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## Federal Credit Concepts for Surface Transportation: Conference Summary

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Number 18

**Federal Credit Concepts for Surface Transportation:**  
*Conference Summary*

Sponsored by the Federal Highway Administration

January 13, 1998  
Washington D.C.

The following is a list of other publications in the Federal Highway Administration's "Searching for Solutions: A Policy Discussion Series."

Number 1	March 1992	Exploring the Role of Pricing as a Congestion Management Tool
Number 2	June 1992	Exploring Key Issues in Public/Private Partnerships for Highway Development
Number 3	August 1992	Public and Private-Sector Roles in Intelligent Vehicle-Highway (IVHS) Deployment
Number 4	August 1992	Assessing the Relationship Between Transportation Infrastructure and Productivity
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Number 16	July 1996	Exploring the Application of Benefit/Cost Methodologies to Transportation Infrastructure Decisionmaking
Number 17	November 1996	State Infrastructure Bank Conference



# Foreword

This report summarizes a conference held on January 13, 1998 sponsored by the Federal Highway Administration (FHWA) on Federal credit concepts for surface transportation.

This report is the 18th issue of *Searching for Solutions: A Policy Discussion Series*. The series deals with emerging transportation issues such as congestion pricing and public-private partnerships as well as other relevant transportation policy topics.

This conference was a follow-up to a November 1997 draft policy discussion paper, *Federal Credit for Surface Transportation: Exploring Concepts and Issues*. The session was intended to address questions stimulated by the discussion paper, identify critical policy and technical issues, and discuss possible solutions to potential barriers to program implementation.

Due to continuing Federal and State budgetary constraints, there are insufficient financial resources to fund major transportation projects with traditional sources. In recent years, the United States Department of Transportation (DOT) has sought to encourage innovative financing as a means to address the Nation's transportation challenges. Using this mandate as a framework, the conference focused on creative approaches for using credit (e.g., direct loans, loan guarantees and lines of credit) to help finance major surface transportation projects.

Conference participants were greeted by FHWA Deputy Administrator Gloria Jeff. In her introductory remarks, Ms. Jeff stated that strategies to facilitate interaction between the capital markets and traditional transportation financing mechanisms figure prominently in the Administration's debates on highway financing.

Three panels gave participants the opportunity to explore Federal credit and its application to the surface transportation sector. The first panel focused on Federal credit legislation pending in both the House and Senate (respectively, the Transportation Infrastructure Credit Act of 1997, H.R. 2330, and the Transportation Infrastructure Finance and Innovation Act of 1997, Subtitle C, Chapter 2, of S.1173). The second panel examined how Federal credit concepts could be used by project sponsors. This session considered how two standby lines of credit to the San Joaquin Hills and Foothill/Eastern Transportation Corridors and a direct Federal loan to the Alameda Corridor assisted these projects in obtaining financing. The third and last panel reviewed potential methodologies for estimating the budgetary costs associated with the provision of Federal credit.

Mitchel Rapaport, Esq., of Nixon Hargrave, Devans & Doyle led an afternoon discussion of Federal tax law matters. The discussion focused on the tax implications of Federal credit, with special focus on those circumstances in which such assistance could be construed as an indirect Federal guarantee of a tax-exempt obligation.

Peter J. Basso, DOT Acting Assistant Secretary for Budget and Programs, delivered a keynote presentation in which he discussed key Federal policy issues relating to credit and administrative procedures for executing and monitoring loans under a DOT-sponsored Federal credit program.



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# Introduction and Opening Remarks

On January 13, 1998, the Federal Highway Administration (FHWA) sponsored a one-day conference on **Federal Credit Concepts for Surface Transportation**. The conference brought together a diverse group of participants from a wide range of organizations and sectors, including the Congressional Budget Office, the Office of Management and Budget, the General Accounting Office, the Department of the Treasury, congressional staff, a number of state Departments of Transportation, constructors and developers, and members of the financial community. (Appendix A contains the conference agenda and Appendix B is a list of participants.)

The purpose of the conference was to explore the implications of using Federal credit (e.g., direct Federal loans, loan guarantees, and lines of credit) to help finance major surface transportation projects. The conference was one in a series of periodic policy discussions the FHWA has sponsored called "Searching for Solutions," in which experts are invited to help FHWA examine key transportation policy issues.

Peter J. Basso, Acting Assistant Secretary for Budget and Programs, United States Department of Transportation (DOT), delivered a keynote presentation, in which he discussed key Federal policy issues relating to credit and administrative procedures for executing and monitoring loans under a DOT-sponsored Federal credit program.

A discussion of Federal tax law matters was moderated by Mitchell Rapaport, Esq., Nixon Hargrave, Devans & Doyle. The discussion focused on the tax implications of Federal credit and potential indirect Federal guarantees of tax-exempt obligations.

Three panels gave participants the opportunity to discuss and learn about Federal credit and its application in the surface

transportation sector. The first panel focused on Federal credit legislation pending in both the House (Transportation Infrastructure Credit Act of 1997, H.R. 2330) and the Senate (Transportation Infrastructure Finance and Innovation Act of 1997, contained in S. 1173). The second panel examined how Federal credit could be used by project sponsors. The third, and last, panel reviewed potential risk-scoring methodologies for estimating the budgetary costs associated with the provision of Federal credit assistance. (Appendix C contains panel discussion questions. Appendix D provides a background paper on credit concepts for surface transportation. Appendix E contains pending Federal credit legislation and a side-by-side bill comparison. Appendix F contains project case studies. Appendix G is a glossary of related terms.)

## Opening Remarks

Introductory remarks were delivered by **Gloria Jeff, Deputy Administrator, FHWA**. Ms. Jeff welcomed the conference participants and stated that one of the goals of the conference was to receive input from those with knowledge, expertise, and a stake in the outcome of the policy decision relating to Federal credit. Ms. Jeff noted that the issue of Federal support for the encouragement of capital markets financing of transportation infrastructure figured prominently in the Administration's internal debates, and that Federal credit is part of the ongoing issue of how to fund surface transportation projects in this country.

Ms. Jeff suggested that the basic question was one of how to maintain the Nation's investment in transportation infrastructure while seeking mechanisms to meet new and difficult transportation challenges. The key, Ms. Jeff added, was in seeking partnerships between the Federal Government, State and local partners, the private sector, and the financial community in a way that produces

the most prudent financing strategies for stimulating more investment in transportation infrastructure.

Ms. Jeff noted that the conference was very timely because Congress would be reconvening later in January to resume the debate on the Intermodal Surface Transportation Efficiency Act (ISTEA) reauthorization. Ms. Jeff noted that the conference was truly a fact finder, and that among the important issues relating to Federal credit were the following:

- Is Federal credit the best way to help large-scale projects in light of what likely will be continuing budget constraints, or are there other forms of assistance the Federal Government should be considering?
- Given that the Federal Government can offer credit incentives, tax incentives, and regulatory incentives, which approaches would have the greatest benefit in stimulating more investment?
- Are there market gaps which the Federal Government can and should address through credit, and if so, how can that be done with least interference to the private capital markets?

Ms. Jeff closed by encouraging participants to contribute to the discussion. Ms. Jeff then introduced David Seltzer, who outlined the format for the session.

**David Seltzer, FHWA Senior Advisor, Office of the Administrator** began by briefly describing the conference agenda and noting that FHWA intended the conference to be as informal and interactive as possible.

Mr. Seltzer noted that the conference was structured to touch on the key issues that FHWA had identified in its research to date. These issues, Mr. Seltzer added, included the following:

- How can Federal credit be used by project sponsors?
- What are the tax issues relating to the provision of Federal credit?
- How can the Federal Government best assess the budgetary costs associated with the provision of Federal credit assistance?
- What are the key Federal policy issues relating to credit and how could DOT best develop administrative procedures for executing and monitoring a portfolio of credit-assisted projects under a Federal credit program?

Mr. Seltzer stated that the conference was a follow-up to a draft policy discussion paper, *Federal Credit for Surface Transportation: Exploring Concepts and Issues*. He added that the session was intended to address questions stimulated by the discussion paper, identify critical policy and technical issues, and discuss possible solutions to potential barriers to program implementation. Mr. Seltzer closed by noting that the major conference findings would be published by mid-spring.

# Panel on Pending Federal Credit Legislation

## Introductory Remarks

David Seltzer, FHWA Senior Advisor, Office of the Administrator, introduced the first panel of the conference as one providing a brief overview of two pieces of pending legislation relating to Federal credit:

- Dan Corbett, of the Senate Committee on Environment and Public Works staff, to describe Senator Chafee's Transportation Infrastructure Finance and Innovation Act (TIFIA) proposal, and
- Andy Garfinkel, of Congresswoman DeLauro's office, to describe the Transportation Infrastructure Credit Act (TICA).

## The Transportation Infrastructure Finance and Innovation Act (TIFIA) of 1997 (Subtitle C, Chapter 2 of S. 1173)

Dan Corbett, Professional Staff Member, U.S. Senate Committee on Environment and Public Works began his presentation by stating that the Senate Committee on Environment and Public Works was very interested in pursuing innovative financing techniques for funding transportation investment. With the National Highway System (NHS) Designation Act of 1995, the Committee authorized the State Infrastructure Bank (SIB) pilot program. The Committee had made it a priority to encourage new financing techniques, implement new technologies and find new solutions to difficult problems.

Mr. Corbett noted that TIFIA was a product of the Committee's willingness to explore new ideas. He said the Committee was also interested in advancing legislation that would encourage design-build contracting and expand the SIB program. He added that TIFIA highlighted the Committee's ongoing efforts to

encourage innovative finance and stimulate private sector participation in transportation.

Mr. Corbett said that the funding shortfall for large new investments and major expansions of existing highways and other transportation investments is particularly acute. Therefore, the strategic goal of TIFIA is to provide credit assistance to projects of national significance generating major economic benefits through *supplemental* and *subordinate* capital.

Mr. Corbett reviewed the general terms of TIFIA. (A copy of TIFIA is contained in Appendix E.) He noted that to be eligible for assistance under TIFIA, projects were required to meet the following threshold criteria:

- Cost at least \$100 million, or 50 percent of a State's annual apportionment (\$30 million for Intelligent Transportation System projects) of Federal-aid highway funds.
- Be supported at least in part by user charges or other dedicated revenue streams.
- Be included in the State Transportation Plan and the State Transportation Improvement Program.

Projects meeting the initial threshold criteria then would be evaluated by the Secretary of Transportation based on:

- *Economic Benefits.* The extent to which a project generates national economic and social benefits that exceed costs.
- *Credit-worthiness.* The likelihood of the credit instrument being supportable by project revenues.
- *Public-Private Partnerships.* The project's ability to create opportunities for public-private partnerships.

- *Project Advancement.* The degree to which credit assistance enables the project to move forward at an earlier date and with lower financing costs than would otherwise be possible.
- *Innovative Technologies.* The extent to which the project uses or promotes innovative technologies in enhancing access, mobility, productivity, and safety.
- *Budgetary Cost.* The budget cost of the credit instrument, given the need to allocate limited Federal resources among project applicants.

Mr. Corbett stated that \$530 million of budget authority was currently reserved for paying the subsidy costs of providing credit assistance under TIFIA. He added that the subsidy costs were the sum of expected default losses and interest rate subsidies. An interest rate subsidy is present when interest rates charged are less than the yields for comparable-term U.S. Treasury securities. He concluded that if the subsidy cost of providing credit assistance under TIFIA is equal to ten percent of the face value of credit offered, the program could support \$5.3 billion in face amount of credit instruments.

Mr. Corbett noted that TIFIA offers three types of financial assistance (secured loans, loan guarantees, and standby lines of credit) to project sponsors.

Mr. Corbett reviewed the general terms of secured (direct Federal) loans, which would be provided under TIFIA:

- The loans offer long-term permanent financing.
- The loans are structured with flexible payment provisions (allowing deferrals up to ten years) to match project revenues.

- The loans improve the marketability of the senior debt by funding a portion of project debt on a junior basis.
- The credit program leverages private financing by limiting loans to 33 percent of project costs.
- The interest rate on loans is set at the 30 year Treasury rate (taxable).
- The loans will be secured with rate covenants, additional debt issuance tests, and defined claims on revenues.

He presented the general terms of assistance as they relate to loan guarantees, the second type of assistance offered under TIFIA:

- Loan guarantees would be used to guarantee long-term taxable rate loans funded by pension funds and other institutional investors, thus resulting in AAA ratings for projects receiving assistance.
- Loan guarantees would improve the caliber of the senior debt by securing private junior-lien debt.
- Loan rates would be determined by the borrower and lender, subject to approval by the Secretary of Transportation.
- Guaranteed loans could be structured with flexible repayment terms (with deferrals up to 10 years) to match project revenues.
- Loan guarantees would leverage non-Federal financing by limiting credit to 33 percent of total project costs.

