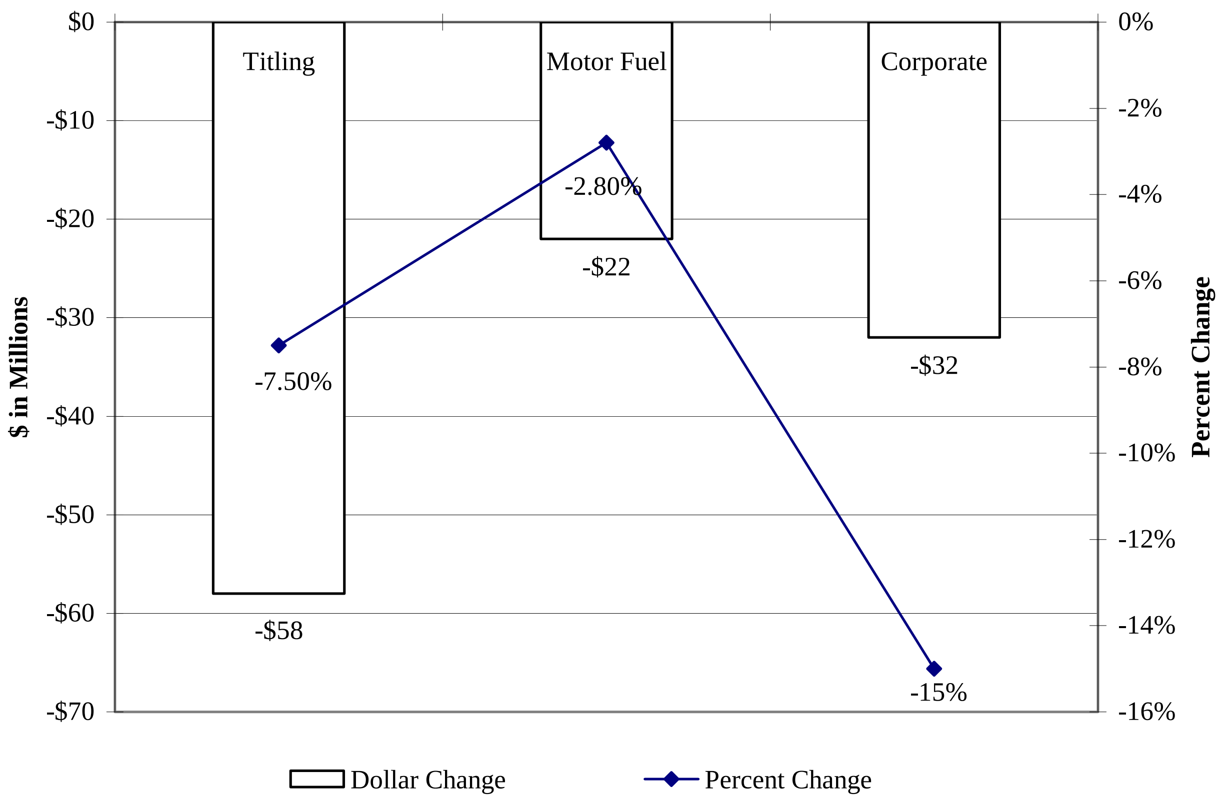
Exhibit 5
Transportation Trust Fund
Estimated Revenues Compared to Actual Revenues Received
Fiscal 2006
($ in Millions)

	Projected 2006	Actual 2006	Variance
Starting Fund Balance	**$245**	**$245**	**$0**
Revenues			
Titling Taxes	$742	$719	-$23
Motor Fuel Taxes	763	758	-5
Corporate Income, Registrations, and Misc. MVA Fees	744	754	10
Other Receipts and Adjustments	489	510	21
World Trade Center	35	0	-35
Bond Proceeds and Premiums	105	100	-5
Total Revenues	**$2,878**	**$2,841**	**-$37**
Uses of Funds			
MDOT Operating Expenditures	$1,312	$1,303	-$9
MDOT Capital Expenditures	957	800	-157
MDOT Debt Service	141	141	0
Highway User Revenues	516	513	-3
Other Expenditures	97	94	-3
Total Expenditures	**$3,023**	**$2,851**	**-$172**
Ending Fund Balance	**$100**	**$235**	**$135**

Note: Numbers may not sum to total due to rounding.

Source: Maryland Department of Transportation, January 2007

Exhibit 6
Major Transportation Tax Revenue Declines in Fiscal 2007
January 2006 v. January 2007 Forecast



Source: Maryland Department of Transportation

The reason for these downward revisions is largely the same as it is for general fund revenues, in that the economy has softened in recent months. More specific to the titling and motor fuel taxes are relatively high and fluctuating gas prices, higher interest rates that reduce vehicle purchases, and the weakened financial condition of domestic automakers that limits their ability to offer manufacturer rebates that have helped spur vehicles sales in past years.

Fiscal 2007 Year-to-date Revenue Receipts

The most significant tax and fee revenues in the TTF are motor fuel taxes, titling taxes, and registration fees. In fiscal 2007, attainments from these sources are expected to total $1.85 billion and represent almost 90% of GMVRA revenues. **Exhibit 7** shows that collections through December 2006 are slightly below estimated levels for the titling and motor fuel taxes. The estimate

Exhibit 7
Transportation Trust Fund
Estimated Revenues Compared to Actual Revenues Received
Fiscal 2007
($ in Millions)

Revenue Source	Total Projected Fiscal 2007	Projected through December 2006	Actual through December 2006	Difference
Motor Fuel Taxes	$765	$330.7	$326.5	-$4.2
Titling Taxes	715	335.4	328.3	-7.1
Registration Fees	365	163.7	169.1	5.4

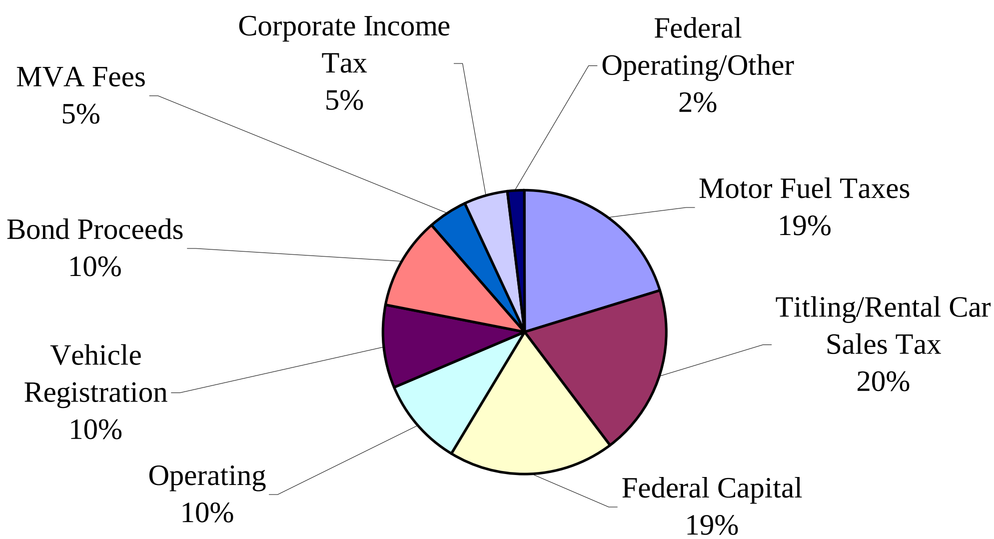
Sources: Fiscal 2007 estimate: Governor's Budget Books, Fiscal 2008, Volume I, pages 566-570
Actual Revenues: Maryland Department of Transportation, Monthly Statement of Revenues for the Gasoline and Motor Vehicle Revenue Account and Motor Vehicle Administration Programs and Fees, July through December 2006 (December numbers are preliminary)

compares actual revenues received through December with average revenues received through December over the previous five years. While the information for December is preliminary, it is likely that there will not be significant changes in the revenues and that it will not affect the overall trend of revenues. Specifically, motor fuel and titling tax receipts are below the current estimate and registration fees are higher than the estimate. Similar to the downward revision of revenues in fiscal 2007, the reasons for the underattainment of revenues is due to the softening State economy, higher interest rates and gas prices, and the financial condition of domestic automakers.

Fiscal 2007 through 2012 Revenue Projections

Exhibit 8 shows that the TTF's largest revenue sources in fiscal 2008 are the motor fuel and titling taxes and federal aid for the capital program, which represent almost $2.3 billion, or 63% of all fund sources. MDOT is projecting that $400 million in bonds will be sold to supplement the transportation capital program in fiscal 2008.

Exhibit 8
Transportation Trust Fund
State-sourced Revenues and Federal Funds
Fiscal 2008

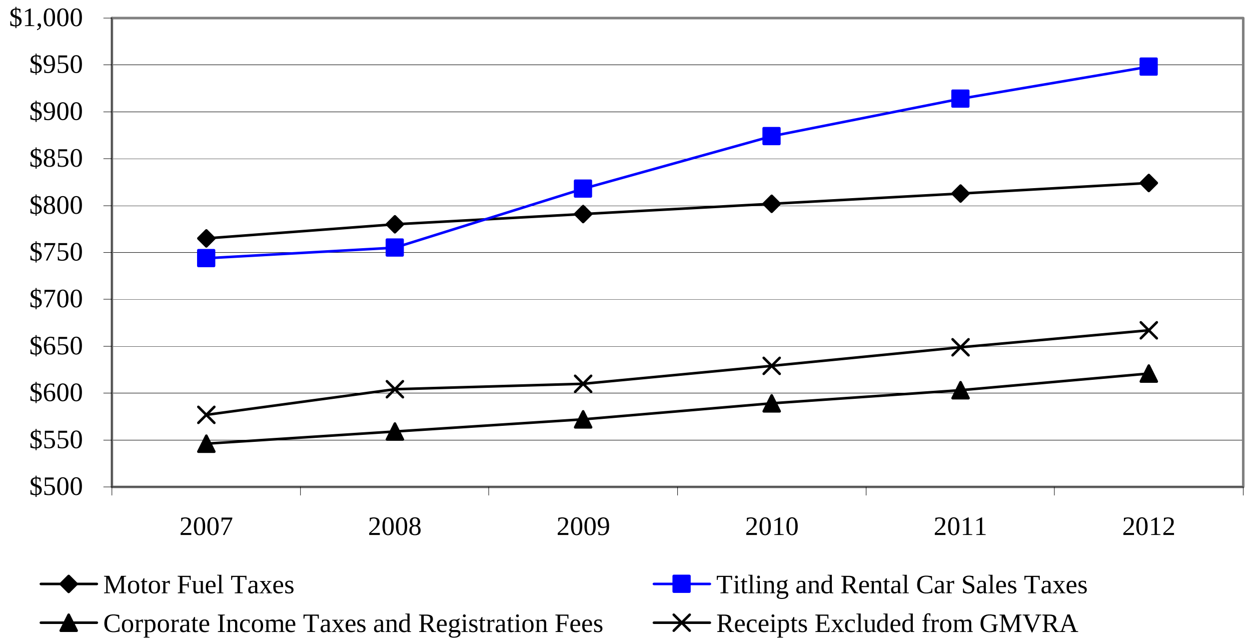


Source: Governor's Budget Books, Fiscal 2008, Volume 1, pages 566-570

Exhibit 9 shows that MDOT's State-sourced revenues are expected to dip slightly in fiscal 2007, with the corporate income tax declining by 8.0% and titling taxes flat from fiscal 2006 to 2007. Over the six-year period, GMVRA revenues are expected to increase and total $2.06 billion in fiscal 2007 and increase to $2.39 billion in fiscal 2012, for an average annual growth rate of 2.6%. Registration fees and motor fuel tax receipts are expected to grow at historically more modest annual rates of 1.47 and 1.3% respectively, with titling growing at 4.1%.

Non-GMVRA revenues are also expected to increase throughout the six-year period, with a somewhat sizable increase in fiscal 2008 for operating revenues for MAA. A summary of the total forecast can be found in **Appendix 1**.

