A CHARRETTE ON FLORIDA'S FUTURE NEW CORRIDORS

Summary of Discussion Sessions

Held August 14 - 15, 2006

Convened By: The Florida Transportation Commission

Facilitation By: InfraPartners

InfraPartners

a joint venture of

Jeffrey A. Parker & Associates, Inc, and

Asesores de Infraestructuras, S.L.

FLORIDA TRANSPORTATION COMMISSION

A CHARRETTE ON FLORIDA'S FUTURE NEW CORRIDORS

Summary of Discussion Sessions

14-15 AUGUST 2006

September 13, 2006

CONTENTS

1. MODERATORS

- **Jeffrey Parker**
  President, Jeffrey Parker & Associates (InfraPartners)

- **Michael Parker**
  Managing Director, Jeffrey Parker & Associates (InfraPartners)

- **Andres Rebollo**
  Partner, Asesores de Infraestructuras (InfraPartners)

- **Patrick Harder**
  Partner, Nossaman, Guthner, Knox & Elliott LLP

2. NOTE TAKERS

- **Gene Branagan**, Manager, Project Finance Office
  Office of Financial Development, Florida Department of Transportation

- **Kathleen Neill**, Intergovernmental Programs Administrator
  Office of Policy Planning, Florida Department of Transportation

- **Christie Holland**, Program and Resource Allocation Manager,
  Office of Financial Development, Florida Department of Transportation

- **Terry Kraft**, PE, AICP, Senior Transportation Planner,
  Office of Policy Planning, Florida Department of Transportation

3. OPINIONS EXPRESSED

Note: the following information is presented as a summary of the discussions held in Tampa on August 14 and 15. Four groups, each comprised of approximately 40 participants, engaged in hour-long conversations about the process for identifying new corridors, as well as issues related to financing, risk sharing and procurement. Each group discussed each theme, thus there were 16 separate sessions.

As a summary of the outcome of the discussion groups, this memorandum does not contain every viewpoint expressed during every session. Rather, these are the common themes and points that were repeated by multiple participants. *The opinions herein are not intended to reflect the opinions of moderators, note takers, InfraPartners, Nossaman, Guthner, Knox & Elliott, the Florida Department of Transportation and/or the Florida Transportation Commission.*

4. SUMMARY OF DISCUSSIONS:

Introduction

The *Charrette on Florida's Future New Corridors* comprised a series of open public meetings that focused on gathering input from private sector concessionaires, developers, operators and financiers of transportation infrastructure, and related advisors and consultants. This event is one of many activities in which the Florida Transportation Commission (Commission or FTC) will engage as it prepares to provide policy guidance on the development of new transportation corridors across the State. The Commission sought input from the private sector on using new project delivery methods to offset funding shortfalls and advance the delivery of projects. Charrette attendees engaged in an open dialog about the process for identifying, financing and delivering new corridors, and the optimal roles of the public and private sectors in the development process.

Defining the Roles of the Public and Private Sectors

While some participants provided personal opinions on key considerations in identifying new corridors, the overwhelming message was that corridor identification and prioritization of new corridors is the responsibility of the public sector, and must be accomplished based on public policy considerations. Once the corridors are identified, most attendees recommended that they be developed using a structured bidding process. Unsolicited proposals and "pre-development" agreements are tools to apply only in exceptional cases.

Once the Florida Department of Transportation (FDOT) determines what it seeks to achieve for a given corridor, then the private sector can help to identify financing options, acceptable levels of risk sharing, and procurement approaches. New, "greenfield" corridors can be extremely risky. However, with the appropriate financing and risk sharing structures, any corridor can be developed with private participation. Even projects that will have insufficient traffic to be self-financing can be advanced as Public Private Partnerships (PPPs). PPP structures can include forms of public support, such as deferred payment mechanisms (e.g. availability payments, shadowed tolls or a combination) and blended public-private equity structures, to fill the feasibility gap.

Charrette discussions focused on how to best deliver projects once they have advanced through the planning process. When the question was posed as to whether the private sector is interested in helping to build and finance new corridors, the overwhelming response was, "Absolutely!"- provided that the projects are truly ready for implementation.