The third, and last, credit mechanism described by Mr. Corbett was the standby line of credit. Under TIFIA, standby lines of credit represent contingent loans to pay debt service, extraordinary repair, and other costs during the project ramp-up phase. These contingent loans have the following features:

- They may be in an amount up to 33 percent of project costs.
- They may be drawn down over a 10-year period after project completion.
- They must be repaid, with interest, within 30 years of project completion.
- The interest rate on any draws is set at the 30-year Treasury rate.

Mr. Corbett noted that the Joint Committee on Taxation (JCT) had unexpectedly scored TIFIA with a tax revenue loss ("tax expenditures"). The argument used by the JCT was that the Federal credit program under TIFIA would result in additional tax-exempt debt issuance, which would deprive the U.S. Treasury of income taxes. The revenue loss estimate assigned by the JCT was \$79 million over five years.

Mr. Corbett stated that in response to the JCT decision, TIFIA was altered so that it would not allow DOT to provide assistance to projects issuing tax-exempt debt. This response, he added, could compromise the long-term viability of the program. Thus, the Senate Environment and Public Works Committee would continue working with the Congressional Budget Office and the JCT to address the tax expenditure score. The outcome, he concluded, would be fundamental to the future success of the Federal credit program.

## **The Transportation Infrastructure Credit Act of 1997 (H.R. 2330)**

**Andrew Garfinkel, Grants Coordinator, Office of Congresswoman Rosa DeLauro** stated that the conference was an excellent forum for bringing together the forces that can advance public investment and business expansion measures, such as Federal credit.

Mr. Garfinkel said that America's future depended on the ability to find creative

approaches to paying for infrastructure. He observed that no local, State, or Federal Government could afford to provide the funding needed to meet all current and future infrastructure needs. In fact, after these traditional sources of funds are spent, the Nation still faces as much as an \$80 billion funding shortfall.

Mr. Garfinkel said that Congress must bring about increased investment in the Nation's schools, roads, mass transit, airports, ports, water and wastewater systems, and other infrastructure. Only then can businesses perform at full capacity and successfully compete in the global market.

Mr. Garfinkel noted that public-private partnerships are still in the earliest stages of development in the United States. These partnerships enable the populace to make better use of the Nation's limited resources. He concluded that it is imperative that the Nation not fall behind in building the best, most economically productive infrastructure possible.

Mr. Garfinkel provided an overview of the Transportation Infrastructure Credit Act of 1997 (H.R. 2330). (A copy of H.R. 2330 is contained in Appendix E.) The bill was intended to amend the Intermodal Surface Transportation Efficiency Act (ISTEA) reauthorization.

The Transportation Infrastructure Credit Act (TICA) would create financing tools that promote public-private partnerships for highway and mass transit projects. Under TICA, DOT would make loans and provide loan guarantees for transportation projects of national significance.

Mr. Garfinkel reviewed the differences between TIFIA and TICA. (A side-by-side comparison of the two bills is provided in Appendix E.) The two bills are nearly identical with the exception of the development cost program and the funding mechanism.

One of the greatest risks to the private sector for investing in projects of national significance are the preconstruction costs, such as feasibility studies, preliminary engineering and environmental impact studies. Under TICA, projects could be insured for up to 40 percent of these preconstruction costs.

This risk reduction has the potential to attract private capital in a number of nationally significant highway and mass transit projects.

The House and Senate bills also differ in the use of budget authority. The House bill enables States to use their unobligated balances of Federal highway funds to pay the subsidy costs of Federal credit. By using this existing budget authority to support the use of Federal credit, Congress avoids the need to authorize new budget authority to pay for the subsidy costs associated with the provision of credit.

Mr. Garfinkel concluded the comparison by noting that both TICA and TIFIA share a common goal: to reduce the risk for private investors to build public-good transportation projects. Reducing the risk, Mr. Garfinkel added, was key to attracting funds from non-traditional funding sources.

Mr. Garfinkel then reviewed another legislative proposal Rep. DeLauro introduced in 1997: the National Infrastructure Development Act (NIDA). The bill would establish a national revolving fund program to finance schools, roads, rail, ports and airports, and water and wastewater projects. The bill would establish a government corporation infrastructure bank to invest in and insure infrastructure projects in order to reduce public and private investment risk.

The bank, called the National Infrastructure Development Corporation (NIDC), could make loans, provide certain loan guarantees, and insure certain project debt for both public and private development entities. The NIDC would be capitalized with an initial \$3 billion Federal investment provided over a three-year

period. This three billion dollars could leverage up to \$30 billion in both public and private loans and to eventually insure certain project debt.

Mr. Garfinkel then analyzed the comparative advantages of the national bank and Federal credit concepts. The advantages of the NIDC are that (1) there is a special purpose corporation whose sole mission is to help finance infrastructure, and (2) as loans are repaid to the NIDC, the repaid funds can then be loaned to other projects without the need for further appropriation. The advantages of the Federal credit concept are that (1) it is not necessary to establish a new government entity and (2) the budgetary cost of capitalizing a federal credit program is a fraction of the amount needed to capitalize a similar scale program through the NIDC, due to the subsidy cost.

Mr. Garfinkel said that Congresswoman DeLauro was also interested in advancing a measure authorizing project sponsors to offer bonds to pension fund 401(k) plans for infrastructure development in the U.S. He added that there are few opportunities for pension funds and other private entities to invest in infrastructure projects, and these important U.S. funds are currently being invested overseas in markets such as Asia. This provision of NIDA would enable institutional investors to invest in the building of roads, water and wastewater projects, airports and schools here in the U.S. at rates comparable to tax-exempt bonds.

Mr. Garfinkel added that the bonds, called Public Benefit Bonds, would be an attractive investment for 401(k) plans because the bonds enable them to pass on tax free interest to their pensioners at retirement. A preliminary analysis showed that they would likely raise revenue for the U.S. Treasury. In addition, the legislation would enable the pension community and other institutional investors to

invest a portion of their \$4.5 trillion in assets in infrastructure projects in the U.S.

Innovative finance, Mr. Garfinkel said, is about good government. American businesses benefit from improved infrastructure, American workers benefit from good paying jobs, and American taxpayers benefit from better infrastructure built with fewer tax dollars.

Mr. Garfinkel concluded by saying that it is essential that the credit enhancement bills are recognized as industry-backed financial tools. He also stated that industry commitment to infrastructure development and industry efforts to develop and expand public-private partnerships will make the difference in establishing Federal credit programs.

## **Discussion**

A member of the audience said that the JCT decision to score TIFIA with a tax revenue loss is troubling. This decision could have implications for other Federal financial assistance programs. If the JCT assigns a tax revenue loss to TIFIA, will it do the same for all assistance programs?

Mr. Corbett responded that the decision to score non-tax legislation with tax revenue losses represents a new way of doing business and challenges several long-standing scoring principles. This sets a new precedent, and the decision will have a widespread effect.

An audience member asked whether the Senate Environment and Public Works Committee had plans to provide offsetting budgetary resources to pay for these tax revenue losses.

Mr. Corbett responded that the Senate Environment and Public Works Committee does not have the resources to offset this provision. This, unfortunately, places the entire program in jeopardy. The Senate Environment and Public Works Committee is

concerned because the JCT is now scoring an authorizing piece of spending legislation with a tax revenue loss. Similar provisions appearing in appropriations bills, however, have not been scored. This seems like unequal treatment. There is also a question of consistency. The JCT has to date never scored tax expenditures against grant programs that induce additional tax-exempt debt, yet is now scoring a revenue loss against credit programs. What the JCT is doing is creating an entirely new set of ground rules for scoring Federal initiatives.

A member of the audience commented that there is too much focus on budget scoring. The focus should be on getting more projects funded. Access to capital is not an issue for good projects, he noted. There are two main barriers to transportation investment: political feasibility and development cost. Debt financing and tolling are often not politically feasible on the local level. Thus, the Federal Government should be providing incentives for local entities to debt finance projects and build toll facilities. One solution could be found in an incentive program that provides Federal funds to States based on toll collections. In fact, this participant opined that the budget authority reserved for Federal credit could be better utilized by creating such a program. The other issue is up-front development costs, which is addressed to some extent in the House bill.

Mr. Corbett responded that by covering the risk subsidy, TIFIA would be providing an incentive to debt finance and build toll facilities.

Mr. Garfinkel responded that in addition to Federal credit, State Infrastructure Banks (SIBs) are encouraging debt financing at the local level. Innovative finance initiatives illustrate the Federal Government's willingness to be creative and create incentives for debt financing.



# Panel on How Federal Credit Could Be Used by Project Sponsors

## The Alameda Corridor Project

James Preusch, Chief Financial Officer, Port of Los Angeles said that his presentation would focus on the Alameda Corridor Project, one of three surface transportation projects currently benefiting from the provision of Federal credit through special legislation. Mr. Preusch provided an overview of the project and its finance plan. (An Alameda Corridor Project case study is contained in Appendix E.)

The ports of Los Angeles and Long Beach are located 25 miles south of downtown Los Angeles. There are three major rail routes that currently move cargo from the port complex up to and through Los Angeles on its way to major midwest and east coast markets. The purpose of the Alameda Corridor Project is to consolidate port-related freight traffic onto a high speed, high capacity and fully grade-separated transportation corridor linking the ports to the region's rail hub, located near downtown Los Angeles.

Trains carrying cargo from the ports to the region's rail hub are about a mile in length and thus present a substantial barrier to traffic. In addition, over the next 20 to 30 years, the number of trains moving along the corridor is expected to grow substantially because port traffic is projected to more than double.

The Alameda Corridor Project will improve logistics and reduce transportation costs by speeding train traffic, taking vehicular traffic up and over the train tracks, which will be below grade. Thus, the project will reduce congestion, remove impediments to emergency vehicles, lessen the impact of environmental externalities such as noise and vibrations caused by trains, and speed the movement of cargo.

The finance plan includes contributions from private as well as Federal, State and local sources. The total cost of the project is approximately two billion dollars. The \$400 million Federal loan is one piece of the finance plan. The Los Angeles and Long Beach port commissions have contributed \$411 million. The Los Angeles County Metropolitan Transportation Authority is supplying another \$348 million. The project is receiving an additional \$109 million from a variety of other sources. Additionally, the Alameda Corridor Transportation Authority (ACTA) plans to issue approximately \$785 million of senior revenue bonds in 1998, a portion of which will be tax-exempt and a portion of which will be taxable.

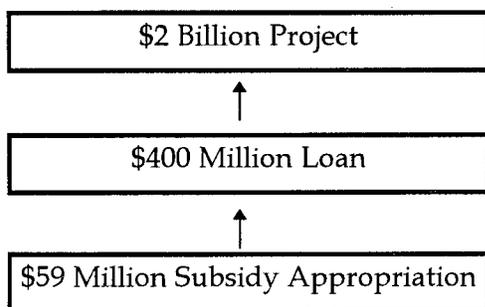
Mr. Preusch said that the \$400 million Federal loan was a key component of the project's finance plan. He then reviewed the basic structure of the loan agreement, as follows:

- The \$400 million loan is taxable, and amortized over its life.
- The loan must be repaid within 30 years of project completion.
- The interest rate on the loan is the 10-year Treasury rate until project completion or for the first five years of the loan, whichever is earlier, and is converted to the 30-year rate thereafter.
- Proceeds from the loan may be used for general design, engineering, construction or project administration.
- The loan will be drawn down over three years. The first draw of \$140 million was made in September 1997.

- The sources of repayment include container charges paid by the railroads using the corridor and port payments.

Mr. Preusch discussed the leveraging potential of Federal credit, and cited the Alameda Corridor Project as a prime example of leveraging at work. As shown in Figure 1, DOT is using a \$59 million appropriation to support the “subsidy cost” of making a \$400 million loan. The \$400 million loan in turn is helping induce other public and private investment for a \$2 billion project. That represents a leveraging ratio of 33 to 1, in terms of total transportation investment to Federal budgetary cost for the Federal credit portion.

**Figure 1**  
**Alameda Corridor Leveraging Potential**



Mr. Preusch concluded that effective leveraging is the key objective of Federal credit. As demonstrated by the Alameda Corridor Project, Federal credit takes limited Federal resources and allocates them more efficiently in order to build infrastructure, move goods, create jobs, and generate tax receipts for the Federal Government.

### **Transportation Corridor Agencies (TCA) Toll Roads**

Mr. Wally Kreutzen, Chief Operating Officer, Transportation Corridor Agencies began his presentation by displaying a map of the TCA toll roads and providing some background information on the Transportation

Corridor Agencies and Orange County which is just south of Los Angeles, California.

The Transportation Corridor Agencies are multi-jurisdictional authorities charged with the construction of a 67-mile beltway system around Orange County. By adding an additional 67 miles of highway to the 100 miles of existing freeways, the TCA toll roads will expand regional freeway/tollway mileage by two-thirds.

The San Joaquin Hills Transportation Corridor (SJHTC) toll road is the first new public toll road facility being developed by TCA. The SJHTC is a 15-mile, six-lane limited access highway in southwestern Orange County. The new toll road was opened for traffic in November 1996.