Exhibit 9
Transportation Trust Fund
Forecasted State-sourced Revenues
Fiscal 2007-2012
($ in Millions)



Source: Maryland Department of Transportation, Transportation Trust Fund Forecast, January 2007

MDOT's Forecast Includes Optimistic Assumptions

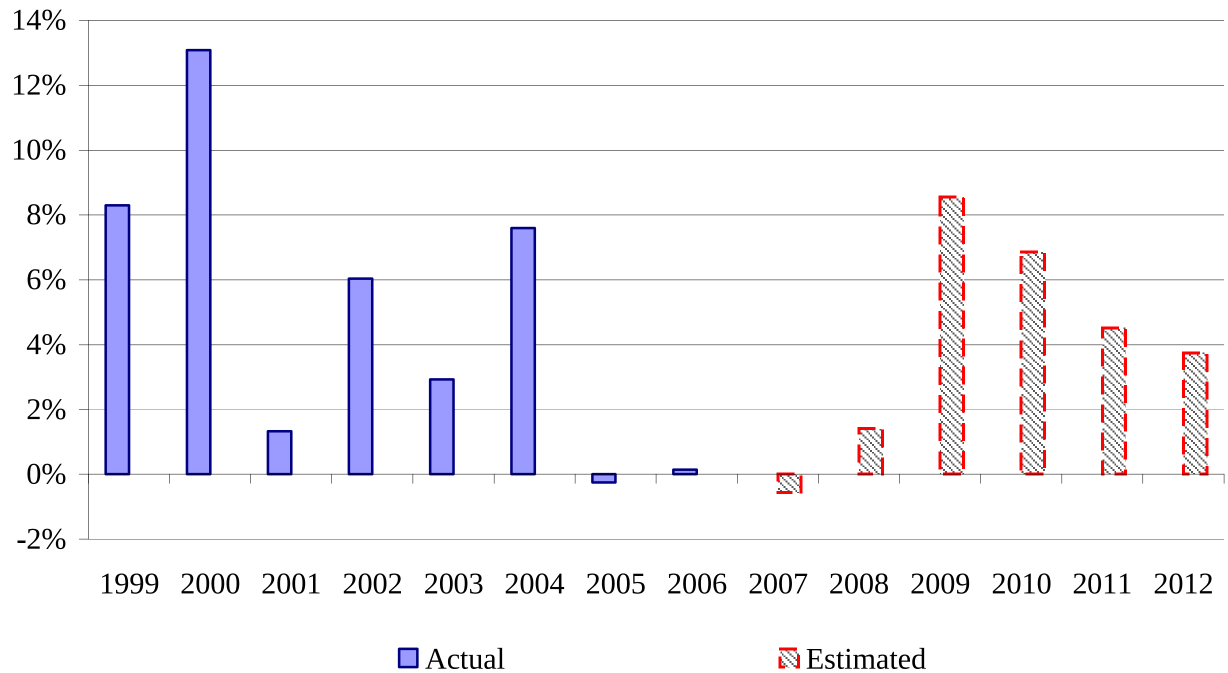
Traditionally, the department is conservative in its revenue estimates and utilizes a number of hedges within the forecast to protect itself against any potential revenue downturns or unforeseen expenditures. Due to the conservative nature of the forecast, the department typically has had ample revenues and cash on hand to support the capital program leading to either reduced or eliminated bond sales in a fiscal year. However, in this forecast, the department has curtailed a previously used hedge and aggressively estimated revenue growth. In doing so, the concern is that MDOT's policy changes introduce downside revenue risk.

Ambitious Titling Tax Revenue Growth

In its fall forecast of the TTF, the Department of Legislative Services (DLS) estimated titling tax revenue growth to be in the 3 to 4% range for fiscal 2009 and 2010, and in December the Board of Revenue Estimates (BRE) projected that the Maryland economy will continue to grow at a moderate rate in the coming years, even with the impact of the base realignment and closure process.

In its forecast of revenues, the department shows what appears to be exceptional revenue growth of 8.6% in fiscal 2009 and 6.9% in fiscal 2010. **Exhibit 10** shows the historical growth rate of the titling tax from fiscal 1999 to 2006 and estimates for 2007 to 2012, with a high of 13% in fiscal 2000 when the economy was rapidly expanding. The average annual growth from fiscal 1999 to 2006 totals 3.0%. While estimating future revenue growth for the titling tax is difficult at best, the assumption of aggressive revenue growth in the titling tax may result in future funding issues for the capital program should revenues not come in at estimated levels.

Exhibit 10
Titling Tax Growth Rate
Fiscal 1999-2012



Source: Maryland Department of Transportation

Corporate Income Tax Growth

In fiscal 2006, the department understated corporate income tax receipts relative to BRE due to concerns that actual revenues may be less than estimated. In the current forecast, MDOT has reversed this policy. The corporate income estimate prepared by BRE is used in fiscal 2007 and 2008; however, beyond fiscal 2008, the department estimates revenue growth at around 5.0% each fiscal year, based upon an historical average. This is much higher than BRE estimate's of approximately 1.2 to 2.2% average growth for each fiscal year. This higher revenue estimate by the department adds roughly $62 million to the forecast.

Another concern regarding the estimating of revenues is that the department did not use the corporate income tax estimates provided by BRE in the out-years. BRE is the agency responsible for estimating general fund revenues and employs trained economists. BRE develops a consensus forecast and receives input from State officials, academics, and business leaders. Rating agencies have commented favorably on this aspect of Maryland's fiscal management. While the department may not agree with the estimates of BRE, given that these estimates are used for the general fund budget of the State, the department should be required to use the BRE estimates as well.

Revenue Contingency Hedge

To reduce any adverse effects associated with the underattainment of revenue, the department typically employs a reserve, revenue hedge, for any changes in revenues, which limits the overall amount of funds available in the forecast. MDOT has eliminated the revenue hedge in fiscal 2007 and 2008 due to the downward revision of revenues in fiscal 2007 and the need to maintain its obligations; however, the hedge returns in fiscal 2009 and beyond. Based upon revenue estimates to date, as shown in Exhibit 7, revenues may come in lower than the fiscal 2007 revised revenue estimates, and the department will either need to make adjustments to its capital program, rely on cash flow changes in the capital program, or allow the fund balance to fall below the $100 million minimum level established by MDOT. Beyond fiscal 2009, the use of an approximate $20 million revenue hedge is questionable given that it does not come close to equaling the $112 million downward revision in estimated fiscal 2007 revenues.

Conclusion: Policy Changes Increase Downside Revenue Risk

Taken together, these changes in assumptions and aggressive revenue estimates allow the department to recognize more revenue over the six-year period, which in turn allows the department to issue more debt to support the capital program and overcome the flattening of revenues in fiscal 2007 and 2008. Unlike previous years, where the department underestimated revenues to insure that there were sufficient funds available, the department has moved in the opposite direction. While the assumptions used in the forecast may come true, there is a danger that revenues will be less than estimated, at which point the department will be required to make midstream adjustments to the capital program.

DLS recommends that the department explain its revenue and hedge assumptions in the TTF forecast, as well as the outlook for fiscal 2007. DLS also recommends that budget bill language be added that requires the department to use BRE estimates for corporate income tax in its forecast for the six-year period.

Fund Transfers Between the TTF and Other Funds

Exhibit 11 shows the fund transfers between the TTF, MdTA, and the general fund. Fiscal 2006 and 2007 include the last two MdTA fund transfers for the transit initiative. Over the forecast period, the TTF will transfer $158 million to MdTA for the InterCounty Connector (ICC). This is required by Chapter 472 of 2005, which establishes a finance plan for the ICC. In fiscal 2006, the TTF received $50 million from the general fund as partial repayment of the $314.9 million transferred to the general fund in fiscal 2003 and 2004. The remaining $264.9 million will be transferred from the general fund to MdTA to fund the ICC. Beginning in fiscal 2007, MdTA will transfer a total of $44 million to SHA to construct an interchange at I-95 and MD 24, which MdTA can not legally do since MD 24 is a State road and does not generate revenue.

Exhibit 11
TTF Fund Transfers
Fiscal 2006-2010
($ in Millions)

Transfer	2006	2007	2008	2009	2010
From MdTA for Transit Initiative	$43	$43	$0	$0	$0
From MdTA for I-95/MD 24 project	0	5	17	17	5
To MdTA for ICC	-38	-30	-30	-30	-30
From General Fund	50	0	0	0	0
Total	**$55.00**	**$18**	**-$13**	**-$13**	**-$25**

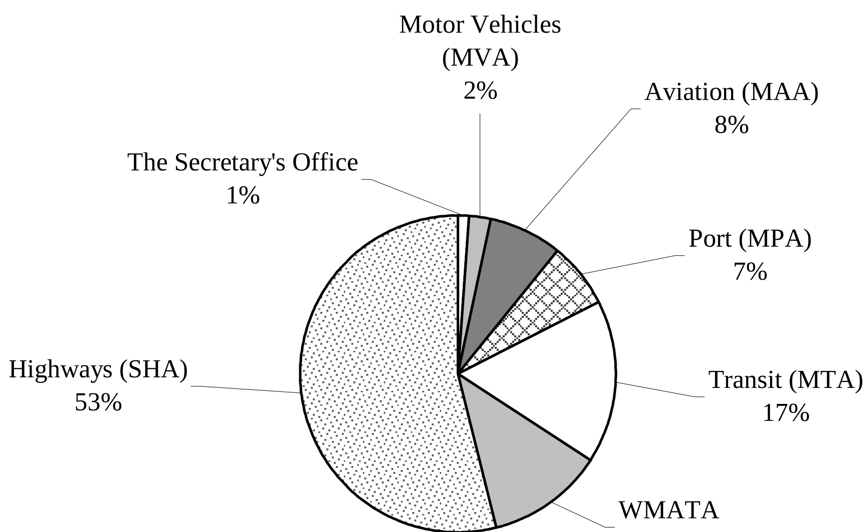
MdTA: Maryland Transportation Authority

Source: Maryland Department of Transportation, January 2007

PAYGO Capital Budget Analysis

The *Consolidated Transportation Program* (CTP) is issued annually to the General Assembly, local elected officials, and interested citizens. The CTP provides a description of projects proposed by MDOT for development and evaluation or construction over the next six-year period. For the period 2007 to 2012, the CTP totals just over $9.0 billion for projects supported by State, federal, and "other" funds. Other funds include Maryland Economic Development Corporation (MEDCO) and MdTA financing, Certificates of Participation, and debt backed by Passenger Facility Charges (PFCs) and Customer Facility Charges (CFCs). To date, other funding has primarily been used by MAA for its capital expansion program at BWI Marshall Airport. This type of funding has also been utilized for projects by MPA and MTA. **Exhibit 12** shows the funding level for each mode over the six-year period.

Exhibit 12
MDOT Proposed Capital Funding by Mode
2007-2012 Consolidated Transportation Program
Total Program – $9.0 Billion

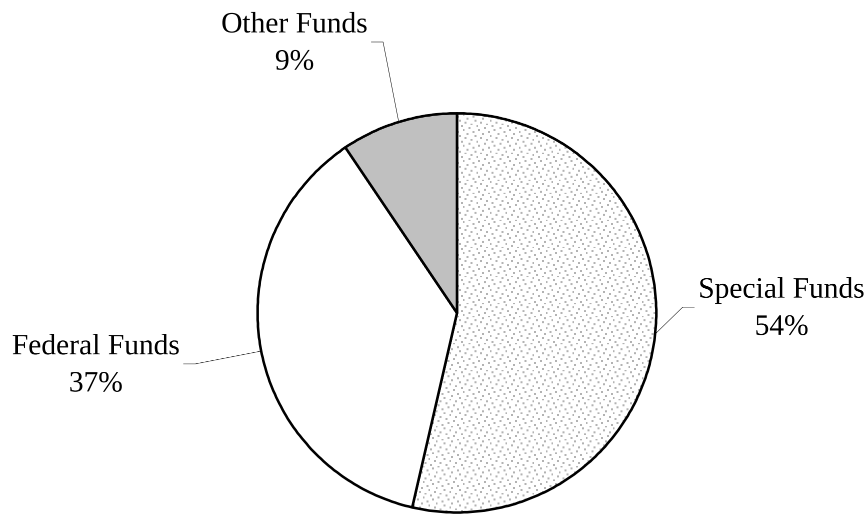


WMATA: Washington Metropolitan Area Transit Authority

Source: Maryland Department of Transportation, January 2007 *Consolidated Transportation Program*

Exhibit 13 shows that special funds support over half of the six-year capital program.

Exhibit 13
MDOT Proposed Capital Funding by Source
2007-2012 Consolidated Transportation Program
Total Program – $9.0 Billion