In considering different project delivery alternatives, Florida should consider these "added value" aspects associated with PPPs or other innovative procurement mechanisms:

- Ability to better manage cost/risk (when risk is adequately transferred);
- Faster project delivery and better quality (if scored in proposal evaluation or a component of the ongoing payment mechanism);
- Discipline – "the value of the 'F'(Finance) in a DBFO" (Design, Build, Finance, Operate) – with respect to time and costs;
- Innovative financial structuring;
- Technological innovation and life cycle cost optimization; and
- Willingness of the private sector to raise tolls when needed, increasing asset valuation and leading to congestion management (a benefit depending on the State's goals).

Participants recommended that a "Value for Money" analysis should usually be performed comparing public and privately financed alternatives side-by-side, before an option is selected. This analysis is a strong tool for informing the public and ensuring that the public good has been protected.

Building Institutional Capability

PPP structuring is an art, and Florida is wise to be evaluating the experiences and precedents of other states and countries. Ultimately, Florida will need to adapt these to its own unique circumstances, opportunities, constraints and goals. No two projects will be identical, but better results and market interest will come from the development of a clear, transparent and consistent process. It costs the private sector millions of dollars to create a proposal for a single project. To the degree Florida can build predictability and fairness in the PPP process, it will attract the widest array of bidders/investors.

Florida is encouraged to develop an experienced PPP cadre within the FDOT that works with the Districts to ensure that PPPs are implemented in a consistent manner and also to make sure that experience gained on each project is retained and applied to future projects. The need for consistency and cumulative experience extends to the deals being spearheaded by expressway and other local authorities. If possible, FDOT's PPP team should assist them as well. In the United Kingdom, the Treasury has a dedicated PFI (Private Finance Initiative) team, and in Canada there are organizations like Partnerships BC (British Columbia) which assist on all PPPs in the Province. Partnerships BC and similar organizations also often have different pay scales to attract specialists and ensure that institutional knowledge does not quickly migrate to the private sector. Texas also addresses this with stringent revolving door restrictions.

Diana Vargas of the Texas Department of Transportation (TxDOT) related that in Texas they centralized PPP responsibilities, and then decentralized them. Now they have been re-centralized: TxDOT now deploys a centralized, "expert team" to work on all PPPs, but always in conjunction with the local districts. Ms. Vargas said that 90% of project work is done by the given district. However, with the PPP team participating, the State's growing expertise is leveraged and applied consistently across projects. In addition, this structure enables district employees to gain valuable experience by working alongside the experienced PPP team.

Within a DOT structure, the districts should not be made to feel that the decision to pursue a project as a PPP is adversarial or will result in a loss of control. Instead, attendees suggested that there needs to be a standardized process (such as the "Value for Money" analysis) which is used to determine the best delivery method and financing scheme for each given project. PPP approaches should be "tools in the toolkit" considered impartially alongside conventional and design-build procurement approaches.

Alternate Procurement Routes

Attendees discussed different procurement options for concessions (Design, Build, Finance, Operate (DBFO) contracts) in light of recent experiences in the United States and other countries. These ranged from unsolicited proposals, pre-development agreements, and structured tender processes like the Port of Miami Tunnel in Florida.

Some local groups showed interest in unsolicited proposals, however, international concessionaires indicated a clear preference for tendered projects. Experience in other states, such as Virginia and Georgia, has been that unsolicited proposals bear risks that, if not controlled, could force funding and advancement of lower priority projects (in other words, unsolicited proposals could result in the "tail wagging the dog.") Many felt that the ability to accept unsolicited proposals was a procurement tool that should be available (and is already available to Florida), but it should not be the primary or even secondary tool for development of new corridors or projects. Feedback on unsolicited proposals included:

- Too much room for manipulation in many states;
- If it does want to receive unsolicited proposals, FDOT needs a clear screening process so as not to waste its or industry's time;
- Proposers will be very selective because of the complications and expense in putting together an unsolicited proposal. Participants also cited concerns over Sunshine Act

issues and perceived lack of competitive advantage, unless there is a right of first negotiation or a very short period for solicitation of competitive proposals; and

- One good use of unsolicited proposals might be to provide a process through which future concessionaires that are operating actual facilities will be able to propose extensions and improvements to such facilities.