The Eastern Transportation Corridor (ETC) will be a 25-mile limited access toll road consisting of three segments connecting with the northern segment of the Foothill Transportation Corridor. The ETC is currently under construction (a \$750 million design-build contract). As originally planned, the ETC was to open to traffic in 1999; however, the project is approximately one year ahead of schedule and should open to traffic by November 1998.

The Foothill Transportation Corridor (FTC) will be a 28-mile toll road, connecting the Eastern Transportation Corridor with I-5 near the Orange County and San Diego County line. A 7.5-mile portion of the FTC is currently completed and open for traffic. A portion of the FTC was funded on a pay-as-you-go basis. Another portion under construction is being funded through debt proceeds. The last 16 miles of the project (known as Foothills-South) will be more difficult to complete. That portion of the FTC currently faces environmental challenges, construction difficulties, and financing shortfalls.

Mr. Kreutzen said that the TCA toll roads were put on the Master Plan for Arterial Highways in Orange County in 1976. Within

that plan, the toll roads were identified as regional congestion mitigation devices. As a result of this plan, Mr. Kreutzen added, regional growth was allowed to continue. Unfortunately, by the mid-1980's, Caltrans and the Federal Government were overcommitted and unable to provide the funding for these projects.

Mr. Kreutzen stated that as a result of this funding shortfall, TCA began to explore local alternatives. During this time, Mr. Kreutzen added, Orange County was experiencing explosive growth and as a result the freeway system was becoming more and more congested. By the mid-1980's, ten of the 22 most congested interchanges in the Nation were located in California. The Transportation Corridor Agencies were formed in response to the growing problem of regional traffic congestion.

Mr. Kreutzen said that TCA sought and received support from the California State Legislature to allow tolling on the facilities once completed. Generating support for the legislation was quite a challenge because members of the California State Legislature generally viewed California as the land of the freeways.

Mr. Kreutzen said that the TCA toll roads gained the support of local businesses and developers. He added that the local business community clearly understood the benefits of transportation infrastructure, and the negative impacts that were occurring as a result of traffic congestion. As a result, TCA was able to impose development impact fees with their support.

The Transportation Corridor Agencies performed a traffic analysis in order to identify the areas that would benefit most from the new toll roads. The findings of the study suggested that the southern and central portions of Orange County would benefit greatly from the new facilities because there were large tracts of undeveloped land located within those areas.

Mr. Kreutzen explained that the development impact fee for a single home is \$3,500 and the fee for commercial buildings is set at four to five dollars per square foot. He added that to date, development impact fees have raised over \$200 million for the projects, and are projected to generate in excess of \$600 million more in the future. This revenue effectively represented TCA's equity capital in moving the projects forward. Development impact fees were used to fund preliminary engineering, environmental, and right-of-way costs.

Mr. Kreutzen described in detail the evolution of TCA's finance plan for SJHTC. Initially, TCA envisaged a more conventional finance plan. The original plan was to obtain bank loans for short term construction capital over a four- to six-year period, build a project and traffic history, seek an investment grade bond rating for the projects, possibly obtain bond insurance, and do take-out permanent financing. The Transportation Corridor Agencies worked on this strategy for four to five years, but were unable to obtain the financial support necessary for coming to market.

It was at this time, that TCA began investigating a new option: long-term fixed rate project financing. In order to do this, TCA was faced with the challenge of convincing investors that the myriad of potential risks relating to the project could be mitigated. These risks and mitigation techniques are outlined below.

- *Environmental Risk.* The projects faced environmental opposition in the form of five disclosed lawsuits. In order to mitigate this risk, TCA needed to convince investors that it would prevail in each of the individual lawsuits and that the amount of time it would take to adjudicate these cases would not cause significant construction delays.

- *Construction Risk.* The projects had to be built on time and within budget. The largest design-build contract in the history of the Nation (\$750 million) with a guaranteed maximum price/guaranteed completion date was used to mitigate the risk resulting from construction delays.
- *Traffic Risk.* After construction there is typically a ramp-up phase, during which the revenue stream is established. Transportation projects are often subject to competing free alternatives, and it is difficult to forecast demand accurately in the early years of operation. A \$120 million Federal line of credit for SJHTC allayed investor concerns relating to traffic risk.

Mr. Kreutzen outlined the basic structure of the Federal line of credit as initially enacted in FY 1993. He noted that the line of credit is available over a 10-year period following construction completion. TCA would be allowed to draw down up to 10 percent of the line, or \$12 million, in any given year.

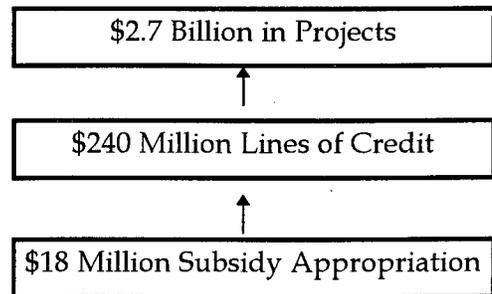
Mr. Kreutzen described the tax implications of the Federal line of credit. He noted that the Internal Revenue Code prohibits Federal guarantees of tax-exempt debt. Because of uncertainty as to whether the line would be deemed an indirect Federal guarantee, TCA informed bond holders it would not utilize the line unless it obtained an unqualified legal opinion from bond counsel. A provision in the Fiscal Year 1996 DOT Appropriations Act subsequently broadened the purposes for which the line could be used. The Federal line of credit is available in the event toll revenues and standard reserves are not sufficient to cover debt service, costs of extraordinary repair and replacement, costs of complying with unexpected Federal or State environmental restrictions, and operation and maintenance expenses.

Mr. Kreutzen stressed that public acceptance for the project was key. The

Transportation Corridor Agencies could demonstrate State and local support for the project by virtue of the development impact fees and State grants dedicated to the project. The Federal line of credit, he concluded, demonstrated the final component: Federal support for the project.

Mr. Kreutzen closed his presentation with a discussion of the leveraging potential of Federal credit for both toll road projects. He noted that Congress used a \$17.6 million subsidy appropriation to support two lines of credit totaling \$240 million (Figure 2). The \$240 million in lines of credit are being used to support \$2.7 billion in projects. That represents a leveraging ratio of 153 to 1, in terms of total transportation investment to Federal budgetary cost.

**Figure 2**  
**Transportation Corridor Agencies Toll Roads**  
**Leveraging Potential and Economic Impact**



In addition to the economic impact, he concluded, the projects would have a major impact on air quality, mobility, and regional livability.

## **Discussion**

A member of the audience asked how does the Alameda Corridor Project generate incremental trade benefits throughout the Nation.

Mr. Preusch responded that shipping is a very cost-sensitive business. The project will generate trade by reducing costs and attracting cargo that would have otherwise been shipped overseas or not produced at all. Because half the cargo passing through the San Pedro Bay Seaports terminates in other areas of the country, the entire Nation will realize substantial economic benefits from this project.

A member of the audience said that based on these presentations, it seemed apparent that the Federal Government could actually receive additional tax receipts as a result of the economic benefits generated by these projects. Is this fact addressed in the scoring analysis performed by the Joint Committee on Taxation (JCT)?

Mr. Kreutzen responded that the Federal scoring process is very difficult to understand; however, it appears that the process does not account for future financial benefits derived from the project in question. In addition, the scoring process does not account for other, less quantifiable benefits such as mobility or air quality.

A member of the audience said that TIFIA would use \$500 million to support \$5 billion to \$10 billion in projects. Given the current funding gap for transportation infrastructure, why is there opposition to a bill that could achieve such substantial leverage?

Mr. Kreutzen responded that it is all a question of responsibility. The Federal Highway Administration is in the business of building and maintaining the Nation's highway system. The Office of Management and Budget, the Treasury, and the Congressional Budget Office have a different

perspective. These agencies are more concerned with balancing the Federal budget.

A JCT representative responded that the JCT has no agenda against tax-exempt debt or Federal loans. The JCT is charged with assessing legislative proposals and estimating their potential impact on Federal tax receipts. The scoring process is driven by the principle that tax-exempt debt attracts capital that would have been otherwise used to purchase taxable debt. As a result, programs that have the potential to induce additional tax-exempt debt are being scored with a tax revenue loss. In addition, programs that accelerate the issuance of tax-exempt debt are also being scored with a tax revenue loss.

A member of the audience asked if the TCA would have considered paying the estimated budgetary costs (subsidy risk and tax revenue loss) of the Federal lines of credit up-front as an administration fee when it sought Federal assistance.

Mr. Kreutzen responded that TCA would have paid the estimated budgetary cost. It would have been considered a cost of doing business.

An audience member commented that it could be argued that Federal credit assistance could reduce the cost of capital for projects and thus the size of tax-exempt debt issued. This would actually result in a net reduction in the volume of tax-exempt debt issued. The JCT should include this in their analysis.

An audience member asked: Are there market gaps which the Federal Government could or should address through credit?

Mr. Preusch responded that the \$400 million Federal loan provided to the Alameda Corridor Project was at a taxable rate. Tax-exempt debt from the capital markets would have been more cost-effective; however, the capital markets could not accommodate the flexibility, subordination, and other issues that

were necessary to make the Alameda Corridor Project feasible. Thus, it would seem that there is a market gap that could be filled by the Federal Government through credit.

A member of the audience commented that the State of Arizona has identified \$9 billion dollars in needs over the next ten years. There is a lack of available funding through traditional funding sources to meet those needs. Arizona does have a State Infrastructure Bank. As a start-up financial institution, however, the Arizona SIB will be limited in the amount of assistance it can provide in the near-term. Arizona has identified three projects that are too large for the traditional Federal-aid or SIB program. For these projects, Federal credit could play a significant role in their development.

# Roundtable Discussion on Federal Tax Issues Relating to Credit Assistance

## Tax Issues Related to Federal Guarantees and Transportation Infrastructure

Mitchell Rapaport, Esq., Nixon Hargrave, Devans & Doyle opened his presentation with a discussion of rules and procedures followed by State and local governments when issuing tax-exempt debt. He said that many of the rules and requirements governing the issuance of tax-exempt debt lack specific guidance. He said that in the absence of guidance, bond counsels were required to issue unqualified opinions regarding the tax-exempt status of bond issues.

Mr. Rapaport stated that his presentation would focus on the Federal guarantee provision in Section 149(b) of the Internal Revenue Code, which effectively prohibits the issuance of Federally guaranteed tax-exempt bonds.

Mr. Rapaport reviewed the basic framework of Section 149(b). He said that a bond was considered Federally guaranteed if the payment of principal or interest on the bond was directly or indirectly guaranteed in whole or in part by the United States. He added that the language of this provision was very broad and that to his knowledge there were no regulations or clear guidance relating to this statute.

Though there were few rulings offering guidance on Section 149(b), Mr. Rapaport noted that when Congress added this provision, it had indicated why the statute was necessary. Congress viewed the combination of tax-exempt debt and Federal guarantees as a double subsidy. Moreover, Congress was concerned that by virtue of the double subsidy,

Federally guaranteed tax-exempt bonds would be more attractive than U.S. Treasury securities. The proliferation of such bonds could make it difficult for Federal and State governments to raise funds in the bond market.

Mr. Rapaport stated that the Internal Revenue Service (IRS) bases its determination of whether or not a Federal guarantee is present on the underlying economic substance of the transaction. Transfer of risk to the Federal Government is a key element of the IRS analysis. IRS interpretation provided further evidence of the statute's breadth and vagueness.

Mr. Rapaport said that there were numerous exceptions to the Federal guarantee prohibition, most of which were granted to programs in existence when the provision was first enacted in 1984. He added that when Congress decided whether or not to exempt such programs, it carefully weighed policy goals against tax policy implications. Where national policy objectives outweighed tax policy implications, exemptions were granted.

In closing, Mr. Rapaport addressed the question of subordinate lending by the Federal Government. He asked the following question: If the Federal Government takes a subordinate position as a junior-lien lender, does it constitute an implicit guarantee of the private capital markets' senior debt? He responded to his own question by stating that under TIFIA and TICA, Federal participation is limited to 33 percent of total project costs. At this level of participation, Federal credit assistance would not improve the rating of the senior debt to AAA. He said that in his opinion, Section 149(b) was designed to prohibit transactions yielding tax-exempt interest and

obtaining a AAA rating as a result of a Federal guarantee. Under this test, the financial products proposed by TIFIA and TICA would not rise to the level of a guarantee.

## Discussion

A member of the audience asked whether a Federal standby line of credit would violate the prohibition against Federal guarantees.

Mr. Rapaport responded that as originally planned, the Federal line of credit extended to the Transportation Corridor Agencies (TCA) was to be available for debt service, if necessary, during the first five years of operation. The issuer and bond counsel went to the Internal Revenue Service (IRS) and attempted to obtain a private letter ruling, arguing that the transaction would not result in a Federal guarantee. The IRS, however, was unwilling to issue such a ruling. In response, TCA broadened the purposes for which the line of credit could be used. As a result of this variation, bond counsel was able to conclude that the line of credit did not constitute a Federal guarantee.