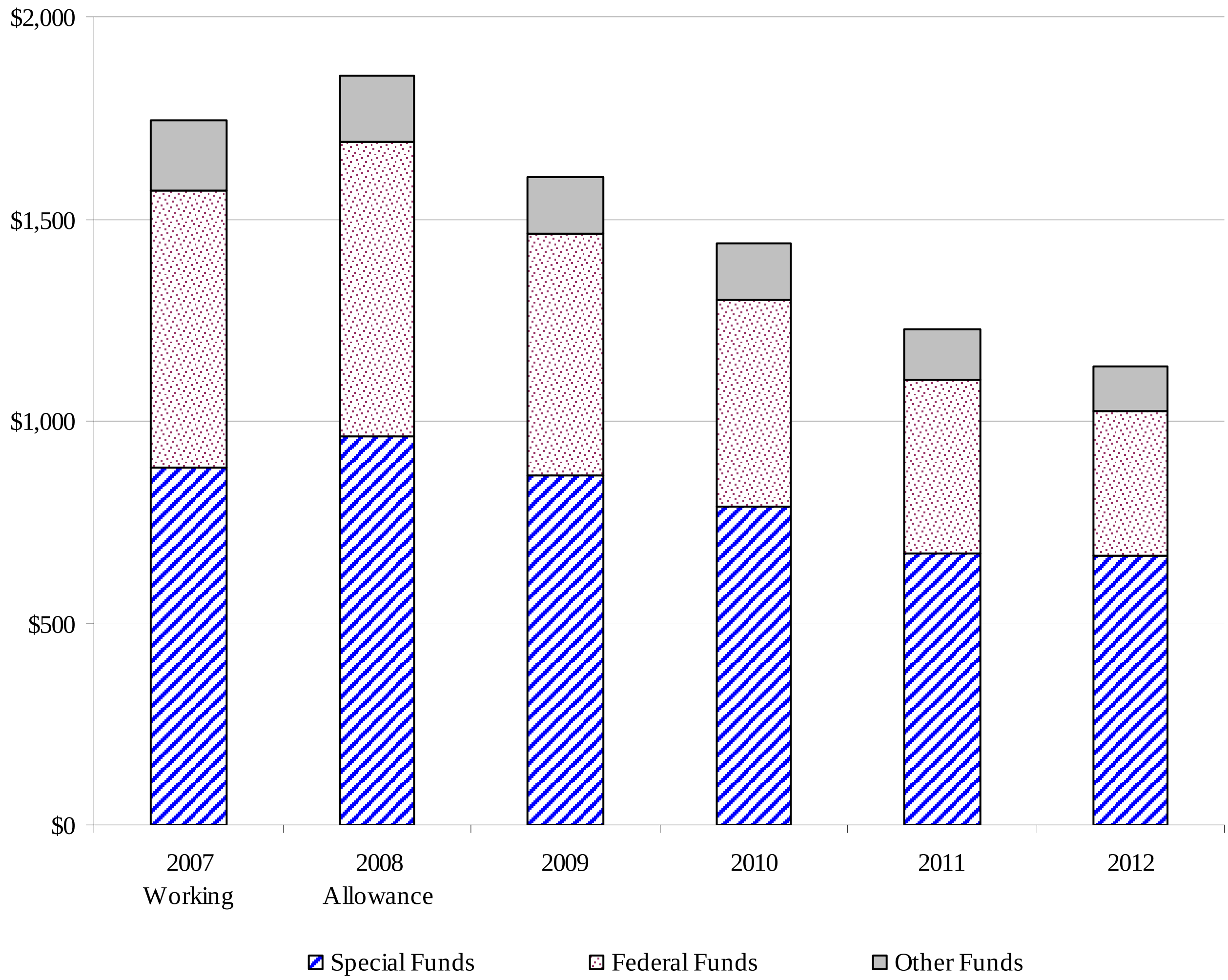


Source: Maryland Department of Transportation, January 2007 *Consolidated Transportation Program*

Exhibit 14 shows the level of special, federal, and other funds for each year. The increase in fiscal 2008 is largely due to cash flow carryover from fiscal 2006. Special and federal funds from fiscal 2006 are more evenly distributed over the capital program rather than placing the money into the first year of the program, as was the previous practice. Doing so more accurately reflects the actual cash flow of projects and reduces the need of bond sales to support the capital program.

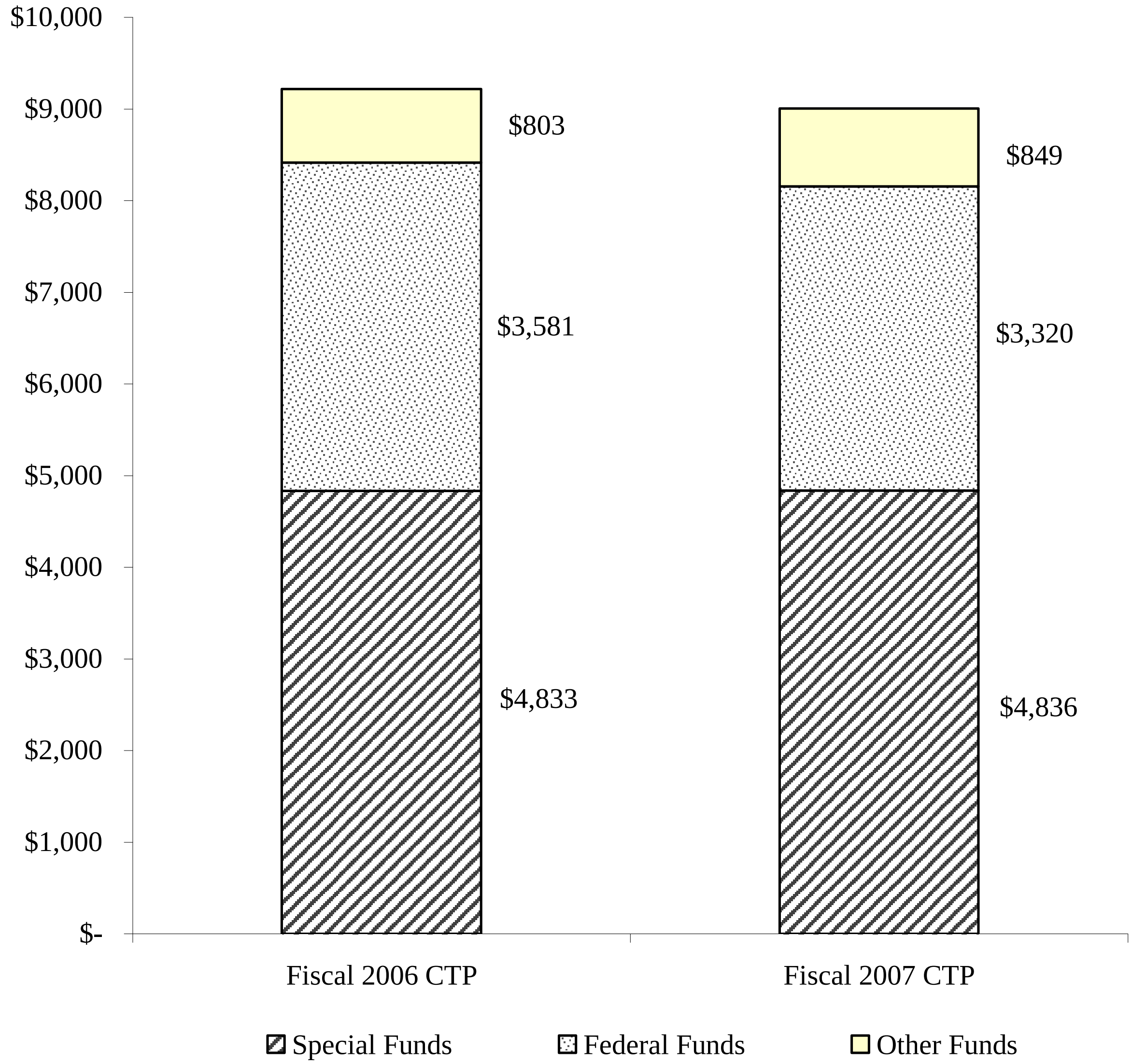
The 2007 to 2012 CTP decreases by $212 million, or 2.3% compared to the 2006 to 2011 CTP. **Exhibit 15** compares the funding of the 2006 to 2011 CTP to that of the 2007 to 2012 CTP by type of funding source. When comparing the two programs, federal funds decrease by $261 million due to completion of the Woodrow Wilson Bridge and related projects in fiscal 2010. Other funds increase by $46 million, primarily as the result of a $21.3 million increase in federal funds for WMATA and an $8.3 million increase for local funding of MTA projects. Special funds increase by only $3 million.

Exhibit 14
MDOT Proposed Capital Funding by Year
2007-2012 Consolidated Transportation Program
Total Program – $9.0 Billion
($ in Millions)



Source: Maryland Department of Transportation, January 2007 *Consolidated Transportation Program*

Exhibit 15
Comparison of 2006-2011 and 2007-2012 CTP
($ in Millions)



Source: Maryland Department of Transportation, January 2006 and 2007 *Consolidated Transportation Program*

The 2007 to 2012 CTP, excluding MdTA, includes $121.3 million for new projects in the construction program, a $67.5 million increase over what was included in the draft CTP presented to the counties this past fall. Fiscal 2008 new construction projects include the procurement of a MARC facility ($25 million), MD 404 Shore Highway ($26 million), US 113 Worcester Highway ($14 million), and MD 32 Patuxent Freeway ($12 million).

Fiscal 2006 and 2007 Cash Flow Changes

Fiscal 2006 ended with special fund expenditures for the capital program being $157 million less than the working appropriation. These funds were not spent due to cash flow changes in projects such as project delays, contracts being re-bid, and approximately $13 million in additional federal aid which allowed special funds to be used elsewhere. The cash flow carry over from fiscal 2006 is needed for capital expenditures in the future and have been redistributed in the capital program in fiscal 2007 and future years. The modes that experienced the largest changes are:

- SHA decreased $80 million in special funds due to cash flow changes in projects and additional federal aid from higher attainment and quicker construction on the Woodrow Wilson Bridge which freed up special funds to be reallocated.

- MTA decreased $24 million in special funds. This decrease is due to cash flow changes in the system preservation program and the Owing Mills Joint Development project. Federal funds also decreased $135 million due to cash flow changes in projects, largely with MARC-related project, and changes in system preservation.

- WMATA decreased $25 million in special funds due to project spending being slower than anticipated.

- MPA decreased $18 million in special funds due to cash flow changes in the dredging program and minor projects being reduced.

- TSO and MVA decreased $10 million in special funds due to cash flow changes in minor projects.

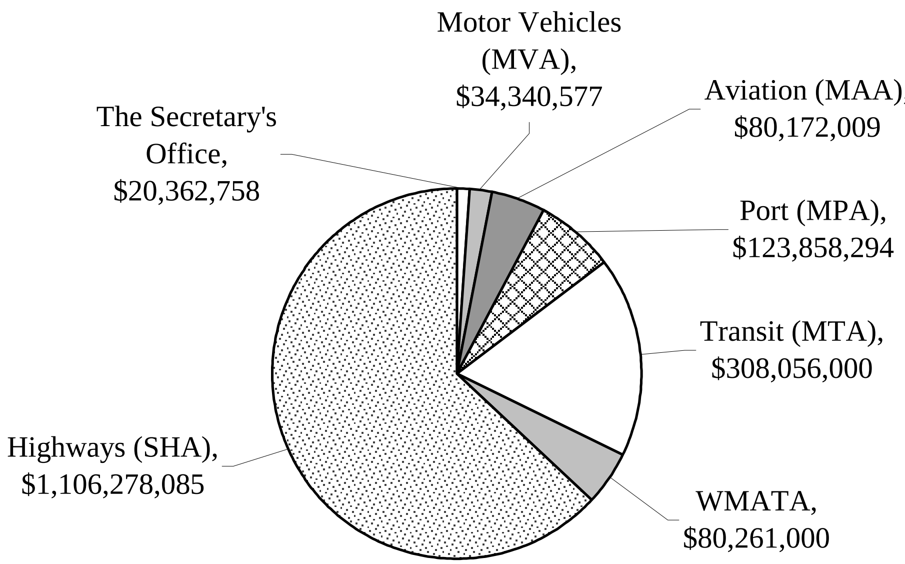
Fiscal 2008 Allowance

Excluding other funding, the fiscal 2008 allowance totals nearly $1.8 billion, an increase of $128 million (7.9%) when compared to the fiscal 2007 working appropriation. This is largely due to cash flow rollout from fiscal 2006 and adjustments in the cash flow of other projects. The fiscal 2008 allowance includes $962 million in special funds and $791 million in federal funds. **Exhibit 16** displays the level of funding for each mode in the fiscal 2008 allowance.

The major increases in fiscal 2008 are for MTA, which increases $68 million (28%) compared to the fiscal 2007 working appropriation. Much of this increase is due to cash flow carry over from fiscal 2006 that was reprogrammed in fiscal 2008. The increase is largely for the Silver Spring Transit Center where funding grows $32 million. Several other projects have experienced funding increases in fiscal 2008 due to cash flow changes in projects.

SHA's fiscal 2008 allowance increases $65 million (6.3%) compared to the fiscal 2007 working appropriation. Most of this is due to increased funding for projects in the development and evaluation program from cash flow carry over.

Exhibit 16
MDOT Fiscal 2008 Allowance*
$1.8 Billion



* Excludes other funding

Source: State Budget Book

MVA and WMATA increase $10 million and $9 million, respectively. MVA increases largely due to cash flow changes for system preservation projects and project additions. The WMATA increase reflects cash flow changes in the Metro Matters program.

TSO decreases $17 million (46%) due to a number of system preservation projects ending in fiscal 2006.

MPA is $7 million (5.4%) lower due to decreases in the Dredge Material Placement and Monitoring program and Security program, which are offset by increases in the dredging program at Seagirt Marine Terminal and land acquisition at Dundalk Marine Terminal.

Other Funds

The fiscal 2008 CTP also includes $162 million in "other" funding as shown in **Exhibit 17**. The other funding is comprised of pass-through federal money for WMATA, COPs backed by revenue from MPA, debt backed with local county participation, MEDCO debt, and debt backed by PFCs and CFCs.