TxDOT recently executed a pre-development agreement with Cintra-Zachary for the Trans-Texas Corridor (TTC-35). Under this model, industry is helping the TxDOT define project scope and feasibility; no environmental approval was in place when the agreement was executed. Several viewed this option as a way to "kick-start" a project helping to surface innovative ideas and feasible projects. However, this alternative may reduce competition and is "a tool that should perhaps be available, but used sparingly."

The preference of most attendees was for a structured, transparent concession procurement process. As described below, discussions focused on this deal structure and contracting methodology.

Preparing to Tender a Concession – Preliminary Design & Environmental (PD&E), Design and Right-of-Way

Participants provided input on the prerequisites for beginning a concession (not pre-development) procurement process. What should the State have in place before proceeding?

- PD&E? The best value for money is for the public sector to complete PD&E before the procurement commences.
    - May be possible to break down environmental risks and share specific risks in certain cases if they are manageable;
    - Would like to see FDOT processes expedited;
    - Proceeding with no National Environmental Protection Act (NEPA) process is also an option (particularly in the case of a pre-development agreement), but federal permits still required;
        - Florida is encouraged to support improvements to federal processes;
        - The Federal Highway Administration (FHWA) is a good lead agency & White House special initiative for critical projects could help; and

- Concessionaire will still be responsible for permit risks associated with means and methods, however would like to see delay risk exposure for permits capped in some way if delay is agency-related only.

- Design? Less is better.
  - Industry in favor of minimal design (15% was the figure brought up by several participants) with maximum design flexibility;
  - More State-supplied design may actually increase the time needed to prepare proposal;
    - Less flexibility in maximizing financial feasibility and life cycle efficiency;
    - More need to redefine existing design to maximize innovation and value to the State;
  - Best to define outputs, not inputs;
    - Performance-based specifications reduce risk to FDOT, especially when the project encompasses an operating period;
    - The needs and desires of the public and local governments can be dealt with via design constraints in a design-build setting; and
    - Unleashes innovation.

- Right-of-Way? Needs to be assembled or demonstrably achievable.
  - Some precedent in the US and abroad with concessionaire or constructor being responsible for assembling right of way, with government responsible for all litigation;
  - Debate as to whether there is any value in giving this responsibility to the private sector;
  - In any case, no appetite for real Right Of Way (ROW) risk;
  - Right of way for new corridors should be preserved now, even if development is years off, because acquisition costs could become prohibitive or subdivision development could occur where there are still open swaths; and
  - A number of representatives of large landowners indicated significant desire to be right-of-way partners with the FDOT in the development of new corridors and interchanges.

Concessionaires are willing to assist in completing the aforementioned components of predevelopment if compensation and risk sharing arrangements are provided. However, concessionaires emphasized that they are not in the consulting business, so it may not always make sense for them to play that role. Their primary motivation for doing so will be to gain a competitive advantage. But this will make the given project less attractive to other concessionaires. Except in the case of a predevelopment agreement, concessionaires have little interest in pursuing projects until they are "ripe" (truly ready for implementation) as demonstrated by a significantly advanced planning process.

Stipends, Shortlisting, Alternative Technical Concepts (ATCs) and Best and Final Offers (BAFOs)

Even if predevelopment tasks have been handled, industry generally believes that procurements for "green field" projects should include stipends:

- Industry considers 20% - 40% of actual proposal costs to be a reasonable amount;
- Stipends represent a showing of good faith by a DOT;
    - Demonstrates intent to award;
    - Recognizes and encourages multi-million dollar investment made by private sector in developing quality proposals;
- Stipends are an Investment by the State in its innovative procurement program;
- Stipend arrangements generally include a transfer of intellectual property interests in the proposal, thereby allowing the use of a losing proposal by the State (some of the participants were more disturbed by this possibility than others); and
- If the use of a stipend results in more bidders on a major project, then the resulting competitive process may deliver greater savings.

A number of promoters (as concessionaires are referred to internationally) recommended that a short-listing process be used to avoid the discouraging effects of facing an undetermined number of competitors. If such a short-listing approach is used, participants stated that the optimal size of the short-list is 3 or 4 bidders to make the procurement attractive to industry. It was suggested that this number will allow better odds of winning the project, while saving time and perhaps reducing the potential for collusion.

ATCs (alternative technical concepts) have a place in some procurements, but they may trigger a BAFO (Best and Final Offer) stage. The overwhelming consensus was that BAFOs are disfavored by industry because they reduce the transparency of the procurement process.