A Treasury spokesman stated that Federal policy for credit programs is outlined in the Office of Management and Budget (OMB) Circular A-129. Treasury is generally supportive of the policies established within Circular A-129. Two such policies relate to the subordination of Federal debt and Federal guarantees of tax-exempt debt. The Federal guarantee provision is based in current tax law. The Federal subordination provision is not. The subordination of Federal debt is an evolving tax policy question which is currently under scrutiny. On one hand, the standby line of credit could operate like a guarantee if project revenues are used to retire debt service and Federal funds are used to backfill by paying other operating expenses. In this case, operating revenues are insufficient to meet

both project debt service and operating expenses, yet annual debt service payments are still made. On the other hand, the standby line of credit doesn't provide bond holders with recourse in the event of default.

An audience member said that by definition, a Federal guarantee is a promise that the Federal Government will pay bond holders if a project fails to generate sufficient revenues. When the Federal Government is more than a mere guarantor and puts money on the table, bond counsel may view the Federal Government's role as a grantor or lender. By broadening the purposes for which the line of credit may be used, limiting the amount that can be drawn down in any given year, and providing a pledge with no recourse, the Federal role is something other than that of a guarantor.

Mr. Rapaport responded that the pledge with no recourse was an important point. When the Environmental Protection Agency (EPA) began the State Revolving Fund program, it contemplated offering lines of credit for debt service reserves rather than outright grants to local bond issuers. In response, the Treasury in 1988 issued a notice stating that the EPA line of credit would not represent a Federal guarantee.

An audience member said that the most important question to Treasury is how much a program will cost. Grant programs are appealing because the budgetary impact is easily quantifiable. When programs become more elaborate, like those proposed in TIFIA and TICA, they become riskier and more difficult to assess.

A spokesperson for the Congressional Budget Office (CBO) responded to remarks made earlier in the day. She indicated that it was untrue that TIFIA was the first piece of non-tax legislation scored with a tax revenue

loss. The CBO has a long tradition of identifying proposed non-tax legislation and submitting a request to the JCT to review it and provide appropriate revenue loss estimates. For example, the Health Care Reform Act of 1993 was scored with a tax revenue loss. Another example of non-tax legislation scored with a tax revenue loss involved the Alaska Power Administration.

A member of the audience asked whether the Federal Government could charge a user fee paid by project sponsors to offset the revenue loss assigned by the JCT.

A CBO spokesman responded that in theory, a user fee would be possible; however, the user fee component would need to be specified in the authorizing legislation.

A member of the audience asked the CBO spokesperson to review the methodology used to calculate the revenue loss estimate assigned to TIFIA.

A CBO spokesperson responded that the official scoring of TIFIA was performed by the JCT, and was based on the assumptions that the program would increase the volume of tax-exempt debt issued and accelerate the issuance of tax-exempt debt. Such activities would result in a tax revenue loss to the Treasury. The \$79 million revenue loss assigned to TIFIA was a conservative estimate.

A member of the audience asked if TIFIA was scored with a revenue loss because it is a credit proposal. The Federal-aid grant program and the SIB program arguably increase the volume of tax-exempt debt issued by State and local governments. Why aren't these programs scored with a tax revenue loss?

A CBO spokesperson responded that the decision to score TIFIA was not based on the fact that it involves credit. When the SIB

program was originally introduced, it was unclear how State and local governments would use the program. It was thus quite difficult to estimate or assign a tax revenue loss to the program. Now that CBO has a clearer understanding of how the funds are being used, it is reevaluating its original decision to not score the SIB program with a tax revenue loss.

A JCT spokesperson said that the JCT is well aware that State and local governments have limited resources to dedicate to transportation infrastructure. Because TIFIA targets projects with dedicated revenue streams, the program is not likely to displace other projects funded solely with grants. The Federal credit program proposed under TIFIA would, therefore, stimulate additional investment and induce additional tax-exempt debt, which has a tax expenditure associated with it.

A member of the audience asked whether it was reasonable to assume that investors would put funds otherwise used to purchase tax-exempt debt into something taxable instead.

A JCT spokesperson responded that when the JCT scores legislation, it does not assume a 1 to 1 taxable to tax-exempt debt displacement ratio. The displacement ratio is case-specific and based on careful analysis of numerous variables.



# Panel on the Credit-Worthiness of Federal Credit

## Introductory Remarks

**Tom McLoughlin, MBIA Insurance Corporation**, introduced the third and last panel as one that would review alternative risk scoring methodologies for Federal credit and assess the implications of the OMB Circular A-129 policy concerning the subordination of Federal debt. He noted that panelist David Litvack, Fitch IBCA, would provide an overview of the risk model developed by Fitch IBCA for evaluating the default risk associated with a Federal credit program involving direct loans, loan guarantees and standby lines of credit for surface transportation projects. He said that panelist Chee Mee Hu, Moody's Investors Service, would draw upon her vast experience in transportation credit analysis to discuss issues relating to potential risk scoring methodologies for Federal credit.

## A Capital Charge Scoring Methodology for Federal Credit

**David Litvack, Fitch IBCA**, began his presentation by noting that as part of FHWA's draft policy discussion paper called *Federal Credit for Surface Transportation: Exploring Concepts and Issues*, Fitch IBCA was asked to develop a model for evaluating the default risk for a Federal credit program involving direct loans, loan guarantees and standby lines of credit for surface transportation projects. (A summary of the Fitch IBCA methodology is contained within Appendix A of *Federal Credit for Surface Transportation: Exploring Concepts and Issues*.)

Mr. Litvack reviewed the methodology used by the Office of Management and Budget (OMB) to score the Alameda Corridor loan. Under the Federal Credit Reform Act, the

budgetary cost of loans and loan guarantees is based on the subsidy cost of the loan, representing the credit risk and any interest rate subsidy. The Alameda Corridor loan was scored using a "yield premium" approach to assess potential default cost. The loan was assumed to be made at an interest rate equal to the U.S. Treasury bond yield. The net present value of loan repayments on the project was then calculated, discounted at both the Treasury yield and the loan's assumed market yield, based on the project's preliminary rating (105 basis points above the Treasury yield). The difference in net present values was deemed to represent the cost of the default risk. Using this methodology, OMB calculated the default risk to be around 15 percent of the \$400 million loan amount. Thus, the budgetary cost for the Alameda Corridor loan was estimated at around \$59 million.

Mr. Litvack stated that in his opinion, the yield spread approach was not a valid measure of the expected default risk. Market yields take into account other factors beside default risk, such as liquidity risk and call risk. Since liquidity risk and call risk are not relevant factors in the cost of the program to the Federal Government, the yield premium results in a cost estimate that is too high.

Mr. Litvack said that the fact that market yield spreads overestimate default risk is evidenced by the existence of a private, for-profit bond insurance industry that guarantees the principal and interest on municipal bonds, as well as asset-backed and mortgage-backed securities. Bond insurers guarantee municipal bonds that have mostly A and BBB underlying ratings; the insurance raises the bonds' public ratings to AAA. The premiums on these policies, which are usually paid by the issuer,

amount to about half of the issuer's interest cost savings as a result of the higher credit rating. At that premium base, bond insurers average around four percent losses on those premiums collected.

Mr. Litvack stated that bond insurers incur other costs besides losses, such as underwriting, surveillance, and administration; however, during the period from 1992 to mid-year 1996, bond insurers averaged 13.1 percent return on equity (income after expenses and taxes, divided by average shareholder's equity).

Mr. Litvack reviewed the methodology employed by Fitch IBCA in rating the claims-paying ability of the bond insurers. He said that a large part of the analysis focuses on the insurers' capital adequacy. To measure capital adequacy, Fitch IBCA uses a stress test model that subjects a bond insurer's portfolio to an economic downturn that produces an extraordinary level of bond defaults. For an insurer to receive a AAA claims-paying ability rating, it must be able to pay all projected claims through the peak years of the stress period and be left with sufficient resources to write new business when more stable economic conditions resume.

Claims during the stress period are forecast using capital charges that Fitch developed based on bond defaults experienced during the Great Depression of the 1930's. Fitch has adjusted the capital charges to reflect regulatory changes and the relative probability and severity of defaults for the types of insured risks in today's market. For example, current banking laws enacted after the Great Depression reduce the potential severity of another depression. However, in the 1930's all municipal bonds were backed by a general obligation pledge; most municipals today are limited recourse revenue bonds which have potentially greater risk. For this reason, Fitch

has developed different benchmark capital charges for various types of insured bonds. For example, transportation bonds on existing facilities are more risky and, therefore, have higher benchmark capital charges than water and sewer bonds. They are, however, less risky and have lower benchmark capital charges than private higher education and hospital bonds. These benchmark capital charges are then adjusted further based on Fitch IBCA's evaluation of the actual credit quality and diversity of the bonds within each sector of the individual insurer's portfolio.

Bond insurers do not currently insure start-up toll roads. Fitch IBCA developed capital charges for this category specifically for FHWA's discussion paper *Federal Credit for Surface Transportation: Exploring Concepts and Issues*. Fitch IBCA's methodology for developing these charges is described in the following paragraphs.

Based on historical evidence, although some start-up toll road projects experience late payment delinquencies in years one through five, and less frequently in years six through ten, almost all do get built, begin operations, and eventually pay off their debt, including interest on interest. Subordinate lenders to projects of investment-grade quality should get paid as well, although perhaps over a somewhat longer time frame than the senior bondholders. It is estimated that only about one percent of the loans rated BBB will not be recovered within a reasonable time frame, which for discussion purposes is defined as 30 years.

A project is rated below investment grade (lower than BBB-) if there is a foreseeable risk that it will not be successfully completed on time or generate sufficient revenues to fully pay creditors. Indeed, default rates are much higher for unrated and below investment-grade municipal bonds than they are for investment-

grade bonds. Because start-up toll roads have only recently received ratings, there is little empirical data on default rates specifically for this sector. Based on the default experience in other sectors of the municipal market, Fitch IBCA estimates that a portfolio of loans on start-up toll road projects rated BB will experience a four percent loss rate and start-up toll road projects rated B an eight percent loss rate (net of recoveries).

Highly rated financial institutions not only require enough capital for an expected level of losses, but for a multiple of such losses. Fitch IBCA has concluded that for start-up infrastructure projects, a multiple of four to five times expected losses is needed to provide the highest credit standard of AAA. Multiplying the expected losses by five produces the capital charges that should be used on loans to start-up toll road projects; these charges (expressed as a percentage of original principal) are shown in Table 1.

**Table 1**  
**Capital Charges for**  
**Start-up Toll Road Projects**

Project Rating	Expected Loss (%)	Multiplier	Capital Charge AAA Scenario (%)
BBB	1.0	5	5.0
BBB-	1.6	5	8.0
BB+	2.6	5	13.0
BB	4.0	5	20.0
BB-	5.0	5	25.0
B+	6.4	5	32.0
B	8.0	5	40.0

Fitch IBCA recognizes that, in many cases, the Federal loan will be junior to the senior debt, but believes the same capital charges are applicable for subordinate, flexible payment debt. The flexibility in the Federal credit program reduces the demands on a project to

make timely payments; however, full repayment is still required. An important element in Fitch IBCA's capital charge calculation is that most loan defaults that occur during the initial ten-year period will be recovered. Fitch IBCA assumes that interest on delinquent loan payments is equal to the U.S. Treasury rate, so timing defaults will not affect the net present value cost of the loan credit program. The same analysis should hold true whether the Federal credit takes the form of a direct loan, a guaranteed loan, or a contingent standby line of credit.

Mr. Litvack said that it should also be noted that the capital charge methodology for private, for-profit bond insurers applies to a large and diversified portfolio of loans. If an insurer were to guarantee loans to only a handful of projects, and one of these projects defaulted, then the overall cost could conceivably be higher than the weighted average capital charge. Fitch IBCA would require considerably more capital to assign a rating of AAA to a private company insuring only a small, non-diversified portfolio of loans. Considering the fact that the Federal Government has no liquidity constraints and these transportation loans would be only one piece of an existing diversified portfolio of approximately one trillion dollars of Federal Government loans and guarantees in a wide range of industry sectors, this capital charge method is considered appropriate.

Mr. Litvack reviewed the suggested rating category for the Federal credit program portfolio. The capital charges Fitch IBCA recommends are consistent with AAA security. For an ongoing Federal credit program that encompasses a portfolio of loans and guarantees, the likelihood of underestimating default cost is remote. In other words, the capital reserves should absorb all anticipated default risk, in essence representing a proxy for

Federal subsidy cost. This makes it a useful and conservative tool for budgeting purposes.