Exhibit 17
MDOT Fiscal 2008 Other Funds
($ in Thousands)

Project	Other Source	2008
South Locust Point Paper Shed	COPs	$13,015
Total Other MPA		**$13,015**
Owings Mills Joint Development	Local	4,100
Elderly Handicapped Nonprofit Services	Local	351
Takoma/Langley Park Transit Center	Local	1,187
MARC Silver Spring Transit Center	Local	6,809
MARC Edgewood Improvements	Local Federal	750
Central Maryland Transit Facility	Local Federal/Local	2,260
Total Other MTA		**$15,457**
Metro Matters	WMATA Federal	94,623
Total Other WMATA		**$94,623**
Airside Taxiway Paving Rehab	PFC	9,034
D/E Airfield Ramp Paving Improvements	PFC	3,645
C/D Airfield Ramp Paving Improvements	PFC	1,134
Hagerstown Airport	Direct Federal	6,000
D/E Baggage System and Claim	MEDCO	5,348
Runway Safety Area Improvements	PFC	308
Minor Projects (10 Projects)	PFC/TSA/CFC	13,459
Total Other MAA		**$38,928**
Grand Total		**$162,023**

COPs: Certificates of Participation
PFC: Passenger Facility Charges
MEDCO: Maryland Economic Development Corporation
CFC: Customer Facility Charges
TSA: Transportation Security Administration

Source: Maryland Department of Transportation

Potential Funding Shortfall for the CTP

In fiscal 2007 and 2008, the department can maintain the capital program through the issuance of debt and cash flow carry over from fiscal 2006, despite the downward revision in revenues. However, beyond fiscal 2008, there exists a potential funding shortfall for the capital program. As noted earlier, the department has used aggressive revenue estimates for the corporate and titling tax. In doing so, the department has added additional cash and bonding capacity to the six-year program. Based on the DLS TTF forecast presented to the Spending Affordability Committee, the January 2007 MDOT forecast is $670 million higher than DLS projections.

Should revenues come in at the levels projected, the capital program can be maintained. However, in using aggressive revenue growth estimates, the department runs the risk of being unable to maintain the capital program due to less cash being available. In addition, future bond sales may be constrained due to less net income for the net income coverage test and higher debt service payments from the fiscal 2008 issuance. As a result, the potential exists that the department may have to make adjustments to the capital program, which may include delaying the construction of projects. **DLS recommends that the department discuss the future of the capital program based upon the revenue estimates that were used and what would happen if revenue estimates do not come in at the levels projected.**

Issues

1. Public-Private Partnerships

The Department of Legislative Services produced a report during the interim regarding public-private partnerships (P3). Following is a summary of that report which can be found in Appendix 2.

Introduction

Traditionally, transportation infrastructure has been paid for through federal aid derived from the motor fuel tax and state funds. However, there appears to be a paradigm shift in how transportation facilities are financed across the country, with public-private partnership agreements being an attractive option for some states to expedite development of new facilities, or as a means to generate large sums of "up-front" revenue by the lease of existing facilities. The demand for transportation projects, coupled with the declining purchasing power of transportation revenues, has helped to precipitate this change.

A P3 is an agreement between a public agency and a private entity whereby the private entity undertakes the construction of a project including planning and engineering (*e.g.*, a highway) or responsibility for the operation of an asset (*e.g.*, toll roads) on the State's behalf. The P3 agreement may involve some sort of private financing. In doing so, the private entity assumes some, but not all, of the responsibilities and risks associated with that project or asset different than the traditional model where facilities were publicly funded and operated with each stage of construction being bid and awarded separately. Typically, P3s for highway projects with financing fall under one of two types of agreements with variations possible:

Concession Agreements: A concession agreement involves the leasing of an existing, publicly financed toll facility to a private entity to operate and maintain for a set period of time in exchange for an upfront lump sum payment.

Design, Build, Operate, and Maintain*:* A private entity is granted the right to finance, design, build, own, operate, or maintain a transportation infrastructure project. The private sector partner may own or lease the project, assumes some of the risk, and may collect all of the revenue depending on the type of financing agreement.

In the past year, a number of P3 concession agreements have been in the news. In 2005, Chicago leased the Chicago Skyway for 99 years in return for a $1.8 billion upfront payment. In 2006, Indiana leased a toll road to a private consortium in a 75-year lease for $3.8 billion.

In Maryland, MdTA has the ability to enter into P3 agreements for toll roadways on behalf of the State. A Request for Expressions of Interest was issued by SHA, in coordination with MdTA and MTA, for the Corridor Cities Transitway in fall 2006.

Advantages of a P3

There are a number of benefits to the State when entering into a P3 agreement. By accessing private equity the State is able to move ahead with projects that might otherwise not have been constructed due to limited resources (including financing and production capabilities). In addition, the State transfers some of the risk associated with a project to the private sector. Finally, given that the private sector is motivated by profit, projects may be completed in a more timely and cost-effective manner.

Disadvantages of a P3

There are also a number of disadvantages to a P3 agreement. Typically, a P3 arrangement for a highway involves a long-term lease. Over the long-term, there is no historical basis to determine whether these arrangements are financially and logistically maintainable. Furthermore, in a concession agreement, the State may forgo future revenues generated by a toll facility for a large lump sum payment, which may result in the State being more cash-strapped and dependent on the private sector in the long run. Another important consideration is how highway users will react to paying tolls for a public highway. Another significant risk that must be addressed in the agreement is toll setting and adjustment criteria for the private partner.

Legal Framework

Currently, P3 arrangements are governed by MdTA's general statutory authority relating to transportation facilities and regulations adopted under this authority and – in certain instances – State procurement law. Under regulations adopted in 1997, MdTA administers the Transportation Public-Private Partnership program on behalf of the Maryland Department of Transportation. The P3 program allows for unsolicited non-highway transportation projects, including port and airport facilities and transit-oriented development. During the 2005 session, legislation was passed that provided the General Assembly with 45 days of review and comment of any P3 agreement. However, there currently exists no specific formal statutory framework governing a P3 agreement. MDOT and MdTA apply existing statutory and regulatory frameworks to develop P3 agreements.

Issues

Before the State continues with its P3 transportation projects and embarks on new P3 highway projects, there are several fundamental issues that need to be addressed. These are discussed below:

- ***Weak Statutory Framework:*** Without a comprehensive statutory framework for P3 agreements, the General Assembly is not afforded an equal voice in determining the appropriate scope of P3 projects. In addition, while there is limited legislative oversight concerning MdTA contracts or agreements to construct new revenue-producing transportation facilities, there is no statutory requirement for legislative review for all types of P3 projects, or at every stage of pursuing a P3 venture. Therefore, in the event of any concern pertaining to a

P3 project, the current framework leaves the General Assembly with no immediate recourse – except ad hoc legislation.

- ***Long-term Implications:*** Before entering into a long-term agreement with a private entity, there are a number of long-term implications that should be addressed by the State. These issues include how toll rate increases will be implemented and for how much; who is responsible for the long-term maintenance of the facility; the process for contract revision; and what recourse the State may have should a private entity go bankrupt.

- ***Financial Implications:*** Depending on the type of P3 agreement, there are a number of financial implications. When the State enters into a concession deal with a private entity, a revenue-producing facility is lost. This loss has implications for the bondholders of MdTA revenue bonds. In addition, a concession deal typically involves a large lump sum payment which would be received by MdTA. As MdTA is a nonbudgeted agency, without legislation, there currently exists little oversight as to how the funds would be expended.

- ***Impact on Taxpayers:*** A P3 agreement involving a highway typically involves a toll road. Although there is a history of tolling in Maryland, it is unclear how many tolled roads Maryland drivers are willing to accept. In addition, the movement toward toll roads represents a policy decision to move toward a user fee system to finance transportation infrastructure which may cause adverse taxpayer reaction.

I-270/Corridor Cities Transitway

In fall 2006, MdTA issued a Request for Expressions of Interest from the private sector regarding a proposed highway/transit project along the I-270 corridor in Montgomery County. The request was not a formal solicitation – rather an attempt to gauge the interest of the private sector in regard to the project. Responses were to be submitted to MdTA in the middle of December 2006.

Recommendations

Given the policy implications surrounding P3 agreements, DLS recommends that either legislation be introduced or that a task force be created to examine the following issues:

- **the role of the legislature in reviewing proposed projects and any associated financing plans;**

- **the use of funds received from a P3 agreement and who receives the funds;**

- **what impact a P3 agreement may have on the Transportation Trust Fund, MdTA, and bonding;**

- **the impact of a P3 agreement on taxpayers;**

- **how tolls may be charged or increased;**
- **long-term facility maintenance, taking into consideration State procurement law;**
- **the implications on the State budget of a P3 agreement (including law enforcement, contract oversight, bankruptcy, and other incidental operating obligations);**
- **the future need for contract modifications; and**
- **environmental concerns.**

DLS also recommends that MDOT brief the committees on the I-270/Corridor Cities Transitway project, including the types of proposals that were received, what the next steps are for the department, and what is the potential of a P3 relationship for this project.

2. Local Funding of State Transportation Projects

In the *Consolidated Transportation Program*, MDOT discusses the need for innovative financing to fill the gap between declining revenues and the increasing cost of construction and maintenance. The last revenue increase was during the 2004 session in which registration fees were increased. The motor fuel tax was last increased in 1992. Construction costs have risen dramatically in the past several years due to the higher cost of materials. This inflationary pressure, coupled with a number of large transit and highway projects in the planning phase, have resulted in MDOT pursuing "innovative" financing options. These options include:

- ***Public-private Partnerships:*** Discussed in an earlier issue, public-private partnerships use private equity to help finance, construct, operate, or maintain a transportation facility.
- ***Non-traditional Debt:*** In recent years, the department has turned to financing projects from revenues generated from the project, instead of the revenues flowing through the TTF. This includes projects such as the expansion of the BWI Marshall Airport, parking garages, or Port facilities. Currently, non-traditional debt outstanding totals $776 million.
- ***Local Financing:*** Recently, a number of projects have included a local funding element. Rather than the State solely financing the cost of a project, some local jurisdictions have provided funding for the planning or construction of a project. The CTP notes that this local financing allows TTF dollars to go farther and allows for projects to proceed to construction. **Exhibit 18** provides a summary of local funding in the fiscal 2007 to 2012 CTP.

Exhibit 18
Local Funding in the 2007-2012 CTP
($ in Thousands)

Jurisdiction	SHA Projects	Non-SHA Projects	Total
Anne Arundel	$4,500	$2,400	$6,900
Baltimore County	549	13,100	13,649
Carroll County	3,627		3,627
Frederick	9,711		9,711
Harford		180	180
Howard	28,865	2,400	31,265
Montgomery	16,762	10,200	26,962
Prince George's	4,207	2,500	6,707
Washington	4,855	403	5,258
Total	**$73,076**	**$31,183**	**$104,259.00**

Source: Maryland Department of Transportation

Public-private partnerships and the increase of non-traditional debt issuances have been discussed in earlier issues, or in prior years. However, the movement toward a local contribution for State projects raises a number of concerns:

- ***Local Funds Paying for State Roads:*** Counties and municipalities receive highway user revenues and contribute additional local general funds for capital projects and the maintenance of the local roads in their jurisdiction. The State Highway Administration is responsible for the maintenance and construction of State roads in counties and municipalities. In requiring local jurisdictions to contribute to the construction or rehabilitation of State roads, local resources are being taken away from local transportation projects or other general fund responsibilities.

- ***Equity:*** Should the trend of local contributions for road projects continue, an issue of equity may arise. Jurisdictions with a large tax base in terms of property or personal income would be better equipped to contribute to State road projects. However, smaller jurisdictions likely would not be able to make such a contribution due to a smaller revenue base. In this scenario, smaller jurisdictions would have a larger percentage of their State road projects paid for by the State. Another scenario is that projects in jurisdictions with a small tax base would not be completed due to the inability of a local jurisdiction to provide funding or conversely projects would not be completed without a local contribution.

DLS recommends that MDOT discuss the need for local funding of State projects and the impact this approach may have on local jurisdictions transportation projects and budgets. In addition, DLS recommends that MDOT discuss the need for some type of formula to account for equity issues if this local funding option continues.

3. Proposed Deferral of the General Fund Payment for the InterCounty Connector

Background

Faced with a daunting $1.2 billion deficit during the fiscal 2003 session, legislators passed the Budget Reconciliation and Financing Act of 2003, which among other things, transferred $314.9 million from the TTF to the general fund to support State spending. The legislation included a requirement for a plan that the general fund repay the TTF.

During the 2004 session, a provision in the budget bill (SB 508) amended the Rainy Day Fund statute to provide repayment to the TTF. The provision required that when there is a surplus of unappropriated funds in the general fund at the close of a fiscal year, the first $10 million will be retained by the general fund, and the next $11 million to $60 million will be transferred to the TTF. The provision was to remain in effect until the entire $314.9 million was repaid.

During the 2005 session, SB 255/HB 1352 revised the terms of repayment. These bills removed the provision that unappropriated general funds be transferred to the TTF in fiscal 2007 and future years. Instead, these bills provided that the remaining balance of $264.9 million ($50 million was paid to the TTF in fiscal 2006) be transferred to MdTA to fund construction of the InterCounty Connector. Repayment was structured for payments of at least $50 million per year between fiscal 2007 and 2010. As shown in **Exhibit 19**, these bills also established a finance plan for the $2.4 billion ICC project.

Exhibit 19
ICC Finance Plan
($ in Millions)

Source of Funds	Amount
MdTA cash and bonds, possible TIFIA loan	$1,247
GARVEE bonds	750
Transfers from the TTF	180
General fund	265
Federal aid*	10
Total	**$2,452.00**

GARVEE: Grant Anticipation Revenue Vehicle bonds

*At least $10 million.

Source: Chapter 471 of 2005

In fiscal 2007, $53 million was paid to MdTA from the Dedicated Purpose Account. MdTA's ICC Finance Plan projects a payment from the general fund of $50 million in fiscal 2008 and 2009, followed by a lump sum payment of the remaining $111.9 million in fiscal 2010.