Contract Duration

What is the optimal term for a concession? This is dependent upon whether the project is tolled or un-tolled; a "green field" vs. a "brown field" (i.e. new construction vs. lease of existing facility). In addition, the risk and scope of services being transferred to the private sector must be evaluated. For "green field" projects like the new corridors, the minimum term should be driven by:

- Maximization of leverage (30-40 years may be enough);
- The lifecycles of the facility's components – the concessionaire should be responsible for the full lifecycle costs to encourage optimization;
    - A 40 – 50 year term would accomplish this;
    - The term length could be shorter (30-40 years) depending on the hand-back requirements and risk structure;
- The selected revenue structure (tolled/non tolled);
    - Feasibility is a driver for tolled projects;
    - Shadow payments can be used to avoid the need for excessive terms, (but then a mechanism to share medium-long term upside may make sense);
    - Declining time-value of money for out-year revenues (consider value for money to the State);
    - State budget constraints if subsidy, availability payment or shadow toll; and
- Tax benefit/tax ownership requirements (depending on the State, 30-35 years could be enough).

For leases of existing facilities, is there an ideal or a maximum term? The term depends on the need for cash but, in any case, states should take care with the value they forfeit – particularly in later years may be undervalued by proposers using current year dollars. For each given project and scope of services, there is a value threshold, after which there are diminishing returns. In any case, long-term leases should potentially include upside sharing mechanisms or Internal Rate of Return (IRR) caps that mitigate this risk for the State.

Sharing the Gains

There is significant international precedent for the public side to share in refinancing gains and "excess revenues." Participants considered this to be fair and appropriate:

- Depending on the risk assumed/shared by the public side;
- Particularly for PFI/availability payment concessions which do not involve revenue risk from external sources, as long as the revaluation of the project still relies on the creditworthiness of the public partner; and
- Just for windfall profits, not all refinancing.

Windfall profits can arise in real toll projects because forecasts are generally conservative. If the public sector mitigates ramp up risk, it has a strong argument for sharing in revenues as traffic matures. A "super-profit" sharing clause mitigates the risk of exceeding forecasts or triggering political risk which will lead to termination.

Tolling and Toll Policy

Unlike many states, Florida does not have an inherent political barrier to user-fee financed projects. The public must understand that when public funding is limited, it's "no toll, no road." The real political barrier in Florida is how to maximize tolls. As discussed above, the concession approach can help, since the private sector is typically given the contract flexibility to increase tolls at market rates, and is willing to do so. This maximizes the self-financing capacity of toll roads, which together with some other advantages identified above, will make the projects more feasible and/or will allow public general funds to be applied to other, less profitable, but publicly desired projects. Therefore, the barrier to maximizing tolls in Florida could be the limited private sector involvement rather than actual tolling policy constraints. Participants expressed hope that public officials and the public in general become more aware of the advantages of the concession approach.

Both public and private sector participants felt that toll enforcement is a concern, and that strong enforcement is needed to make any toll-based financing work. In addition, the private sector requires a clear rate setting mechanism. Rates should be priced for value, not cost recovery. To some extent toll rates should be homogenized throughout a corridor – even if there are multiple segments run by multiple concessionaires. The State can achieve this by cross-subsidizing among projects, but still some high cost segments may still need/deserve higher tolls. Some participants explained that in other countries, rate setting agreements were viewed as living documents. In Latin America there are examples of periodic renegotiations and trade-offs.

Three out of four discussion groups disliked the idea of hybrid approaches, wherein the public sector has the right to buy down tolls at a pre-negotiated rate. This can take away from the upside in projects where higher levels of equity investment are required and tends to disrupt traffic risk portfolio strategies. On the positive side, however, this approach could be refined to involve mitigation of some downside ramp-up risk, and could be more palatable if the compensation mechanism was clear in terms of replacing foregone revenues.