## Comments on Risk Scoring Methodologies

**Chee Mee Hu, Moody's Investors Service**, is the managing director of a group that focuses on high profile sectors, including all areas of transportation. Ms. Hu indicated that the portfolio capital charge approach for estimating default rates was a useful tool, but it was important to note a number of issues. These issues are reviewed below:

- The portfolio modeling approach is just a tool, and only as useful as the assumptions and data that are used to structure the model. Moody's has been studying corporate default rates since the 1920's. The factors used to study corporate default rates are very different from those used to study municipal default rates. Toll road projects have limited default history. The lack of history means that the numbers will be tricky and data interpretation will be key.
- Critical mass is an issue. In order to optimize a portfolio approach which looks to blend risk, critical mass must be reached. With respect to the types of financial assistance envisioned under TIFIA, it could take a long time to build up to critical mass.
- Portfolio approaches work best when there is diversification. The portfolio of loans offered under TIFIA and TICA may exhibit geographic, size and project diversity; however, all the projects funded under the proposed Federal credit programs will be transportation projects and thus the portfolio will not have sector diversity.

Ms. Hu said that in the portfolio modeling approach, there are two levels of analysis. The

first is the micro level, which is where a probability of default is assigned to a particular project. The second is the macro level, which is where a probability of default is assigned to a portfolio of projects. The default assumptions made for the entire portfolio of loans is based on the micro-level analysis performed for the individual projects.

Ms. Hu concluded by noting that the types of projects targeted for assistance under TIFIA and TICA are start-up projects and thus involve individual project finance. She stated that project finance is perceived as one of the most complex and riskiest areas of credit analysis. When analyzing start-up projects, a probability of risk is assigned to something that does not yet exist. Therefore, it is important to perform a complete and thorough micro level analysis. The focus, therefore, should be placed on the micro level.

## Discussion

Mr. McLoughlin commented that Nathalie Cohen had performed an excellent analysis of municipal default risk. Her study, entitled *Municipal Default Risk*, was published by the Enhance Reinsurance Company. The paper had no parallel in terms of depth of its analysis of historical municipal default rates. The study looks as far back as the 1870's, and particularly focuses on defaults occurring during the great depression of the 1930's.

Mr. Litvack said that other studies on municipal default rates were performed by the Public Securities Association (PSA) and J.J. Kenny. Few studies on municipal defaults exist because municipal defaults are rare. There is a strong negative correlation between investment grade rated debt and default risk. Virtually all defaults occur in the sub investment-grade sector.

Mr. McLoughlin stated that the historical negative correlation between investment grade debt and default risk speaks well to the ability of rating agencies to assess default risk and assign ratings to bond issues.

Mr. McLoughlin asked Mr. Litvack whether the Fitch IBCA model would assign a percentage capital charge to all projects within a certain category of projects, or would the charges only be applied to specific projects, based on project-level analysis.

Mr. Litvack responded that micro-level analysis would be performed to assign a project-specific rating to each project receiving assistance under the Federal credit program. The rating would be plugged into a matrix (see Table 3) in order to assign appropriate capital charges for that project.

Mr. McLoughlin asked Ms. Hu how instrumental the Federal line of credit was in obtaining an investment grade rating on the bonds issued by the Transportation Corridor Agencies for the San Joaquin Hills Corridor Project.

Ms. Hu responded that the Federal line of credit, while helpful, was not determinative. The project still must make sense. If the project makes sense and the political, legal and structural issues are resolved, the project receives an investment-grade rating. If not, a Federal line of credit does not help. What the Federal line of credit did was provide a source of contingent revenues during the project's ramp-up phase and, most importantly, demonstrate public support for the project.

Mr. McLoughlin asked Ms. Hu how important public support was for start-up toll road projects seeking debt financing through the capital markets.

Ms. Hu responded that public support for a project was absolutely critical. When rating agencies hold discussions with project sponsors, warning bells go off when the rating agency is not hearing from Federal, State, and local governments. Government support for a project is essential, especially because of all the permitting, paperwork, and bureaucratic issues that must be addressed. If there is any doubt that public acceptance is solid, the rating agency will typically step back and delve further into the transaction.

Mr. McLoughlin asked Ms. Hu how important the subordination of Federal debt was to the San Joaquin Hills Corridor project.

Ms. Hu responded that the subordination of debt was important, but was not the key issue.

A spokesperson from the Federal Railroad Administration (FRA) stated that the scoring of Federal loans and loan guarantees was a dilemma facing the FRA. The FRA has provided loans and loan guarantees for high-speed rail, rail acquisition and track acquisition. These transactions require significant micro-level analysis. Unfortunately, FRA doesn't have the appropriate level of expertise to accurately score the budgetary costs associated with the provision of credit.

Mr. McLoughlin responded that the issue of timing was also important. Projects are not in their final form when project sponsors first come to the Federal Government for assistance. Between the time a project requests Federal assistance and it issues bonds, the project's plan evolves and may change completely.

A member of the audience stated that to qualify for assistance under TIFIA, projects would be required to produce a preliminary credit assessment by a nationally recognized rating agency. The audience member asked

Ms. Hu how Moody's would treat a project that was well on its way, but needed more refinement before it could obtain an investment grade rating.

Ms. Hu responded that Moody's might take a two-step approach to such a project. Moody's would first assign a rating estimate. The rating estimate takes into account all available information. The rating estimate states that a project is investment-grade provided key project parameters stay within a certain tolerable level of variation. The second step involves comparing the original structure of the transaction to its final form and determining whether the project parameters remained within the scope of the rating estimate. A rating is assigned if the final structure is within the bandwidth established by the rating estimate.

An audience member said that historically, bond insurers had not insured start-up toll road projects. Given recent project experience, is MBIA rethinking its position on insuring start-up toll road projects?

Mr. McLoughlin responded that start-up toll roads were assessed on a case-by-case basis. Initially, the San Joaquin Hills and Denver E-470 toll road projects were not viewed as insurable; however, when they were refinanced, MBIA was comfortable with providing unconditional guarantees for both of the projects. MBIA is not going around the country specifically looking for start-up toll road projects to insure, but it will listen to project sponsors that are interested in obtaining insurance for their projects.

A member of the audience said that there is a particular level of support that must be demonstrated over a period of time before a bond insurer will feel comfortable with start-up toll roads. There have been a couple of very successful start-up toll road facilities. Does that

mean the bond insurers are going to be more receptive to start-up toll road projects in the future? Mr. McLoughlin responded that the answer is probably yes; however, the ultimate judgment will be made on a project-by-project basis.

An audience member noted that Federal agencies face significant time constraints in assembling their budgets. Annual budget requests must include assumptions about program and project costs, including subsidy estimates for credit activity, many months before enactment and finalization of plans. How could project sponsors be assured that Federal budgetary resources would be available at subsequent times when projects are ready to draw on Federal credit?

Another audience member responded that the answer for dealing with the budgetary process lies with a two-step portfolio approach. Initial estimates of subsidy costs should be conservative placeholders, based on the capital charges and related multipliers assigned to minimum investment grade (BBB) applicants. Those conservative (high) capital charges or subsidy costs would then be revised when credit agreements are finalized and projects are ready to receive assistance.

A member of the audience suggested that the Federal Government could assess capital charges based on project type for a given project rating. For example, a five percent capital charge could be assigned to all start-up toll road projects and a three percent capital charge assigned to investment grade port facilities.

An audience member stated that it was important to note that on a project-by-project basis, the subsidy cost estimate would always be wrong. However, the aggregate, program-level estimate would be roughly accurate.

A member of the audience noted that when bond rating agencies rate an individual project, the focus is on the project's ability to pay off its debt in full and on time. Since, under TIFIA, the Federal Government would be a "patient investor" willing to accept deferrals, should the timing of the repayment be a factor?

Ms. Hu responded that the flexible features of the loans proposed under TIFIA would be important. These features would not be present in capital markets debt. In the capital markets, late payments are not acceptable.

An audience member stated that before DOT gets too involved in the credit business, it must first structure itself like a lender. Thus, DOT should establish a credit committee to review applications and provide appropriate procedural checks and balances.

An audience member noted that government agencies must be able to demonstrate due diligence when monitoring credit activities. In order to do so, officers of the Federal Government must fully understand each credit transaction. That doesn't mean that Federal officers should be second-guessing rating agencies. What it does mean is that the Federal Government could incur substantial losses if its officers failed to understand the nature of the risks associated with the provision of credit.

Mr. McLoughlin responded by stating that due diligence would be essential on the part of the lender. There are, however, some safeguards built into the market now. The projects targeted by TIFIA would have continuing disclosure obligations and senior-lien debt instruments held by the public. In theory, any private organization that somehow attempts to cloak continuing losses would be subject to anti-fraud rules. To a certain degree, there is access to information without the need to establish a separate parallel organization.

An audience member noted that because TIFIA limits Federal credit to 33 percent of project costs, the Federal Government would be sharing the risk with other investors. This co-investment should provide some reassurance.

An audience member stated that credit analysis is only one step in the process. Moreover, some projects may offer substantial economic benefits, but for one reason or another are not deemed to be credit-worthy. The policy goals should be weighed against the outcome of the credit analysis. Political considerations must also be weighed.

A member of the audience said that the projects targeted by TIFIA would be those that otherwise might be delayed or not constructed at all because of risk or cost. Part of the analysis should focus on the question of whether or not the project could be constructed in the absence of Federal credit. The Federal Government should not offer credit assistance to projects with access to the capital markets. The Federal loans envisioned under TIFIA and TICA should be viewed as credit enhancements for marginal projects.

An audience member stated that the Federal Government is in a much different position than that of a private lender. A private lender does not care about ancillary project benefits. Moreover, the Federal Government is not interested solely in the rate of return on investment. By offering Federal credit, the Federal Government is also in the enviable position of replacing grants with loans. Thus, there are other factors to weigh in addition to risk.

An audience member commented that Federal loans as proposed under TIFIA would act as a credit enhancement. The net effect of which would be to lower the overall cost of financing, reduce the risk to investors, and

lower the costs to users of the facility. The Joint Committee on Taxation (JCT) should note that in many cases, the Federal loans actually could reduce the cost of capital and thus reduce the volume of tax-exempt debt issued for transportation infrastructure.

Mr. Seltzer stated that OMB Circular A-129 specifies that Federal credit should not be repaid or refinanced with the proceeds of tax-exempt debt. If a project initially financed with Federal credit later demonstrates that it can support itself without Federal involvement, why shouldn't it be allowed to do so with tax-exempt debt? In such a case, the Federal Government is repaid in full, and the project is completed at no cost to the Federal Government.

A member of the audience responded that the Federal Government's primary objective should not be to reduce the volume of tax-exempt debt. The main objective of the Federal credit programs envisaged under TIFIA and TICA would be to provide financing to nationally significant projects. By refinancing Federal loans with tax-exempt debt, projects reduce Federal exposure and promote private investment in public infrastructure.

# Keynote Presentation on Federal Policies and Administrative Issues Relating to Federal Credit

## Introductory Remarks

David Seltzer, FHWA Senior Advisor, Office of the Administrator stated that the last discussion of the conference would focus on key Federal policy issues relating to Federal credit and administrative procedures for executing a Federal credit program. He introduced Peter J. Basso, Acting Assistant Secretary for Budget and Programs, United States Department of Transportation (DOT), as a keynote presenter and noted that he would be providing conference participants with a view from the tenth floor of the Nassif Building: the location of the Office of the Secretary of Transportation.

## Key Federal Policies and Administrative Issues Relating to Federal Credit

Peter J. Basso, Acting Assistant Secretary for Budget and Programs, United States Department of Transportation, began his presentation by noting the importance of vetting the issues relating to Federal credit. He stated that his presentation would focus on the credit-related issues deemed most relevant by the Office of the Secretary of Transportation.

Mr. Basso noted that Federal credit has historically been a very sensitive issue. The main point of contention is related to the appropriate role of government, both in terms of its taxing power and its ability to influence fiscal policy through tax rules.

Mr. Basso said that the Nation's economy relies substantially on the private capital markets to finance its activities. That being the

case, both Federal and State governments are beginning to recognize the role that the private markets could play in the financing of transportation infrastructure.

Mr. Basso stated that in recent years, a new era of public-private partnerships and financial arrangements involving credit have evolved. New financial arrangements and programs have provided both shining and disastrous moments for the Federal Government. He credited the Federal Housing Administration and Student Loan Program with making a huge difference in the standard of living of Americans during the post-World War II era. The savings and loan debacle provided a good example of how Federal involvement in the credit market may be harmful. Thus, it is not surprising that many are skeptical about the prospect of expanding Federal involvement in the credit market.

Mr. Basso said that traditionally the Federal role in funding transportation infrastructure has almost exclusively involved grant programs. Grant programs were viewed favorably for three main reasons:

- Grant programs are easier to administer.
- Grant programs involve stable, long-term trust funds.
- Grant programs involve a clearly defined flow of funds.