Fiscal 2008 Allowance

The Governor's budget for fiscal 2008 includes the required $53 million appropriation to the Dedicated Purpose Account. However, budget bill language reduces the $53 million contingent on the passage of legislation. HB 57/SB 73 proposes to amend the financing plan to remove fiscal 2008 as one of the years that payment is due. The amended language will require payment of at least $50 million in fiscal 2007, 2009, and 2010. Therefore, the total remaining balance of $211.9 million (includes payments made through the end of fiscal 2007) would take place in 2009 and 2010, with at least $50 million appropriated in each year. By removing the required payment in fiscal 2008, this enables the Governor to present a positive cash flow in the fiscal 2008 budget.

Lawsuits Filed

MDOT reports that part of the reasoning behind the deferral of the $53 million payment is the expectation that the money would not yet be needed due to the effect of the lawsuits that were filed in December 2006. These lawsuits challenged the ICC project, one on the grounds of inadequate environmental analysis, and the other on the grounds that other alternatives were not adequately considered. Conservative estimates project that a final decision on the lawsuits may not come until fall 2007. Although no injunctive orders were filed to stop work, MdTA is undertaking an extra level of due diligence.

Issues

- ***Effects on the Project's Cash Flow:*** In addition to the deferral of the fiscal 2008 payment to MdTA, there are other changes to the project currently taking place. First, SHA, which is involved in the project planning on MdTA's behalf, has revised the project's forecasted expenditures. These revisions affect right of way purchases and construction schedules, thereby changing the cash flow of the project. MDOT reports that it has enough money in the short-term, without the fiscal 2008 payment, to continue on this revised schedule.

- ***General Fund Repayment Issues:*** Deferral of the $53 million general fund repayment in fiscal 2008 raises two issues. First, it increases pressure on the general fund, which already faces a substantial structural deficit by requiring the repayment of $212 million over fiscal 2009 and 2010. The viability of providing this magnitude over two years instead of three is questionable. Second, and more importantly, reopening the ICC financing plan this year, coupled with the general fund's financial position, invites future legislation to further modify the general fund repayment cash flow. The issue revolves around whether future modifications would be proposed to extend general fund repayment beyond fiscal 2010. This could raise questions with the Federal Highway Administration (FHWA) about the viability of the financing plan, could alter the project's cash flow, increase total project cost, and impact interest rates as debt is issued (not to mention the concern of bondholders who purchase Grant Anticipation Revenue Vehicle (GARVEE) bonds or other debt that could be issued to cover cash flow shortfalls in the short-term).

- ***Approval of a New Finance Plan at State and Federal Level Necessary:*** Given that federal funds will be a significant contributor to fund the ICC and that the total cost of the projects exceeds $500 million, federal law requires the submittal and annual review of a detailed financial plan for the project. The initial finance plan was submitted and approved by FHWA in 2006. A change to the finance plan will necessitate not only a change to Maryland statute but also to the finance plan submitted to FHWA.

- ***Uncertainty in the Bond Market Means Higher Costs:*** The first GARVEE issuance of $380 million was originally planned for January 2007; however, this issuance has been delayed by the filing of the lawsuits. MDOT reports that MdTA will still issue debt, likely GARVEE bonds, sometime in fiscal 2007 to support its planned expenditures. DLS is concerned that going to the bond market at this time, with an air of uncertainty surrounding the project because of the lawsuits, could be premature. The bond market does not like uncertainty, and entering the bond market now may result in less favorable terms, meaning that over the life of the bonds, MdTA could pay more for financing costs.

If a general fund repayment is not made in fiscal 2008 and no debt is issued until resolution of the lawsuits, MdTA would likely confront cash flow problems, as more money will need to be expended over the next year than would be received. Although MdTA maintains a large cash balance, it does so because of its financial management policies, and it is unable to spend any of this cash on the ICC or any other project. This means that in the short term, MdTA would have to find alternative means of financing. As the effects of the deferral of the fiscal 2008 payment to MdTA, lawsuits, and change in cash flow are still being evaluated by MDOT and MdTA, a more thorough discussion of cash flow issues will be presented in the MdTA budget analysis later this session.

The Secretary should address:

- **how the proposed repayment deferral will affect the project's cash flow and construction; and**

- **current developments in the ICC project, including the lawsuits filed, changes to the issuance of debt, and how MdTA will continue forward on ICC spending in the short-term without the $53 million transfer from the general fund and without the issuance of debt.**

It is further recommended that the administration discuss the viability of appropriating the remaining $212 million for the ICC in fiscal 2009 and 2010 in the context of this deferral and the general fund's fiscal position.

Recommended Actions

1. Add the following language:

It is the intent of the General Assembly that projects and funding levels appropriated for capital projects, as well as total estimated project costs within the Consolidated Transportation Program (CTP), shall be expended in accordance with the plan approved during the legislative session. The department shall prepare a report to notify the budget committees of the proposed changes in the event the department modifies the program to:

(1) add a new project to the construction program or development and evaluation program meeting the definition of a "major project" under Section 2-103.1 of the Transportation Article that was not previously contained within a plan reviewed in a prior year by the General Assembly and will result in the need to expend funds in the current budget year; or

(2) change the scope of a project in the construction program or development and evaluation program meeting the definition of "major project" under Section 2-103.1 of the Transportation Article that will result in an increase of more than 10 percent, or $1,000,000, whichever is greater, in the total project costs as reviewed by the General Assembly during a prior session.

For each change, the report shall identify the project title, justification for adding the new project or modifying the scope of the existing project, current year funding levels, and the total project cost as approved by the General Assembly during the prior session compared with the proposed current year funding and total project cost estimate resulting from the project addition or change in scope.

Notification of changes in scope shall be made to the General Assembly concurrent with the submission of the draft and final CTP. Notification of new construction project additions, as outlined in paragraph (1) above, shall be made to the General Assembly prior to the expenditure of funds or the submission of any contract for approval to the Board of Public Works.

Explanation: This annual budget bill language requires the department to notify the budget committees of proposed changes to the transportation capital program that will add a new project that was not in the 2007 CTP, or will increase a total project's cost by more than 10%, or $1.0 million, due to a change in scope. Reports are to be submitted with the draft and final versions of the CTP, with each using the 2007 session CTP as the basis for comparison.

Information Request	**Author**	**Due Date**
Capital budget changes	Maryland Department of Transportation	With draft CTP With final CTP

2. Add the following language:

<u>It is the intent of the General Assembly that funds dedicated to the Transportation Trust Fund shall be applied to purposes bearing direct relation to the State transportation program, unless directed otherwise by legislation. To implement this intent for the Maryland Department of Transportation in fiscal 2008, no commitment of funds in excess of $250,000 may be made nor such as an amount may be transferred, by budget amendment or otherwise, for any project or purpose not normally arising in connection with the ordinary ongoing operation of the department and not contemplated in the approved budget or the last published Consolidated Transportation Program without 45 days of review and comment by the budget committees.</u>

Explanation: This annual language prohibits the Maryland Department of Transportation (MDOT) from using transportation funds for uses other than for transportation-related purposes without review and comment by the budget committees.

Information Request	**Author**	**Due Date**
Information on non-transportation expenditures exceeding $250,000	MDOT	As needed

3. Add the following language:

<u>The Maryland Department of Transportation (MDOT) shall not expend funds on any job or position of employment approved in this budget in excess of ________ positions and _____ contractual full-time equivalents paid through special payments payroll (defined as the quotient of the sum of the hours worked by all such employees in the fiscal year divided by 2,080 hours) of the total authorized amount established in the budget for MDOT at any one time during fiscal 2008. The level of contractual full-time equivalents may be exceeded only if MDOT notifies the budget committees of the need and justification for additional contractual personnel due to:</u>

<u>(1) business growth at the Helen Delich Bentley Port of Baltimore or Baltimore/Washington International Thurgood Marshall Airport which demands additional personnel; or</u>

<u>(2) emergency needs that must be met (such as transit security or highway maintenance).</u>

The Secretary shall use the authority under Sections 2-101 and 2-102 of the Transportation Article to implement this provision. However, any authorized job or position to be filled above the regular position ceiling approved by the Board of Public Works shall count against the Rule of 50 imposed by the General Assembly. The establishment of new jobs or positions of employment not authorized in the fiscal 2008 budget shall be subject to Section 7-236 of the State Finance and Procurement Article and the Rule of 50.

Explanation: The General Assembly has established a position ceiling for MDOT each year to limit growth in regular positions and contractual full-time equivalents.

Information Request	**Author**	**Due Date**
Additional regular positions and contractual full-time equivalents	MDOT	As needed

4. Add the following language:

The Maryland Department of Transportation shall use the corporate income tax revenue estimate provided by the Board of Revenue Estimates for the general fund in its official March 2007 and December 2007 estimates when estimating revenue and expenditures for its fiscal 2008 to 2013 six-year draft and final forecast and Consolidated Transportation Program.

Explanation: This language requires the Maryland Department of Transportation to use the corporate income tax revenue estimate provided by the Board of Revenue Estimates in its official estimates for the general fund when building its six-year forecast and Consolidated Transportation Program.

Appendix 1

Transportation Trust Fund Forecast
Fiscal 2006-2012
($ in Millions)

	Actual 2006	Current 2007	Est. 2008	Est. 2009	Est. 2010	Est. 2011	Est. 2012
Opening Fund Balance	**$245**	**$235**	**$106**	**$100**	**$100**	**$100**	**$100**
Closing Fund Balance	**$235**	**$106**	**$100**	**$100**	**$100**	**$100**	**$100**
Net Revenues							
Taxes and Fees	$1,614	$1,615	$1,658	$1,726	$1,791	$1,842	$1,892
Operating and Miscellaneous	465	476	491	482	497	512	524
Transfers btw. TTF and GF	50	0	0	0	0	0	0
MdTA Transfer	5	18	-13	-13	-25	0	0
Net Revenues Subtotal	***$2,134***	***$2,109***	***$2,136***	***$2,195***	***$2,263***	***$2,354***	***$2,416***
Bonds Sold	100	155	400	330	255	125	140
Bond Premiums	0	0	0	0	0	0	0
Total Revenues	**$2,234**	**$2,264**	**$2,536**	**$2,525**	**$2,518**	**$2,479**	**$2,556**
Expenditures							
Debt Service	$141	$115	$128	$155	$168	$183	$206
Operating Budget	1,303	1,392	1,454	1,511	1,567	1,627	1,689
State Capital	800	886	960	859	783	670	662
Total Expenditures	**$2,244**	**$2,393**	**$2,542**	**$2,525**	**$2,518**	**$2,480**	**$2,557**
Debt							
Debt Outstanding	$1,078	$1,166	$1,497	$1,751	$1,927	$1,964	$1,996
Debt Coverage – Net Income	5.8	5.8	3.8	2.9	2.6	2.6	2.5
Local Highway User Revenues	**$561**	**$556**	**$567**	**$589**	**$610**	**$627**	**$644**
Transferred to General Fund	49	0	0	0	0	0	0
Net HUR to Counties	**$513**	**$556**	**$567**	**$589**	**$610**	**$627**	**$644**
Capital Summary							
State Capital	$800	$886	$960	$859	$783	$670	$662
Net Federal Capital (Cash Flow)	721	687	731	601	515	428	358
Capital Expenditures Subtotal	***$1,521***	***$1,573***	***$1,691***	***$1,460***	***$1,298***	***$1,098***	***$1,020***
GARVEE Debt Service	0	0	45	45	85	85	85

Source: Maryland Department of Transportation, January 2007

The Road to Privatization: Implications of Public-Private Partnerships for Transportation Projects

Department of Legislative Services
Office of Policy Analysis
Annapolis, Maryland

December 2006

Appendix 2 (Cont.)

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Appendix 2 (Cont.)

December 6, 2006

The Honorable Thomas V. Mike Miller, Jr., President of the Senate
The Honorable Michael E. Busch, Speaker of the House of Delegates
Members, Maryland General Assembly

Ladies and Gentlemen:

In recent years, there has been a growing national trend to turn to the private sector to assist in transportation infrastructure projects due to the demand for these projects and the fact that motor fuel tax revenue growth has not kept pace with construction costs. The Maryland Transportation Authority (MdTA), who is responsible for public-private partnerships in the State, issued a Request for Expressions of Interest from the private sector regarding a highway and transit project along the Interstate 270 corridor in Montgomery County in the fall of 2006.

Given that the engagement of the private sector in transportation finance represents a fundamental shift in how projects are constructed, during the 2006 interim, the Natural Resources, Environment, and Transportation Workgroup of the Office of Policy Analysis prepared a report regarding what a public-private partnership is, the current legal framework in the State for this type of program, and a number of issues for the General Assembly to consider. Enclosed please find a copy of the report for your review.

I trust this report will prove useful to you as the MdTA considers moving ahead with a public-private partnership agreement and any legislation that may be introduced during the 2007 session.

For further information on this report, please contact Lesley Cook of the Office of Policy Analysis at 410-946-5510.

Sincerely,

Karl S. Aro
Executive Director

Appendix 2 (Cont.)

Contents

Appendix 2 (Cont.)

Chapter 1. Introduction

Beginning with the construction of the highway interstate network, highways and transit have typically been funded by federal and state aid derived from the motor fuel tax. However, given the national reluctance to increase the motor fuel tax coupled with more fuel efficient automobiles, motor fuel tax revenue growth has not kept pace with construction costs. In addition, there has been an increasing demand for transportation system preservation and new projects to meet the increasing demands of congestion. To address the needs of residents and the relative static growth in the motor fuel tax, a new national trend appears to be developing in financing transportation projects.