Revenue Risk and Payment Mechanisms

In the considering future new corridors, there is extremely limited appetite for 100% traffic risk on "green field" projects where the traffic will depend on new development. These "field of dreams" projects will face traffic ramp-up risks that make real tolls an insufficient revenue source for full funding. Hence, it was clearly stated that the private sector should focus (at least at the outset of the development of the program) on projects with established traffic, or alternatively the State should share traffic risks or help to fill the feasibility gap. The following options and combinations thereof were discussed:

- Availability payments alone or combined with real tolls;
- Shadow toll alone or combined with real tolls or availability payments;
- Maximize / take advantage of revaluation of adjacent real estate through public retention of tax increment/CRA gains;
- Minimum revenue guarantees;
- Grants or milestone payments during construction; and
- Public equity or public subdebt as an alternative to grants.

In any of these instances, where there is a real toll component, it was agreed that it would be fair for the public to retain a right to share in the long term upside of the real toll revenues.

Risk Sharing and Policy Flexibility

As Florida develops its PPP program, participants recommended, "Don't put riskiest projects out first; let market build confidence from successes." In general, the PPP-related policy and risk sharing decisions being applied to the Port of Miami Tunnel –

regarding surety, weather (State self-insurance), and unforeseen conditions – met with market approval.

As Florida looks ahead to entering into long-term concession contracts, it must also anticipate social policy changes at state and local levels which will impact the concession or be constrained by it, such as High Occupancy Vehicle (HOV) rules, public transit use and hybrid vehicles, speed limits, truck weights, etc. Non-compete arrangements (with lessors of toll facilities) need not be too onerous to the public sector. They are not tenable if they are absolute and there are no established approaches to resolution. In particular, a standard approach is to allow the public sector to complete all projects in the current long range plan. In the course of developing corridors, Florida must also take care to ensure that planned projects are properly phased, sequenced and actually built. A concessionaire will not be willing to take traffic risk if it does not have some assurance that the connectors to its facility will be in place.

Finally, national constructors and international concessionaires view development of relationships with local contractors as a way to mitigate risk and a critical component to in-state success. Working with locals is a given, "just good business practice" as locals know the area, and can therefore be more efficient and cost effective.

5. CONSIDERATIONS IN IDENTIFYING NEW CORRIDORS

In considering the new corridors studies and public discussions in which Florida may soon be embarking, participants shared personal views on important considerations and criteria. It is the 50th anniversary of the interstate system, and Florida should consider how those corridors were selected and whether the right choices were made. There is otherwise little recent precedent for new corridor development. The State should also look at macro trends, including examining current and future truck traffic patterns, e.g. anticipating commerce links with Cuba and development in bordering states. While the Texas concept of placing rail and utilities into the same roadway corridors is desirable, the need may not actually exist to make this financially feasible.

Key criteria for identifying new projects include:

- Existing congestion or desire for economic development;
- Public support;
- Environmental impacts;
- Financial feasibility;
- Strong public/partner champions for the project;
- Consistency with regional visions; and
- Availability of right-of-way.

A large number of participants underscored their beliefs that one of Florida’s greatest assets and leading economic engines is its natural environment. New corridors will inevitably run through environmentally sensitive areas and will not be viable unless they are “designed with nature” to preserve the State’s environmental treasures and be compatible with new forms of land use.

6. CONCLUSION

As Florida develops a PPP “program,” attendees strongly advised that the State prioritize the most feasible projects and/or least risky projects – particularly in terms of traffic risk to be borne by the private sector – for initial tendering through a structured bidding process, so as to build market confidence in the long term program. In general, by spending more time carefully developing projects upfront and reducing risk, the State will get more value for money – whether it pursues public or privately-financed project delivery alternatives.

Participants in the Charrette explained that they can offer Florida a new source of financing to support its future capacity needs through PPP structures. In many cases, PPPs also can better align incentives to encourage effective life cycle planning, faster and higher quality project delivery, and optimized risk sharing/mitigation arrangements. Looking ahead, the market is very interested in the future opportunities presented by Florida’s vision for new corridors. However, it is too soon for industry to commit its resources to their development. If the planning efforts continue to progress as part of an open, orderly process (“over the medium term”) the market will have time to systematically allocate resources to meet the State’s needs and expectations.

Industry looks forward to participating in the development of Florida’s new corridors once they have advanced through the planning process, as well as to competing in the near term to assist Florida DOT with its existing work program.

The Florida Transportation Commission

605 Suwannee Street, Mail Station 9, Tallahassee, Florida 32399-0450
Phone: 850-414-4105 Fax: 850-414-4234

www.ftc.state.fl.us