In recent years, the Federal Government has responded to the shortfall in conventional public funding sources by tinkering at the margins: relaxing burdensome Federal restric-

tions and regulations and providing incentives to leverage new sources of capital. Congress incorporated some of the new Federal financing innovations (e.g., grant management techniques and State Infrastructure Banks) into the National Highway System Designation Act of 1995. In addition, the Administration's National Economic Crossroads Transportation Efficiency Act proposal sought to expand the role of innovative finance by expanding the State Infrastructure Bank (SIB) program to all States and providing \$900 million in additional seed funding for the program, establishing a Federal Credit Enhancement Program in order to leverage non-Federal and private resources for projects of national significance, and codifying two more grant management concepts.

Though the Federal Government has in recent years made great progress in fiscal policy, Mr. Basso noted that DOT still prefers to minimize risk. With that said, DOT is considering the following questions:

- Is there a Federal transportation role in the private financial markets?
- If there is such a Federal role, how best can it assist project sponsors without interfering with the private capital markets?

Mr. Basso stated that the Alameda Corridor was a prime example of how a project can benefit from the provision of Federal credit assistance. In the case of the Alameda Corridor, a \$400 million loan was secured with a \$59 million subsidy appropriation.

Mr. Basso suggested that scoring was the name of the game, and that scoring rules allow the Federal Government to use minimal budget authority to achieve significant goals through cost assistance. He cautioned that the scoring process was quite difficult to understand. However, the Federal credit scoring process is

based in principles relating to revenue streams, timing of repayments, and credit-worthiness.

Mr. Basso noted that the scoring process also included a component dealing with tax revenue losses. Though there are a number of practical issues yet unresolved, it is clear that programs which induce tax-exempt debt will be scored with a tax revenue loss.

Mr. Basso stated that the Administration supports investigating Federal credit enhancement concepts. The Administration's original ISTEA reauthorization bill contained provisions that would have expanded the SIB program and established a Federal credit enhancement program.

He said that the SIB program is best suited for assisting portfolios of smaller, relatively homogenous, shorter-term projects that are regional or local in scope. Federal credit, however, was designed to provide assistance to large-scale projects of national significance. Though the term "national significance" is difficult to define, projects deemed nationally significant would most likely have the following features:

- Be difficult for State and local entities to fund with traditional grant-based financing.
- Involve a matter that the Federal Government deems to be of national interest.
- Provide economic benefits that extend beyond one region.

Mr. Basso said that the Alameda Corridor is a good example of a nationally significant project. The Alameda Corridor will generate economic activity throughout the entire Nation. He noted that the Woodrow Wilson Bridge was another good example of a nationally significant project. The Woodrow Wilson Bridge is

the only Federally owned bridge on the Interstate system. The current facility, which is located on the Capital Beltway surrounding Washington D.C., is a structural bottleneck and a major contributor to regional congestion. Current plans involve replacing the deteriorating I-95/495 drawbridge across the Potomac River with an expanded-capacity facility consisting of twin six-lane drawbridges spanning 70 feet above the Potomac. At a total cost of over \$1.7 billion, the Woodrow Wilson Bridge is a prime candidate for innovative finance and credit assistance.

Mr. Basso posed and provided responses to a number of key Federal policy and program administration questions.

- What's to prevent DOT from making a loan to a bad project? No matter how good or scientific the methodology is for scoring loans, a percentage of projects in a portfolio will always fail. Thus, he said the key for the Federal Government is to minimize risk by engaging private sector experts, performing careful analysis and budgeting for the expected losses.
- How can DOT most effectively monitor a portfolio of nationally significant projects? Projects receiving credit assistance would be required to meet payment schedules, pass practical examinations, and demonstrate credit-worthiness. The U.S. Department of Transportation has been successfully monitoring grant programs for over 90 years. Thus, he was confident that DOT could competently monitor a Federal credit program.
- Should DOT gain more experience before establishing a nationwide Federal credit program? He noted the paradoxical nature of the issue. On one hand, DOT should gain more experience before establishing a nationwide Federal credit program. On the

other, DOT cannot gain experience if it does not offer Federal credit assistance. The answer may be to establish a credit program, assess its progress carefully, and use lessons learned to improve the program over time.

Mr. Basso closed his presentation by stating that DOT plans to work closely with Congress to overcome barriers standing in the way of innovative programs. He noted, however, that DOT and Congress would need to strike a balance between innovation and prudence.

## Discussion

An audience member stated that DOT's innovative finance initiative has helped change the way in which America's transportation decision-makers and professionals think about transportation investment strategy. Increasingly, extended partnerships involving multi-agency and public-private collaboration are being seen as keys to funding strategy and implementation.

An audience member noted that the Federal budget approach to capital issues was less than intuitive. What is the likelihood of capital budget reform, or of simplifying budget scoring issues?

Mr. Basso responded that there is a capital budgeting commission currently studying the issue. The jury, however, is still out on capital budgeting. There are policy and practical concerns over how capital projects could best be budgeted.

An audience member asked about the timing for the ISTEA reauthorization.

Mr. Basso responded that there are three major issues yet to overcome. The first, "how much money is there to spend on authorization bills given the need to balance the budget?"

The second, “what are the latest economic projections?” The third and last involves the multiple factions currently debating distribution formulae. These factions must come together before a bill can be passed.

# Appendix A: Conference Agenda

Washington Grand Hyatt Hotel  
1000 H Street, NW • Washington, D.C.  
Tuesday, January 13, 1998

- 9:00 a.m.      **Coffee/Tea**
- 9:30 a.m.      **Introduction**  
*Purpose of the Roundtable; FHWA's "Searching for Solutions" Series of Research Papers on Key Public Policy Issues*  
Gloria Jeff, Deputy Administrator, Federal Highway Administration
- 9:45 a.m.      **Overview of Pending Federal Credit Legislation**  
*Outline of Provisions of TIFIA and TICA Bills*  
Dan Corbett, Staff, Senate Environment & Public Works Committee  
Andy Garfinkel, Staff, Representative Rosa DeLauro
- 10:15 a.m.     **How could Federal Credit be used by Project Sponsors?**  
*A Review of how Federal Credit was Employed by Three Transportation Projects, and an Open Discussion of Its Potential Role in Other Financings*  
Moderators: James Preusch, Alameda Corridor Transportation Authority  
Wally Kreutzen, Transportation Corridor Agencies
- 11:45 a.m.     **Break/Buffer Lunch**
- 12:30 p.m.     **What are the Federal Tax Issues relating to Credit Assistance?**  
*The "Federal Guarantee" Issue when Using Federal Credit Alongside Tax-Exempt Debt; Scoring of Indirect Tax Expenditures*  
Moderator: Mitchell Rapaport, Esq., Nixon Hargrave, Devans & Doyle
- 1:45 p.m.      **Break**
- 2:00 p.m.      **How Credit-worthy is Federal Credit?**  
*A Review of Alternative Risk-Scoring Methodologies; Implications of OMB Circular A-129 Concerning Subordination*  
Moderator: Tom McLoughlin, MBIA Insurance Corporation  
Comments: David Litvack, Fitch IBCA, Inc.  
Chee Mee Hu, Moody's Investors Service  
Peter Bianchini, Standard & Poor's
- 3:15 p.m.      **Refreshment Break**
- 3:30 p.m.      **Program Administration / Recap of Key Federal Policy Issues**  
Moderator: Peter J. Basso, Acting Assistant Secretary for Budget and Programs, U.S. Department of Transportation
- 4:15 p.m.      **Adjourn**



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# Appendix C: Panel Discussion Questions

## **Panel: How could Federal Credit be used by Project Sponsors?**

Is Federal credit the best way to help large-scale projects in light of what likely will be continuing budget constraints, or are there other forms of assistance we should be considering?

Given that the Federal Government can offer credit incentives, tax incentives, and regulatory incentives, which approaches would have the greatest benefit in stimulating more investment?

Are there market gaps which the Federal Government should address through credit, and if so, how can that be done with the least interference to the private capital markets?

If the role defined for the Federal credit program is too risky for private investors, why should the Federal Government get involved?

Do we need a Federal credit program in addition to the State Infrastructure Bank program? Given the limited experience of the State Infrastructure Bank program, is the request to create another new program premature?

Should there be concern that project sponsors will seek to maximize the amount of assistance they receive from the Federal Government in the form of direct or guaranteed loans?

Why is it necessary to have a deferral feature for principal and interest for the first 10 years?

To be truly effective, is it essential that the Federal credit be subordinate?

Are there other types of transportation projects not currently envisioned under the Federal credit program (e.g., private freight rail yards) which would benefit from the provision of credit assistance?

## **Roundtable Discussion: What are the Federal Tax Issues relating to Credit Assistance?**

If the Federal Government takes a subordinate position as a junior-lien lender, does that constitute an implicit guarantee of the private capital markets' senior debt?

Would a standby line of credit be viewed as an "indirect guarantee" under Section 149(b) of the Internal Revenue Code?

Are there other precedents of borrowers receiving both Federal credit and tax-exempt bond proceeds?

Have other Federal programs which may result in additional tax-exempt debt issuance (e.g., EPA State Revolving Funds, SIBs, FHWA Federal-aid) been scored with tax expenditures?

What is the policy rationale for Section 149(b), and what types of financing was it designed to discourage?

## **Panel: How Creditworthy is Federal Credit?**

How risky are transportation infrastructure projects generally? Is this too risky a business for the Federal Government to be in?

The Federal Credit Reform Act of 1990 requires that budget authority be provided for the “expected losses” resulting from every loan or loan guarantee. How should the credit risk of large infrastructure projects be assessed and scored against the budget?

OMB Circular A-129 prohibits paying outstanding Federal credit with the proceeds of tax-exempt obligations. Is this a desirable policy?

Could the Federal credit program set a precedent for other industry sectors to seek similar assistance? Is this a desirable outcome?

## **Keynote Presentation: Program Administration/Recap of Key Federal Policy Issues**

Are the program goals and project selection criteria outlined in the policy discussion paper appropriate, or should other factors be considered?

How should DOT assess the economic benefits of a project? Should it just consider future revenue streams or should it consider pollution reduction, congestion relief and other indirect benefits?

Should a credit program offer both guaranteed loans and direct loans, or just one or the other?

What’s to prevent DOT from making a loan to a bad project?

How can DOT best monitor a portfolio of these types of projects?

Given that the Department has limited experience with direct credit projects such as the Alameda Corridor, should more experience be gained before establishing a nationwide program?

# **Appendix D: Executive Summary of the Draft Policy Discussion Paper *Federal Credit Concepts for Surface Transportation: Exploring Concepts and Issues***

## **Introduction**

The continued growth of the U.S. economy depends, in large part, on a comprehensive and interconnected nationwide surface transportation system. The nation's growing population and increased shipping demands are straining the capacity of existing facilities. The federal-aid grant program has enabled the construction of an extensive transportation system; however, the program's financial limitations are becoming evident in the face of growing investment needs and the lack of available public funding to meet those needs. This funding shortfall is particularly acute for large new investments and major expansions of existing highways and other transportation facilities, the costs of which can amount to hundreds of millions of dollars each.

Federal assistance in the form of credit (direct loans, loan guarantees, and other lending arrangements) rather than outright grants is currently being used to stimulate investment in such sectors as housing, education, and agriculture. Federal credit has achieved important social and economic goals in these areas (e.g., affordable housing, universal access to higher education, and a stable food production system). A federal credit program oriented toward large surface transportation projects of national significance could be an important tool in helping close the current funding gap and supporting the national economy in an era of constrained public resources.

## **Budgetary Pressures Constrain Capital Investment**

Although receipts from transportation-related excise taxes have been growing at a steady rate, federal budgetary constraints limit the amount of grant assistance that can be distributed to the states. The primary form of federal assistance - the federal-aid program - reimburses state capital expenditures on transportation infrastructure at prescribed rates (historically, up to 80 or 90 percent); the remainder of project costs is covered by the states. Sole reliance on a grant-based reimbursement program may no longer be the most productive approach for funding certain large infrastructure projects. This approach is limited in range, slow to accommodate change, and unable to leverage sufficient private and non-federal capital to meet growing investment needs.

## **Federal Credit Complements Existing Programs**

A federal credit program for surface transportation projects could complement existing federal-aid grants by directing resources to transportation investments of critical national importance that otherwise might be delayed or not constructed at all because of risk, complexity, or scope. Federal credit could encourage more private sector and non-federal participation, address important public needs in a more budget-effective way, and take advantage of the public's willingness to pay user fees

in order to receive the benefits and services of transportation infrastructure sooner than would be possible under traditional, grant-based financing.

## Credit Program Objectives

The overarching goal of a surface transportation credit program should be to leverage limited federal funding in a prudent, budget-effective way in order to help advance major projects of national significance. In addressing the needs of large transportation investments, such a program should be designed to achieve six key objectives.