Specifically, a growing national interest is developing in partnering with the private sector to access cash and equity that might not otherwise be available for transportation projects. The relationship between the public and private sector is commonly known as a public-private partnership (P3). The partnership can take several forms, including the State leasing an existing revenue generating State asset to a private entity for operation in exchange for a lump sum payment. Alternatively, the private sector can construct a transportation infrastructure project, generally a toll road, for the right to collect future revenues.

The Maryland Department of Transportation (MDOT) is evaluating several projects currently in the *Consolidated Transportation Program* for a P3 as a way to initiate projects that might not otherwise be developed due to limited resources. For example, in the fall of 2006, a Request for Expressions of Interest was issued by the Maryland Transportation Authority (MdTA) for the Corridor Cities Transitway project. Since 1997, MdTA has administered a P3 program for non-highway projects for MDOT. Under regulations adopted by MdTA, along with guidance found in a 1996 Attorney General's opinion, the P3 program has been used for a variety of non-highway transportation projects, including port, transit, and airport facilities. MdTA and MDOT have broadly defined P3 arrangements to include transit-oriented development, design-build contracts, and other relationships with the private sector. This paper will focus on P3 arrangements where the private sector invests large amounts of equity to develop mega-transportation infrastructure projects, mainly highways.

In considering P3s and the role of private finance in transportation infrastructure, there are a number of issues for the State to consider, including the role of the legislature, the legal framework for such an agreement, and how the State should engage the private sector. The Department of Legislative Services has prepared the following document as background on P3s, including national and international examples, and a number of issues for the General Assembly to consider regarding these partnerships. **Appendices 1** through **3** provide case studies of other P3 arrangements.

Chapter 2. What Is a Public-Private Partnership?

A public-private partnership (P3) is an agreement between the State and a private entity whereby the private entity undertakes the construction of a project (*e.g.*, a highway) or responsibility for the operation of an asset (*e.g.*, toll roads) on the State's behalf. In doing so, the private entity assumes some, but not all, of the responsibilities and risks associated with the project or asset. The agreements typically involve large, complex, and expensive projects.

In 2004, the Maryland Transportation Authority (MdTA), in conjunction with the Maryland Department of Transportation and the State Highway Administration, conducted a research project and issued a Request for Information on P3s for highways. The findings of these studies showed that the factors a private partner considers when deciding whether or not to compete for a P3 agreement include:

- the level of investment and technical risk associated with the project;
- the allocation of risk between the public and private sector;
- the perceived trustworthiness of the State's procurement process;
- the strength of the public sector project management;
- the strength of the State's commitment to the project;
- the clarity of enabling legislation; and
- the project size (private entities prefer projects that exceed $200 million).

P3s typically fall under two types of agreements, with variations possible:

Concession Agreements: A concession agreement involves the leasing of an existing, publicly financed transportation facility to a private entity to operate and maintain for a set period of time in exchange for an upfront lump sum payment. Furthermore, the private entity collects and retains the revenues from that facility for the length of the lease. The two most publicized examples of this type of partnership are the City of Chicago signing a 99-year lease with a private entity for a lump sum payment of $1.82 billion for a toll road, and Indiana signing a 75-year lease for a toll road totaling $3.85 billion. In both of these examples, the private entity is responsible for maintaining the toll road for the length of the lease as well as a number of capital improvements, such as installing electronic toll collection. In Maryland, this type of P3 agreement would most likely involve leasing existing assets operated by MdTA, such as the Chesapeake Bay Bridge, the Fort McHenry Tunnel, or the John F. Kennedy Memorial Highway

(I-95), assuming provision could be made under the Authority's outstanding agreements with bondholders. Alternatively, leasing could be applied to presently untolled properties of the Department of Transportation.

Design, Build, Operate, Maintain: Under this arrangement, a private entity contracts to finance, design, build, operate, and maintain a transportation infrastructure project. The private sector partner may own or lease the project, assumes some of the risk, and may collect all the revenue.

Possible Advantages of a Public-Private Partnership

There are several reasons why states are turning to private entities to assist in the development of transportation infrastructure.

Cash Influx to Advance Projects: States are leasing existing state assets for large lump sums of cash which in turn can be used to advance transportation projects that may not otherwise be constructed immediately. For example, Indiana's P3 agreement enabled the state to use the proceeds from the project to advance other transportation needs.

The issue of congestion is increasingly an issue state and local governments are looking to address. However, state sourced revenues for transportation, largely derived from the motor fuel tax, have not kept pace with inflation and have lost purchasing power. Given the national reluctance to raise the motor fuel tax, governments have turned to other revenue sources to move ahead transportation projects. Partnering with private entities allows a state to access other revenue streams outside of state sourced revenues to close the gap between what is needed and what is available in terms of revenues. By accessing private dollars, partnerships can also prevent the need for additional state bond indebtedness.

Risk Distribution: P3 arrangements allow at least some of the risk for cost overruns and anticipated future revenues to be transferred to the private sector.

Efficiency in Operations and Maintenance: Public entities have turned to the private sector to either perform or learn how to perform certain services in a more efficient and less expensive manner. A P3 arrangement allows for a private entity to operate and maintain a transportation facility. There is an assumption that greater efficiency will develop since market factors encourage innovation, and the private sector is better suited to respond more quickly to changes, utilize technology, focus on customer service, and learn how to reduce costs more effectively than the public sector. For example, the introduction of electronic tolling by private entities has contributed to the efficiency in the operation and collection of revenue for toll roads.

Developer Benefits: Private contractors can also reap benefits from P3 projects. Toll roads in particular provide a relatively stable and predictable stream of revenue which is important to investors and developers. Large pension funds are particularly interested in the investment opportunities provided by P3 agreements. The federal government has also provided incentives for these types of agreements. Specifically, in the recently passed transportation reauthorization bill (SAFETEA-LU), $15 billion was authorized for tax-exempt private activity bonds to be used for the construction of eligible transportation facilities nationwide. Utilizing these bonds, a private entity can issue tax-exempt debt as part of its financing plan for a P3 project.

Possible Disadvantages of a Public-Private Partnership

Long-term Lease Risks: There will always be economic downturns and recessions in the future. Whether state governments, with aid from the federal government, can weather these financial storms better than the private sector is unknown. Clearly, when a state experiences a budget crisis, it cannot abandon its responsibilities, such as providing a functioning transportation system. Should a private company fall victim to bankruptcy, it is unclear how its abandoned responsibilities will be dealt with and allocated. Appendix 1 details a case study from Virginia where traffic volumes were below estimates and, as a result, the private entity sold the toll road to another private entity.

Enforcing a P3 Agreement: Because the private sector inherently places its own financial interest above all other interests, there is a risk that the agreement to provide a certain level of service will be called into question as the private entity seeks to maximize its return. In such a case, a state could incur significant legal expenses to enforce a contract that may have been written as long as 75 years ago.

Lost Revenue: While selling or leasing a transportation facility can create a huge influx of money for a state at first, the long-term revenue stream that would normally be provided by a revenue-generating facility is lost. This can result in less money for future capital projects, or a situation where a state is more cash-strapped once upfront payments are depleted and must therefore be dependent on the private sector to perform traditional public services. Another important consideration is that an asset may be undervalued when a concession agreement is reached. Under this scenario, the state will not fully realize the value of the asset.

Unions and the Use of Local Labor: Unions may object to P3 agreements, on the belief that privatization is a threat to state jobs. Alternatively, local trade unions may be concerned that the Davis-Bacon Act (requiring specific wage levels on federal projects) will not apply or that labor may be brought in from outside the area to complete the project. Finally, local contractors may worry that they cannot compete with national and international firms for very large projects.

Environmental Concerns: P3 projects also may raise environmental concerns. The National Environmental Policy Act (NEPA) requires the development of an environmental impact statement for "major federal actions," which usually includes actions taken using federal funds. If a P3 project is privately financed in its entirety, then the application of NEPA would depend on whether another major federal action, such as the requirement for a wetlands permit or the connection of the P3 project to a federal highway, is involved in the project.

Impact on Taxpayers: Finally, another important policy consideration is to what extent a state wants to implement a user fee system to pay for transportation infrastructure. Typically, a P3 arrangement involves a revenue-producing facility such as a toll facility. By entering into a P3 agreement, a state is adding another revenue-producing facility to the transportation infrastructure inventory and in essence moving toward a user fee system. Policy concerns regarding double taxation, the appropriate role of toll roads, and the extent and impact of toll increases may arise.

Chapter 3. Legal Framework for P3 Agreements in Maryland

Legal Authority

In Maryland, there is no formal statutory framework governing public-private partnership (P3) agreements. Currently, P3 arrangements are governed by the Maryland Transportation Authority's (MdTA) general statutory authority relating to transportation facilities and regulations adopted under this authority, and – in certain instances – State procurement law. A 1996 Opinion of the Attorney General provides additional guidance with respect to this governing authority. Under regulations adopted in 1997, MdTA administers the Transportation Public-Private Partnership program on behalf of the Maryland Department of Transportation (MDOT). Legal authority for the MdTA to adopt the P3 program regulations is provided in Title 4 of the Transportation Article, Annotated Code of Maryland. Under § 4-204, MdTA "has those powers and duties relating to the supervision, financing, construction, operation, maintenance, and repair of transportation facilities[1] projects." Section 4-205 authorizes MdTA to set and collect tolls with regard to transportation facilities, and to enter into any contracts or agreements "necessary or incidental to the exercise of its powers and performance of its duties."

To date, the P3 program has been used for non-highway transportation projects, including port and airport support facilities and transit oriented development. All toll roads, bridges, and tunnels are currently owned and operated by MdTA. However, according to the Attorney General, "nothing in the law precludes a private entity from contracting with MdTA to participate in the construction of a toll road, [bridge, or tunnel]."[2] Furthermore, based on the exclusive authority to fix and collect tolls and to enter into contracts relating to an MdTA function, the Attorney General has opined that "to the extent that a private entity provides the financing for a State-owned toll road, the MdTA would be authorized to permit tolls to be charged by the private party [to finance the project]."[3]

Current MdTA P3 Regulations

Under the P3 program, MdTA may select a private entity to acquire, finance, construct, or operate a new transportation facility, or to perform major rehabilitation or expansion of an existing facility. Proposals for a P3 project may either be in response to a request for proposal issued by MdTA, or unsolicited. Regulations currently allow unsolicited proposals only for new transportation facility projects. However, the regulatory definition of "transportation facility" differs from the statutory definition. Under the P3 regulations, a transportation facility only

[1] A "transportation facility" includes airport facilities, highway facilities, port facilities, railroad facilities, and transit facilities. TR, 3-101(l).
[2] 81 Opinions of the Attorney General 261, 265 (1996).
[3] *Id.* at 264.

includes a "port, airport, railroad, or transit facility…and structures related to transportation facilities, as described in Transportation Article, Annotated Code of Maryland." Under this definition, the P3 regulations preclude unsolicited P3 proposals for a new highway project. In addition, the P3 regulations do not allow unsolicited proposals for the sale of assets or the procurement of operational or maintenance services.

Once a private entity is chosen by MdTA for a project, regulations require the private entity to enter into a comprehensive agreement addressing the rights and obligations of MdTA and the private partner. Noteworthy requirements include:

- the duration of a right to acquire, construct, finance or operate a transportation facility;
- how any user fees will be established;
- performance milestones;
- responsibilities for acquiring environmental approvals and other permits;
- the terms for reimbursement of State services; and
- that the maximum rate of return to the private partner be negotiated as part of the agreement for the project.

Applicability of State Procurement Law

State law establishes MDOT and MdTA as primary procurement units with exclusive jurisdiction over specified procurements, subject to the authority of the Board of Public Works. The Board of Public Works does not, however, have authority over capital expenditures by MDOT or MdTA in connection with State roads, bridges, or highways. Whether State procurement laws apply to a contract between a State agency and a private entity depends on whether the contract reflects a "procurement."[4] Under § 11-101(m)(1)(ii) of the State Finance and Procurement Article, a procurement involves "buying or otherwise obtaining supplies, services, construction, construction-related services, architectural, [or] engineering services…" Procurement includes a State agency's leasing real or personal property as the lessee; however, it does not include a State agency leasing property as the lessor.[5] Therefore, a contract between the State and a private entity to lease a transportation facility to the private entity would not, in and of itself, expose the contract to State procurement laws. Moreover, pursuant to a regulation adopted by the Board of Public Works, State procurement regulations do not apply to

[4] *Id.* at 265.
[5] *Id.*

revenue-producing contracts involving a license, permit, or similar permission to use a transportation facility, or a lease of a transportation facility.[6]

While State procurement laws and regulations may not apply to specific P3 agreements, MdTA regulations do provide that a project selected under the MdTA P3 program is subject to Board of Public Works approval. Furthermore, under § 12-204 of the Transportation Article, the terms of any lease of real or personal property of the State to a private entity is subject to Board of Public Works approval.