- 1. Target Capital Market Gaps.** A key objective of any federal credit program should be to facilitate the borrower's access to the private capital markets by overcoming market imperfections. Large, complex start-up projects frequently encounter market resistance as a result of investor concerns about investment horizon, liquidity, predictability, and risk. This is particularly the case for subordinate and secondary sources of capital. The federal government is uniquely qualified to fill the role of a patient investor, willing to accept a long-term return in order to help advance projects providing substantial benefits to the nation's economy. There may be an appropriate federal role for a carefully defined credit program to fill these gaps until the capital markets develop greater capacity to absorb these risks. Addressing these risks would reduce the transactional friction associated with large and complex project financings which is reflected in unnecessarily large reserve requirements, coverage margins, capital costs, and transaction fees.
- 2. Assist Projects of National Significance.** A credit program should be designed to assist transportation projects that are large-scale capital investments generating major economic benefits, such as trade corridors, intermodal facilities, international border crossings, and Intelligent Transportation Systems (ITS). The sum of public and private benefits would be expected to substantially exceed project costs. Given their size, many of these projects cannot be readily funded through existing government assistance programs, including state infrastructure banks. A surface transportation credit program could offer a cost-effective mechanism for financing these important national investments.
- 3. Encourage New Revenue Streams.** A credit program should be designed to assist those projects capable of generating their own revenue streams. The revenues may come from direct user charges, such as tolls or fares, or indirect beneficiary fees, such as special benefit district assessments or local dedicated tax revenues. Using revenues from beneficiaries to support part or all of the capital costs is recognized as a more equitable and efficient way of funding such projects. By assisting state and local government sponsors in identifying new project-related revenue streams, a federal credit program would allow existing state and federal grant resources to be directed toward other, more traditional projects that lack the potential to become self-sustaining.
- 4. Limit Federal Exposure by Relying on Market Discipline.** A credit program should seek to minimize the risk to the federal government of borrowers defaulting on their repayment obligations. A key element in reducing risk involves limiting the federal role to that of a minority investor (financing not greater than 33 percent of project costs). The majority investment of private capital would instill market discipline by forcing the selection of only those projects that are financially feasible and have acceptable risk profiles. Program rules should be established to ensure that project risks are assessed and scored against the federal budget in a realistic and conservative manner. The risk assessment should be based on credit analysis techniques used by the capital markets in assessing the default risk of similar infrastructure loans.

**5. Make Credit Available on Equitable and Uniform Terms.** To date, federal credit activities in the surface transport sector have been characterized by ad hoc efforts. For example, Congress in recent years has passed several pieces of special legislation assisting three major projects in California. However, the success of these transactions has stimulated considerable interest and created demand for a program structure accessible to a broader range of projects. An important objective of a surface transportation credit program, therefore, should be to establish uniform, objective, and transparent criteria for states, local governments, and other sponsors to submit applications for credit assistance, and to set forth an orderly process for evaluating, selecting, and funding projects.

**6. Enlist State and Local Participation.** More than other types of federal credit activities, large infrastructure projects depend on state and local government approval and support. A federal credit program for surface transportation projects should draw on the active involvement of state and local governmental units throughout the entire process, from the initial identification of suitable candidates to the ongoing monitoring and servicing of the credit products.

### **Credit Program Products**

A surface transportation credit program could offer four distinct types of assistance to manage the different financial needs of projects at various points in their life cycles.

**1. Flexible Payment Loans.** Given the uncertainty of projected revenue streams and operating costs for start-up transportation projects, investors may require an unusually high coverage margin for debt service. The excess coverage constrains the permitted level of annual project debt service, which limits the amount of debt that can be issued.

Flexible payment loans would be direct loans from the United States Department of Transportation (DOT) to project sponsors to provide long-term, fixed-rate financing of a portion of construction costs. The flexible payment loan could be in an amount up to 33 percent of the cost of a project and have a final maturity date as long as 35 years after construction is complete. The interest rate on the flexible payment loan would be set at a level equal to comparable-term U.S. Treasury bonds.

The loan would be repayable from project-related revenues. The terms and conditions of each loan would be negotiated between the federal government and the borrower, but would enable the federal government to accept a claim on revenues junior to the project's other senior indebtedness. In the event of default, the loan would have a parity or co-equal claim on project assets with other investors. If project revenues were insufficient to meet current debt service on the loan, interest and principal payments could be deferred.

The flexible payment loan would enable the senior debt to demonstrate higher coverage margins and attain investment-grade bond ratings. This, in turn, would facilitate project access to private capital.

**2. Loan Guarantees.** Loan guarantees by the federal government to private lenders would be designed to attract private capital on similar terms to direct loans. The guarantees could be limited to loans from large institutional investors who would be better-equipped to absorb the timing uncertainty of loan repayments.

A loan guarantee could apply to subordinate debt and be capped at 33 percent of total project costs. In the event net revenues were insufficient to meet scheduled debt service on the guaranteed

loan, repayments could be deferred for a pre-determined period of time, as with the flexible payment loan. Because the federal government would fully guarantee debt service repayments over the life of the loan, interest payments would be taxable, consistent with federal tax law. A full faith and credit guarantee of the United States should command a “AAA” rating, making such loans attractive to large purchasers of taxable debt securities. Potential investors would include public, private, and union pension plans, which to date have not been active in financing domestic infrastructure projects.

Loan guarantees of this nature would help meet the need for patient capital for revenue-backed project financing by encouraging junior-lien, flexible payment loans that enhance the coverage and creditworthiness of the senior capital market debt. As investors in guaranteed loans become more familiar with the repayment characteristics of junior start-up debt, it may ultimately be possible for them to take on the role of providing junior-lien credit for surface transportation projects without a federal back-up. This would support the program’s principle of developing private credit sources to supplant the federal role.

**3. Standby Lines of Credit.** In certain cases, investors may recognize that a project is likely to experience growth in its revenue stream over time, but they may be uncertain about the timing of the growth, especially during the ramp-up period in the years following project completion. The standby line of credit would fill a gap by providing a secondary source of capital during this critical phase of initial project utilization.

The line of credit would take the form of a government commitment to make one or more flexible payment loans in the future, if needed. The total line could not exceed 33 percent of project costs, and would be available for draws only during the ten-year ramp-up period following project completion. Up to 20 percent of the line could be loaned in any given year, and any draws would need to be repaid from project-related revenues within 35 years from project completion. These contingent loans would be structured in a similar manner to the direct flexible payment loans.

The standby line of credit is intended to assist marginally-ratable projects in attaining investment-grade bond ratings and securing bond insurance.

**4. Development Cost Insurance.** The pre-construction phase of project development is the most speculative stage. During this stage, the project sponsor must complete environmental reviews, secure permits, perform feasibility studies, and carry out various other preliminary tasks required for constructing the facility.

For traditional public projects, these costs routinely are borne by state or local governmental sponsors. For public/private partnerships, these costs often are required to be advanced largely by private developers. However, developers are becoming increasingly reluctant to finance pre-construction costs because of the large exposure, long lead times, and political risks involved.

Development cost insurance would provide federal reimbursement to a project sponsor for a portion of the pre-construction development costs in the event the project failed to proceed to construction. The federal amount of the insured development expenses could be capped at some pre-determined level (e.g., \$4 million per project). Additionally, the federal share should be limited to 40 percent of covered costs, and the government sponsor should be required to insure at least 20 percent in order to instill significant financial and political discipline. Up-front insurance premiums would be collected upon execution of the policy, thus offsetting a portion of the budgetary cost of the program. A claim on the insurance could be made at the end of five years if the project had not proceeded to

construction; however, if the project did advance at a later date, the federal insurance payment would be reimbursable. A relatively small portion of a credit program's budgetary resources – perhaps no more than ten percent – could fund a pilot program that would effectively demonstrate the potential of development cost insurance.

### **Project Selection Based on Quantitative and Qualitative Criteria**

To be considered for federal credit assistance, project sponsors would submit applications to DOT and undergo a review and selection process. The first step in the evaluation process would be to determine whether a project meets certain objectively measurable criteria. These initial threshold criteria would include project purpose, project size, whether benefits exceed costs, evidence of state and local support, and the potential for user charges or non-federal revenues. Qualified projects meeting the threshold eligibility criteria then could be evaluated and selected based on the extent to which they meet various qualitative criteria, such as promoting innovative technologies, demonstrating creditworthiness, solving special transportation needs, and fostering public/private partnerships.

### **Contract Authority to Fund Credit Costs**

In recognizing the need for a stable and predictable source of funds for multi-year surface transportation projects, Congress has legislated the use of contract authority for the federal-aid highway program since 1921. Under contract authority, sums authorized are available for obligation in advance of annual appropriations.

To facilitate the planning and structuring of large project financing arrangements involving federal credit assistance, program funding levels should be known in advance. Providing specified amounts of contract authority, rather than annual appropriations of budget authority, would ease market concerns about the availability of future funds and enable DOT to better allocate resources and avoid costly delays in committing federal credit assistance.

The commitment of federal credit assistance would require stable funding levels known in advance even more than the commitment of traditional grant reimbursements. Project candidates for federal credit assistance would tend to be larger, their financial structures would be more complex, and the majority of their funding would come from private capital predicated on the timely and assured receipt of federal credit.

A further refinement could allow states to utilize their unobligated balances of prior-year federal-aid apportionments as a source of contract authority to pay the subsidy costs of credit assistance.

### **Federal Credit to Leverage Limited Resources**

The traditional federal-aid grant program, which typically allows federal contributions of up to 80 percent of total project costs, has an implicit leveraging ratio of 1.25 to 1. A surface transportation credit program could provide meaningful assistance to certain large infrastructure projects with federal participation of no more than 33 percent of project costs. And the budgetary cost of the credit assistance, based on rating agency risk assessment models and prevailing averages for existing credit programs in other sectors, might be less than ten percent of an equivalent amount of grant assistance. Under the federal credit program structure outlined in this paper, annual capital investment of more than \$3.5 billion could be generated by \$1.2 billion of federal credit assistance at a budgetary cost of

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only \$100 million. Those amounts represent a leveraging ratio of 35 to 1 in terms of total capital investment to budgetary resources consumed.

## Federal Credit and Tax Policy Issues

A surface transportation credit program would need to address certain federal credit and tax policy issues, especially as they relate to subordination and tax-exempt debt, since many of the recipient projects would be eligible for municipal bond financing.

**1. Flexible Payment Loans.** Under the Internal Revenue Code, there is no provision that prohibits the use of tax-exempt debt simply because a portion of project costs is financed with federal funds (including direct loans). In fact, it is quite common for state and local project sponsors to finance surface transportation facilities with a combination of federal grant assistance and proceeds of tax-exempt debt.

The federal credit program structure outlined in this paper is consistent with most OMB directives on credit assistance, including the requirement of a parity claim on assets in the event of borrower default. Implementation of such a program, however, would require waiving a policy against the subordination of direct loans to the claim of tax-exempt obligations on annual project revenues. Subordination in the form of a junior lending position would be essential if the credit program were to meaningfully assist project sponsors in accessing the capital markets for the preponderance of their financing needs. Moreover, in the opinion of a major rating agency, a junior position does not increase the effective long-term risk associated with extending credit to transportation facilities.

The flexible payment loan in many cases would involve the side-by-side coexistence of direct loans with tax-exempt obligations of state and local governments, but would not involve direct or indirect federal guarantees of those tax-exempt obligations.

**2. Loan Guarantees.** Tax-exempt debt is prohibited from being supported by federal loan guarantees. Section 149 of the Internal Revenue Code provides that any obligation that benefits from a direct or indirect federal guarantee, either in whole or in part, is deemed taxable; the interest payments to investors would not be exempt from federal income taxation.

Federal loan guarantees under a surface transportation credit program would not be used to guarantee tax-exempt senior bonds. However, they could be used to secure taxable junior-lien financing where other project debt was issued on a tax-exempt basis. As taxable instruments, the guaranteed loans themselves would comply fully with Section 149. But as with the direct loan program, the loan guarantee program would require a waiver from OMB policy prohibiting the subordination of federal credit to tax-exempt obligations, since in many cases the senior project debt would be municipal bonds.

**3. Standby Lines of Credit.** The language in Section 149 of the Internal Revenue Code is so absolute (any direct or indirect guarantee in whole or in part) that the standby lines of credit could be viewed as indirect federal guarantees under current tax law. Consequently, bond counsel might not be able to render an unqualified opinion as to the tax status of bonds secured by a federal line of credit.

One way to ensure that a standby line of credit does not undermine the tax status of tax-exempt debt is to revise the Internal Revenue Code to state that a standby line of credit does not constitute a federal guarantee.

Alternatively, if the purpose for which a standby line of credit can be used is broadened to include other costs, such as extraordinary repair and replacement and operation and maintenance, in addition to debt service, the implication of a federal guarantee may be sufficiently diluted to allow bond counsel to render an unqualified legal opinion. The Transportation Corridor Agencies used this approach in conjunction with the standby lines of credit for their two toll road projects in southern California which were financed with tax-exempt debt.

**4. Development Cost Insurance.** Federal credit and tax policies pertaining to subordination and tax-exempt debt should not be applicable to any federal payments under a development cost insurance program, since these pre-construction expenses generally are funded with developer equity.