Legislative Oversight

Chapter 472 of 2005 provides 45 days for legislative review and comment on any MdTA contract or agreement to acquire or construct a revenue-producing transportation facility. Specifically, under § 4-205(c), MdTA must provide to the Senate Budget and Taxation Committee, the House Committee on Ways and Means, and the House Committee on Appropriations, for review and comment, "a description of the proposed project, a summary of the contract or agreement, a financing plan that details the estimated annual revenue from the issuance of bonds to finance the project, and the estimated impact…on the bonding capacity of the [MdTA]." While this requirement provides legislative review and comment for P3 agreements to construct new revenue-producing transportation facilities, it does not apply to P3 agreements pertaining to existing transportation facilities; nor does it require legislative review and comment before MdTA issues a request for P3 proposals from the private sector.

[6] COMAR 21.01.03.03

Appendix 2 (Cont.)

Chapter 4. Issues

Before the State continues with its public-private partnership (P3) transportation projects and embarks on new P3 highway projects, there are several fundamental issues that need to be addressed. These are discussed below:

Weak Statutory Framework

As mentioned above in the Legal Framework section, there is no formal statutory framework governing P3 agreements in Maryland. Currently, P3 agreements are governed by Maryland Transportation Authority (MdTA) regulations. As such, the General Assembly has not established the appropriate scope of P3 projects. While there is limited legislative review of any regulation proposed by an executive agency, the process of adopting or altering regulations occurs with less legislative deliberation than does the process of enacting a statute. In fact, review by the legislative body charged with reviewing executive regulations – the Joint Committee on Administrative, Executive, and Legislative Review – is limited to whether statutory authority exists for adopting the regulation and whether it complies with legislative intent while also considering the fiscal impact. Furthermore, despite legislative objection to a proposed regulation, the Governor may instruct an agency to adopt a regulation over the legislature's objections. Because of the complex and enduring policy issues relating to P3 agreements, a statutory framework would provide the necessary structure to govern P3 projects in a manner that is fully vetted and agreed upon.

There are currently 21 states with laws authorizing some form of P3s for transportation projects.[7] Of those states, Arizona, Missouri, Indiana, North Carolina, and Alaska limit authorization to only one or more "pilot" projects. For states that have actually utilized a P3 agreement for a transportation project, such as California,[8] Indiana,[9] Texas, and Virginia,[10] the respective legislatures have enacted comprehensive statutory frameworks governing P3 agreements.

The lack of a comprehensive statutory framework governing all forms of P3 projects raises issues relating to the oversight role of the legislature. Currently, only limited legislative

[7] These states are Alaska, Alabama, Arizona, California, Colorado, Delaware, Florida, Georgia, Indiana, Louisiana, Maryland, Minnesota, Missouri, Nevada, North Carolina, Oregon, South Carolina, Texas, Utah, Virginia, and Washington.

[8] California authorizes P3 agreements for a range of "fee-producing infrastructure projects" but explicitly excludes the use of toll roads on state highways.

[9] Indiana's enabling statutes were meant to implement a particular P3 project and specifically prohibit future P3 agreements without legislative approval.

[10] Although Texas and Virginia laws do not prohibit particular P3 projects, both states have enacted detailed requirements for any P3 agreement.

oversight for contracts or agreements entered into by MdTA to acquire or construct a revenue-producing transportation facility is granted through the 45 days of review and comment by the above mentioned Senate and House committees. Documents that must be submitted for review include a description of the proposed project, a summary of the contract or agreement, a financing plan, and the estimated impact on MdTA's bonding capacity. This requirement does not apply to any contract or agreement pertaining to existing transportation facilities, nor does it apply to request for proposals (RFPs) issued by the MdTA.

House Bill 1555 of 2006 (failed) was introduced in an effort to extend legislative oversight of P3 agreements. In addition to the existing requirements for acquiring or constructing a revenue-producing transportation facility, this legislation, as amended in the House, would have required a 45-day legislative review and comment period for any RFP issued by MdTA for a P3 project, a description of the proposed lease, and a summary of the proposed P3 arrangement, including the estimated length of the lease, a cost benefit analysis, the scope of any toll-setting authority to be granted to the private entity, and the estimated scope of payments to MdTA from the proposed arrangement. While House Bill 1555 would have been a step toward legislative oversight for P3 projects, it did not address unsolicited P3 proposals, nor did it provide a statutory framework for P3 agreements. Without a comprehensive statutory framework addressing all forms of P3 projects that provides notice and critical information during all stages of a P3 project, the General Assembly's oversight role is greatly diminished.

One role of the legislature is to serve as a check and balance to the Executive Branch. Given the length and financial commitment involved in a P3 arrangement, legislative involvement would provide an additional level of oversight. In addition, as the body charged with enacting a balanced State budget, the General Assembly should play a central role in any long-term financial commitment that will impact the ability of the General Assembly to affect appropriations. This issue is compounded by the fact that MdTA is a nonbudgeted agency; as such, the General Assembly has little control over the funds and expenditures of MdTA. Moreover, with varying expertise, members of the General Assembly may add value to the process of determining the most appropriate financing plan and P3 agreement for a particular project.

Currently, a P3 project is subject to approval by the Board of Public Works. While the board has the expertise and experience in determining the merits of a contract, board members do not represent specific jurisdictions of the State. As legislators representing their respective districts, members of the General Assembly are better suited in protecting the interests of a jurisdiction in which a P3 project is proposed. Although MdTA regulations provide for local agencies and affected jurisdictions to submit comments on P3 projects, these comments are not binding on MdTA. Therefore, any concern that is not adequately addressed during the comment phase essentially leaves the General Assembly or a local jurisdiction with no immediate recourse – except ad hoc legislation.

Long-term Implications

While there can be great benefit to states from entering into P3s, there are also several long-term effects that must be considered. These long-term effects can vary according to what type of partnership is entered into. Many of these effects can be mitigated by a well-constructed contract with the private partner. Some of the long-term effects which can be mitigated through a contract include:

Toll Rate Increases: The contract should include provisions about toll rate increases. This may include how often tolls are increased, a cap on total increases over a certain time frame, limits on yearly increases (often tied to inflation), and whether or not tolls should stop being collected at some point (*i.e.*, once the private entity has received a specified return on its investment). Without these provisions stipulated ahead of time, drivers may be faced with large, unexpected increases in tolls, or toll roads may see a decrease in usage.

Long-term Maintenance: The contract should also include provisions regarding who has responsibility for long-term road maintenance, what road standards are to be maintained, and who will have responsibility for repairing the road after a catastrophic event (*i.e.*, road ruined by earthquake). Long-term maintenance is especially important if the road will be turned back over to the State at some point in the future, as the State does not want to take ownership of an asset that has long been neglected. To combat this, the State may include a provision that allows for monitoring of road conditions throughout the life of the contract.

Ability to Allow for Revisions and Modifications to the Contract: Over the life of the contract, any number of events or changes in circumstances could happen which could necessitate a change in the contract. It is important that both parties be able to revisit the contract when necessary. Many states also include a provision that any changes to the contract may not adversely affect either party. For example, if the State wants a new interchange and the private partner does not believe that the additional toll revenue will be sufficient to cover the cost, the State and partner may enter into a cost sharing agreement to build the additional interchange.

Threat of Bankruptcy: With any private partner, there is always the chance of bankruptcy. If the partnership involves a concession agreement, in order to prevent disruption of service, there should be a provision in the contract that ownership of the road will revert to the State, without any refunding of the concession payment. This will allow the State to retain all proceeds of the lease as well as ownership of the project. However, this also means that the State will suddenly need to again provide service and maintenance for the facility. If the partnership involves a Design, Build, Operate, Maintain agreement, the State should decide during contract negotiations if it wants the potential liability of operating the road should its private partner go bankrupt. This could place an unexpected burden on the State's finances. However, this can be mitigated by securing a new contract for operation through an expedited procurement process.

Non-compete Clause: In various types of P3 agreements, the private partner may sometimes request a non-compete clause to be included in the contract. This specifies that the State may not build a road within a certain proximity to the toll road. This ensures that the road that the private partner built or leased will not suffer from a decrease in ridership and revenues due to the availability of a free alternative route that drivers could use. In previous contracts containing non-compete clauses that were not carefully worded, states were actually prohibited from making improvements to existing roads in the vicinity of the toll road. Careful consideration should be given to this factor.

Other Outstanding Issues

One consideration that cannot be negotiated through a contract relates to the appropriate role of the private sector in the construction and delivery of public goods. In a P3 arrangement, the public sector cedes some, if not all, control of an asset to the private sector. The public sector is motivated by providing goods and services to the public whereas the private sector is motivated by market and economic forces. Whether or not these differing motivations can work together is an important consideration.

Financial Implications

MdTA is a nonbudgeted agency; therefore, the General Assembly has little control over its budget. MdTA pays for its operations through toll revenue collected from seven bridges, tunnels and highways, lease payments from the Maryland Port Administration for improvements at the Helen Delich Bentley Port of Baltimore (Port), food concessions on the John F. Kennedy Memorial Highway, payments for police services at the Baltimore/Washington International Thurgood Marshall Airport and the Port, and investment income. MdTA also issues revenue bonds to pay for its capital program and to help finance transportation related projects such as the InterCounty Connector. The revenue bonds are governed by a trust agreement which specifies that funds can be transferred from the Transportation Authority Fund (TAF) for transportation-related projects. It is unclear as to whether the trust agreement specifically prohibits transfers for non-transportation projects; however, MdTA's stance is that non-transportation transfers are prohibited.

Effect of a P3 Agreement on Existing MdTA Operations

Concession Agreement: If MdTA were to enter into a concession agreement or revenue sharing agreement to operate one of its existing facilities, it would have to refund or defease its existing revenue bonds, which now include the future revenue from six of MdTA's toll facilities as backing. In addition to the administrative costs associated with the refunding or defeasement, money to pay for the bonds would have to be put into escrow until it could be paid to the bondholders. Part of the strength of MdTA's credit rating and attractiveness of its bonds is based on the pool of shared revenues, in that bonds are backed by many toll facilities and not just one.

Reducing the number of toll facilities included in the revenue pool could potentially weaken MdTA's credit rating and make its bonds less attractive.

A concession agreement typically involves a lump sum payment for the right to collect future tolls. To determine the amount of the concession payment, an evaluation of the present value of all of the future toll revenues over the length of the contract would need to be completed. The risk of a concession agreement is that the valuation of an asset and the future revenues may not be accurate or truly reflect the actual value of an asset. If the facility is more profitable than expected, MdTA would not have captured the full value of the asset in its evaluation, and would essentially lose income as a result of being underpaid for the agreement. If the facility is less profitable than expected, then the private entity would have overpaid for the facility. Under that scenario, the private entity would be seeking to generate more revenue through toll increases, by cutting costs (possibly by deferring maintenance or capital improvements), or by walking away through a sale to another firm. The case study of Ontario in Appendix 3 provides an example of an occurrence where an asset may have been undervalued.

Design, Build, Operate, Maintain: If MdTA were to enter into a Design, Build, Operate, Maintain project for a new facility, operational control could eventually revert to MdTA. Existing bonds would not be affected by this, as they are dependent on the revenues of the current facilities; however, future bonds could potentially include the new project as a revenue source. Depending on whether or not the facility was projected to earn more than its expenses once operational control reverted, this could be a positive or negative development for MdTA. However, it is important to note that eventually the facility would revert to MdTA, not the Maryland Department of Transportation (MDOT).

Effect of a P3 Agreement on the Budget

When entering into a P3 agreement, there exist a number of budgetary implications that need to be considered.

Concession Payments: When a State agrees to lease a toll facility to a private partner, it gets a large influx of cash; however, in doing so, it also gives up its right to future revenues for the term of the contract. Because this future annual revenue will not be coming in, states must ensure that they use the upfront payment wisely. Ideally, the proceeds of the upfront payment will be used to pay off debt or for one-time projects, rather than ongoing expenses. By using the payment for debt service, there will be future benefits as the effects of the lesser debt burden move forward.

Although it was a pioneer of large concessions agreements in the United States, Chicago set a relatively good example of what to do with the proceeds. The $1.83 billion in proceeds it received from the lease of the Skyway is being distributed in the following way:

- $436 million to pay off outstanding debt for the Skyway;

- $258 million to pay down city owned short-term debt;

- $134 million to pay off other city owned long-term debt;

- $500 million to be invested as a reserve fund (earning an additional $25 million in interest each year);

- $325 million for an annuity to provide budget relief over the next several years; and,

- $100 million for various one time neighborhood improvement projects, including homeless shelters, seniors' facilities, libraries, and welfare services.

These are all what may be referred to as "balance sheet" transactions, in that they all improve the city's fiscal position. These types of transactions are vastly better than using the money for operating expenses, which would only serve to postpone addressing operating budget problems.

If MdTA leases or enters into a revenue sharing agreement for one of its facilities, the question is what would become of the initial payment. The first obligation would be to put money into an escrow account to defease existing MdTA bonds. Given that the current amount of MdTA debt outstanding is $264.4 million, and the deals discussed are often in the billions of dollars, there would be money left over. Since P3s would be implemented through MdTA, the concession payment would be transferred to MdTA, unless legislation specified otherwise. There are no other existing guidelines as to where the net proceeds of a P3 should be distributed, or whether to consider them as general fund revenue or Transportation Trust Fund revenue. Consequently, without specific legislation, MdTA would have ultimate authority to decide what to do with the net proceeds.

If the General Assembly wished to use the proceeds of a concession agreement for projects such as school construction, or other general fund purposes, it would include that provision in the contract with the private entity, or pass legislation transferring a portion of that income to the general fund after the fact. MdTA would need to be compensated for the loss of the projected toll revenue without the full benefit accruing to it. The loss of that revenue negatively impacts MdTA's operating budget and capital plan, as well as MDOT's capital plan.

If the General Assembly took no action, MdTA could use the concession proceeds for its capital program or to help fund MDOT's capital plan. Alternatively, in order to maintain interest in its bond products, MdTA could keep the funds in the TAF to generate interest for debt service. That would compensate MdTA for the loss of the projected toll revenue in the future; however, it would not help the State meet non-transportation goals.

Design, Build, Operate, Maintain: While the State's overall involvement on a design, build, operate, maintain project may be limited in terms of the total cost of the project, it is not necessarily without capital outlays. As Virginia recently learned from its P3 project involving I-495, sometimes in order to complete a P3, federal highway money or even state money is required. Virginia is adding high occupancy toll lanes on the Capital Beltway. The Virginia Secretary of Transportation recently announced that completing the project could require as much as $100 million in public money in addition to the funding provided by the private partners.

Tax Payer Perception

Currently, there is no way of knowing what kind of toll rates may result from a P3 agreement. Most P3 agreements that have been implemented include some type of formula that determines what the toll rate will be and how often it will increase. Regardless, the private sector is motivated by profit and as such, the toll rate and associated increases are likely to be greater than what the public sector provides. Whether or not taxpayers will pay to travel a road or are willing to pay a potentially higher toll is an important consideration that directly impacts the viability of a P3 agreement.

In addition, Design, Build, Operate, Maintain projects that involve highways are typically done as toll roads. In moving ahead with P3 agreements, a policy decision is simultaneously being made to move toward a user fee system to pay for transportation infrastructure. This policy decision represents a departure from how highways have been funded previously, through federal and state aid derived from the motor fuel tax and other state revenues. To what extent the State wants to develop a network of toll roads and how much taxpayers will tolerate such a network, both financially and philosophically, is an important consideration.

Appendix 2 (Cont.)

Chapter 5. Conclusion

Although the Maryland Transportation Authority (MdTA) has administered a public-private partnership (P3) transportation program for nearly a decade, the program must be reevaluated in response to new conditions that are changing the scope of P3s. Some of the issues that need to be revaluated include:

- **What Is the Role of the Legislature?:** Currently there exists little legislative oversight over P3 agreements. To what extent the legislature wants to or should have oversight over such arrangements is an important consideration. In addition, when the legislature should assert oversight, either at the beginning of the request for proposal process or once an agreement has been reached, should also be addressed. There are a number of important statewide policy considerations the legislature should consider regarding P3 agreements such as environmental impacts, the impact on unions, and non-compete clauses for other State roads. An important financial consideration as well is to what extent the legislature has control over the use of funds resulting from a concession agreement.

- **Impact on the Taxpayer:** P3 agreements typically involve toll roads. To what extent tax payers will accept paying a toll to traverse a road given other financial obligations is a concern. In addition, toll rate increases and the frequency of such increases is an issue that should be considered. Finally, P3 agreements, and by proxy toll roads, represent a shift to a user fee system for transportation finance that is different than the current financial model.

- **Operational Considerations:** There are a number of operational considerations that need to be considered regarding P3 agreements. Most of these issues can be addressed in the contract itself; however, the legislature may want to provide some input. Issues that need to be considered include who is responsible for the operation and maintenance of the facility, how to resolve disputes or to modify the contract based upon unforeseen developments, how to address a firm's bankruptcy, and any law enforcement responsibilities.

Given the policy implications surrounding P3 agreements, the Department of Legislative Services recommends that either legislation be introduced or that a task force be created to address the following issues:

- **the role of the legislature in reviewing proposed P3 projects and any associated financing plans;**

- **the use of funds received from a P3 agreement and who receives the funds;**

Appendix 2 (Cont.)

- **what impact a P3 agreement may have on the Transportation Trust Fund, MdTA, and bonding;**

- **the impact of a P3 agreement on taxpayers;**

- **how tolls may be charged or increased;**

- **long-term facility maintenance, taking into consideration State procurement law;**

- **the implications on the State budget of a P3 agreement (including law enforcement, contract oversight, bankruptcy, and other incidental operating obligations);**

- **the future need for contract modifications; and**

- **environmental concerns.**

Appendix 1
Case Study of Pocahontas Parkway

The Pocahontas Parkway (Route 895) is an 8.8-mile tolled highway seven miles south of Richmond, Virginia. The current toll is $2.25 for both electronic tolling and cash receipts.

The project was initially a design build project that connects Chippenham Parkway at I-95 in Chesterfield County with Interstate 295 south of the Richmond International Airport in Henrico County. The design build partner was a joint venture of Fluor Enterprise and Morrison Knudsen (now Washington Group) with oversight from the Virginia Department of Transportation (VDOT). Construction began in the fall of 1998, and the parkway was opened to traffic in stages beginning in May 2002. VDOT was responsible for operations and maintenance.

The project was authorized using the Virginia Public-Private Partnership Act of 1995. It originally cost $381 million, using $354 million in 63-20 corporation tax exempt toll revenue bonds, $9 million in federal funds for design costs, and $18 million in State Infrastructure Bank loans. In addition, VDOT assumed subordinate loans to provide operations and maintenance.

A 63-20 corporation is a non-profit organization organized by a state or local government that may issue tax-exempt revenue bonds. In this case, the corporation was the Pocahontas Parkway Association (PPA), established for the sole purpose of funding the project. A State Infrastructure Bank is a revolving fund mechanism for financing highway and transit projects through loans and credit enhancement, originally capitalized with federal dollars.

Although traffic has been growing on the parkway, traffic volumes on the Pocahontas Parkway have historically been 50 percent below projections. Unable to generate enough revenue, the PPA was forced to draw down reserves and eventually seek to divest itself of its financial responsibility for the road. Transurban, a private Australian toll road operator with subsidiaries in the United States, executed an Asset Purchase Agreement with the PPA and entered into the Amended and Restated Comprehensive Agreement with VDOT on June 29, 2006. Under the terms of those agreements, Transurban has acquired the sole rights to enhance, manage, operate, maintain and collect tolls on the parkway for a period of 99 years. Transurban has also repaid all of PPA's underlying debt.

The lease amount was for $611 million, which went to repay the debt ($487 million), make operational enhancements, and establish a reserve and contingent funding ($92 million). A consortium of three banks provided $420 million in long term senior loans, and Transurban provided $191 million in equity ($136 million at the close, and $55 million over the next six years). The split between the total debt and equity provided was 70/30. In addition, the lease required Transurban to construct an additional 1.58-mile extension to Richmond Airport, if it could obtain a Transportation Infrastructure and Finance and Innovation Act loan. If it could not, VDOT would build the road.

There is a fixed rate of toll increase until 2016. After that, tolls can be adjusted by whichever is greatest: (1) a rate of 2.8 percent annually; (2) the Consumer Price Index; or (3) the annual change in real gross domestic product.

Instead of an upfront concession fee to the State of Virginia, Transurban and Virginia entered into a profit sharing agreement after the net internal rate of return on capital and debt exceeds 6.5 percent, or 14.5 percent of a nominal rate of return on equity (adjusted for inflation and other factors). After that point, Virginia will receive 40.0 percent of the revenues. This amount would increase to 80.0 percent if the net internal rate of return exceeds 8.0 percent. Transurban estimates a 12.6 percent internal rate of return on its equity. Transurban has also projected a growth in traffic on the parkway to nearly 35,000 vehicles per day in 2012 due to nearby construction and population growth.

Transurban views this project as a way to gain experience in Virginia, as it is seeking to enter into agreements to build and operate the Capital Beltway High Occupancy Toll (HOT) lanes and HOT lanes on I-95 and I-395.

Appendix 2
Case Study of the Indiana Toll Road

The Indiana Toll Road is a 157-mile road constructed in the 1950s that runs from the Chicago area to the Ohio state border. Its current toll is $4.65 to travel the entire road. Currently, a coin system is used on the western half of the road, while a ticket system is used on the eastern half. In 2006, the Indiana Financing Authority leased the Indiana Toll Road to ITR Concession Company, a joint venture between Cintra Concessiones de Infraestructuras de Transporte, S.A. of Spain and Macquarie Infrastructure Group of Australia.

The lease term is 75 years. ITR Concession Company will be responsible for both operating and maintaining the toll road. The Indiana Financing Authority, which worked to secure the lease for approximately one year before it was signed, will maintain oversight of the road and will be responsible for enforcing the lease.

Indiana received a lump sum payment of $3.8 billion for the concession agreement. The majority of the payment has been designated for transportation funding for new and existing roads and bridges in the state. Approximately $200.0 million will be used to retire the existing toll road bonds, and $200.0 million to $250.0 million will be used to subsidize passenger vehicle toll road rates, which will help shift any increase in tolls to commercial traffic.

ITR Concession Company is required to put in place an electronic tolling system that covers the entire road in the first two years, and to expand one stretch of the road to three lanes. ITR Concession Company has stated that it will make approximately $4.4 billion in capital improvements over the life of the lease. In addition, the concession agreement spells out the rate of toll increases and limits the rate of return that the partnership can earn on the toll road. Further, if the contractor fails to meet its obligations, Indiana has the option to resume operations.

At the time of the lease, Indiana's legislature had not passed legislation authorizing the Indiana Department of Transportation or the Indiana Financing Authority to enter into a public-private partnership (P3). It passed House Bill 1008 in the 2006 session in order to specifically authorize the lease of the Indiana Toll Road.

Opponents argued that ITR Concession Company would likely increase tolls on the road beyond what the state would, and that maintenance would suffer. The Governor of Indiana had already proposed raising tolls as an alternative to a P3. If the state raised tolls, opponents argued that the state could generate more revenue from operating the road than it would from the lease agreement. There was also a legal challenge arguing that the lease was unconstitutional. Proponents of the legislation argued that leasing the road would enable Indiana to fund transportation projects that it might not have been able to complete otherwise, or which would

Appendix 2 (Cont.)

have been delayed due to a lack of funding. In addition, after the lease was signed, proponents pointed out that the lump sum payment will generate interest even while being spent down, benefiting the state.

Appendix 3
Case Study of Ontario Highway 407

Ontario Highway 407 has been involved in two public-private partnerships (P3s).

P3 # 1: Design Build

Although construction began on Highway 407 in the mid-1980s, the road was nowhere near complete when it was re-conceived as a design, build, operate maintain P3 in the early 1990s. The Ontario Ministry of Transportation (MTO) established a government chartered corporation, the Ontario Transportation Construction Corporation (OTCC), to handle governmental responsibilities for the road and solicited bids from a private consortium to finish construction and operate the road. In order to pay for the cost of the road, OTCC anticipated tolls being collected for 30 years.

A consortium named CHIC, consisting primarily of local firms, was selected to design, build and operate 69 kilometers of the road; however, instead of using private financing, the Ontario government decided to finance the road itself, issuing approximately $1.4 billion Canadian dollars (CAD) in short- and long-term debt, to be repaid from future toll revenues. The government assessed the value of the road as completed in 1997 at $1.5 billion CAD.

The financing and construction of the road was a departure from typical Ontario road financing where roads are financed from MTO's annual operating budget. Issuing debt allowed Highway 407 to be constructed by 1997, rather than 2020 as otherwise projected. In addition, privatizing the project using a design-build mechanism enabled its construction at a lower cost than had been anticipated if MTO's traditional road construction mechanisms were used.

However, there has been some speculation that the reduction in price was due to changes in design practice and could have been achieved by MTO. For instance, some costs savings were achieved by:

- strictly adhering to MTO safety and engineering standards (MTO had been exceeding those standards on individual projects for several years, which increases costs);
- delaying the construction of several interchanges until traffic volumes increased; and
- shortening the length of merging lanes. When Ontario used the imperial measurement system (inches and miles), merging lanes had been a minimum of 500 yards (446 meters). When Ontario switched to the metric system, the design standard was rounded up to 500 meters, a standard which was relaxed to 446 meters for Highway 407.

P3 # 2: Concession Agreement

In 1998, the Ontario government sought bids to pay off the debt associated with Highway 407's construction. Legislation enacted in 1998, Bill 70, allowed the government to lease Highway 407 to 407 International, a consortium consisting of Cintra Concesiones de Infrastructuras de Transporte S.A., a Spanish company, and SNC-Lavalin, a Quebec-based engineering firm.

The term of the lease was 99 years (nonbinding bids had also been solicited for 55 and 199 years) and 407 International paid $3.1 billion CAD in 1999 for the project. In addition, 407 International was required to construct 39 km of additional toll sections. 407 International constructed those segments from 1999 to 2001 for $507.1 million CAD.

After the $1.5 billion book value of the highway was deducted and used to retire the existing debt, the Ontario budget showed a net profit of $1.6 billion CAD. The funds were included in the general budget to help pay off the existing debt and offset a budget deficit and were not dedicated specifically to transportation purposes.

In 2001, the value of the highway was established at $6.3 billion when SNC Lavelin sold their share to Grupo Ferrovial, Cintra's parent company. This drastic increase in price over a two-year period (from $3.1 billion CAD to $6.3 billion) caused public controversy over whether the road was under-priced at the time of initial sale.