## **Conclusion**

In a fiscal environment of constrained public resources, it has become increasingly difficult to fund major transportation projects. Yet in many cases, these are precisely the types of infrastructure investments which produce the greatest economic benefits to the nation. These facilities also tend to have the potential to generate their own revenue streams, allowing them to be funded with project-based debt.

A surface transportation credit program could address the need for supplemental and subordinate capital in a highly budget-effective manner. It could enable large projects of national significance to gain significant market access with only a limited federal investment, thus leveraging substantial multiples of capital from private and other non-federal sources. Such a credit program could also help states conserve their customary federal-aid grants for smaller, but more numerous, traditional state and local projects that cannot be supported through user charges or other dedicated revenue streams.



# Appendix E: Pending Federal Credit Legislation and Side-by-Side Comparison

## Transportation Infrastructure Finance and Innovation Act of 1997 (Subtitle C, Chapter 2 of S. 1173)

### SEC. 1311. SHORT TITLE.

This chapter may be cited as the `Transportation Infrastructure Finance and Innovation Act of 1997'.

### SEC. 1312. FINDINGS.

Congress finds that--

- (1) a well-developed system of transportation infrastructure is critical to the economic well-being, health, and welfare of the people of the United States;
- (2) traditional public funding techniques such as grant programs are unable to keep pace with the infrastructure investment needs of the United States because of budgetary constraints at the Federal, State, and local levels of government;
- (3) major transportation infrastructure facilities that address critical national needs, such as intermodal facilities, border crossings, and multistate trade corridors, are of a scale that exceeds the capacity of Federal and State assistance programs in effect on the date of enactment of this Act;
- (4) new investment capital can be attracted to infrastructure projects that are capable of generating their own revenue streams through user charges or other dedicated funding sources; and
- (5) a Federal credit program for projects of national significance can complement existing funding resources by filling market gaps, thereby leveraging substantial private co-investment.

### SEC. 1313. DEFINITIONS.

In this chapter:

- (1) ELIGIBLE PROJECT COSTS- The term `eligible project costs' means amounts substantially all of which are paid by, or for the account of, an obligor in connection with a project, including the cost of--
  - (A) development phase activities, including planning, feasibility analysis, revenue forecasting, environmental review, permitting, preliminary engineering and design work, and other preconstruction activities;

(B) construction, reconstruction, rehabilitation, replacement, and acquisition of real property (including land related to the project and improvements to land), environmental mitigation, construction contingencies, and acquisition of equipment; and

(C) interest during construction, reasonably required reserve funds, capital issuance expenses, and other carrying costs during construction.

(2) FEDERAL CREDIT INSTRUMENT- The term 'Federal credit instrument' means a secured loan, loan guarantee, or line of credit authorized to be made available under this chapter with respect to a project.

(3) LENDER- The term 'lender' means any non-Federal qualified institutional buyer (as defined in section 230.144A(a) of title 17, Code of Federal Regulations (or any successor regulation), known as Rule 144A(a) of the Securities and Exchange Commission and issued under the Securities Act of 1933 (15 U.S.C. 77a et seq.)), including--

(A) a qualified retirement plan (as defined in section 4974(c) of the Internal Revenue Code of 1986) that is a qualified institutional buyer; and

(B) a governmental plan (as defined in section 414(d) of the Internal Revenue Code of 1986) that is a qualified institutional buyer.

(4) LINE OF CREDIT- The term 'line of credit' means an agreement entered into by the Secretary with an obligor under section 1316 to provide a direct loan at a future date upon the occurrence of certain events.

(5) LOAN GUARANTEE- The term 'loan guarantee' means any guarantee or other pledge by the Secretary to pay all or part of the principal of and interest on a loan or other debt obligation issued by an obligor and funded by a lender.

(6) LOCAL SERVICER- The term 'local servicer' means--

(A) a State infrastructure bank established under title 23, United States Code; or

(B) a State or local government or any agency of a State or local government that is responsible for servicing a Federal credit instrument on behalf of the Secretary.

(7) OBLIGOR- The term 'obligor' means a party primarily liable for payment of the principal of or interest on a Federal credit instrument, which party may be a corporation, partnership, joint venture, trust, or governmental entity, agency, or instrumentality.

(8) PROJECT- The term 'project' means any surface transportation project eligible for Federal assistance under title 23 or chapter 53 of title 49, United States Code.

(9) PROJECT OBLIGATION- The term 'project obligation' means any note, bond, debenture, or other debt obligation issued by an obligor in connection with the financing of a project, other than a Federal credit instrument.

(10) SECURED LOAN- The term `secured loan' means a direct loan or other debt obligation issued by an obligor and funded by the Secretary in connection with the financing of a project under section 1315.

(11) STATE- The term `State' has the meaning given the term in section 101 of title 23, United States Code.

(12) SUBSTANTIAL COMPLETION- The term `substantial completion' means the opening of a project to vehicular or passenger traffic.

#### **SEC. 1314. DETERMINATION OF ELIGIBILITY AND PROJECT SELECTION.**

(a) ELIGIBILITY- To be eligible to receive financial assistance under this chapter, a project shall meet the following criteria:

(1) INCLUSION IN TRANSPORTATION PLANS AND PROGRAMS- The project--

(A) shall be included in the State transportation plan required under section 135 of title 23, United States Code; and

(B) at such time as an agreement to make available a Federal credit instrument is entered into under this chapter, shall be included in the approved State transportation improvement program required under section 134 of that title.

(2) APPLICATION- A State, a local servicer identified under section 1317(a), or the entity undertaking the project shall submit a project application to the Secretary.

(3) ELIGIBLE PROJECT COSTS-

(A) IN GENERAL- Except as provided in subparagraph (B), to be eligible for assistance under this chapter, a project shall have eligible project costs that are reasonably anticipated to equal or exceed the lesser of--

(i) \$100,000,000; or

(ii) 50 percent of the amount of Federal-aid highway funds apportioned for the most recently-completed fiscal year under title 23, United States Code, to the State in which the project is located.

(B) INTELLIGENT TRANSPORTATION SYSTEM PROJECTS- In the case of a project involving the installation of an intelligent transportation system, eligible project costs shall be reasonably anticipated to equal or exceed \$30,000,000.

(4) DEDICATED REVENUE SOURCES- Project financing shall be repayable in whole or in part by user charges or other dedicated revenue sources.

(5) PUBLIC SPONSORSHIP OF PRIVATE ENTITIES- In the case of a project that is undertaken by an entity that is not a State or local government or an agency or instrumentality of a State or

local government, the project that the entity is undertaking shall be publicly sponsored as provided in paragraphs (1) and (2).

(b) SELECTION AMONG ELIGIBLE PROJECTS-

(1) ESTABLISHMENT- The Secretary shall establish criteria for selecting among projects that meet the eligibility criteria specified in subsection (a).

(2) SELECTION CRITERIA- The selection criteria shall include the following:

(A) The extent to which the project is nationally or regionally significant, in terms of generating economic benefits, supporting international commerce, or otherwise enhancing the national transportation system.

(B) The creditworthiness of the project, including a determination by the Secretary that any financing for the project has appropriate security features, such as a rate covenant, to ensure repayment. The Secretary shall require each project applicant to provide a preliminary rating opinion letter from a nationally recognized bond rating agency.

(C) The extent to which assistance under this chapter would foster innovative public-private partnerships and attract private debt or equity investment.

(D) The likelihood that assistance under this chapter would enable the project to proceed at an earlier date than the project would otherwise be able to proceed.

(E) The extent to which the project uses new technologies, including intelligent transportation systems, that enhance the efficiency of the project.

(F) The amount of budget authority required to fund the Federal credit instrument made available under this chapter.

(c) FEDERAL REQUIREMENTS- The following provisions of law shall apply to funds made available under this chapter and projects assisted with the funds:

[Struck out->] (1) Section 113 of title 23, United States Code. [<-Struck out]

[Struck out->] (2) [<-Struck out] (1) Title VI of the Civil Rights Act of 1964 (42 U.S.C. 2000d et seq.).

[Struck out->] (3) [<-Struck out] (2) The National Environmental Policy Act of 1969 (42 U.S.C. 4321 et seq.).

[Struck out->] (4) [<-Struck out] (3) The Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 (42 U.S.C. 4601 et seq.).

[Struck out->] (5) Section 5333 of title 49, United States Code. [<-Struck out]

**SEC. 1315. SECURED LOANS.**

(a) IN GENERAL-

(1) AGREEMENTS- Subject to paragraphs (2) and (3), the Secretary may enter into agreements with 1 or more obligors to make secured loans, the proceeds of which shall be used--

(A) to finance eligible project costs; or

(B) to refinance interim construction financing of eligible project costs of any project selected under section 1314.

(2) LIMITATION ON REFINANCING OF INTERIM CONSTRUCTION FINANCING- A loan under paragraph (1) shall not refinance interim construction financing under paragraph (1)(B) later than 1 year after the date of substantial completion of the project.

(3) AUTHORIZATION PERIOD- The Secretary may enter into a loan agreement during any of fiscal years 1998 through 2003.

(b) TERMS AND LIMITATIONS-

(1) IN GENERAL- A secured loan under this section with respect to a project shall be on such terms and conditions and contain such covenants, representations, warranties, and requirements (including requirements for audits) as the Secretary determines appropriate.

(2) MAXIMUM AMOUNT- The amount of the secured loan shall not exceed 33 percent of the reasonably anticipated eligible project costs.

(3) PAYMENT- The secured loan--

(A) shall be payable, in whole or in part, from revenues generated by any rate covenant, coverage requirement, or similar security feature supporting the project obligations or from a dedicated revenue stream; and

(B) may have a lien on revenues described in subparagraph (A) subject to any lien securing project obligations.

(4) INTEREST RATE- The interest rate on the secured loan shall be equal to the yield on marketable United States Treasury securities of a similar maturity to the maturity of the secured loan on the date of execution of the loan agreement.

(5) MATURITY DATE- The final maturity date of the secured loan shall be not later than 35 years after the date of substantial completion of the project.

(6) NONSUBORDINATION- The secured loan shall not be subordinated to the claims of any holder of project obligations in the event of bankruptcy, insolvency, or liquidation of the obligor.

(7) FEES- The Secretary may establish fees at a level sufficient to cover the costs to the Federal Government of making a secured loan under this section.

(c) REPAYMENT-

(1) SCHEDULE- The Secretary shall establish a repayment schedule for each secured loan under this section based on the projected cash flow from project revenues and other repayment sources.

(2) COMMENCEMENT- Scheduled loan repayments of principal or interest on a secured loan under this section shall commence not later than 5 years after the date of substantial completion of the project.

(3) SOURCES OF REPAYMENT FUNDS- The sources of funds for scheduled loan repayments under this section shall include tolls, user fees, or other dedicated revenue sources.

(4) DEFERRED PAYMENTS-

(A) AUTHORIZATION- If, at any time during the 10 years after the date of substantial completion of the project, the project is unable to generate sufficient revenues to pay scheduled principal and interest on the secured loan, the Secretary may, pursuant to established criteria for the project agreed to by the entity undertaking the project and the Secretary, allow the obligor to add unpaid principal and interest to the outstanding balance of the secured loan.

(B) INTEREST- Any payment deferred under subparagraph (A) shall--

(i) continue to accrue interest in accordance with subsection (b)(4) until fully repaid; and

(ii) be scheduled to be amortized over the remaining term of the loan beginning not later than 10 years after the date of substantial completion of the project in accordance with paragraph (1).

(5) PREPAYMENT-

(A) USE OF EXCESS REVENUES- Any excess revenues that remain after satisfying scheduled debt service requirements on the project obligations and secured loan and all deposit requirements under the terms of any trust agreement, bond resolution, or similar agreement securing project obligations may be applied annually to prepay the secured loan without penalty.

(B) USE OF PROCEEDS OF REFINANCING- The secured loan may be prepaid at any time without penalty from the proceeds of refinancing from non-Federal funding sources.

(d) SALE OF SECURED LOANS- As soon as practicable after substantial completion of a project, the Secretary shall sell to another entity or reoffer into the capital markets a secured loan for the project if the Secretary determines that the sale or reoffering can be made on favorable terms.

(e) LOAN GUARANTEES-

(1) IN GENERAL- The Secretary may provide a loan guarantee to a lender in lieu of making a secured loan if the Secretary determines that the budgetary cost of the loan guarantee is substantially the same as that of a secured loan.

(2) TERMS- The terms of a guaranteed loan shall be consistent with the terms set forth in this section for a secured loan, except that the rate on the guaranteed loan and any prepayment features shall be negotiated between the obligor and the lender, with the consent of the Secretary.

**SEC. 1316. LINES OF CREDIT.**

(a) IN GENERAL-

(1) AGREEMENTS- The Secretary may enter into agreements to make available lines of credit to 1 or more obligors in the form of direct loans to be made by the Secretary at future dates on the occurrence of certain events for any project selected under section 1314.

(2) USE OF PROCEEDS- The proceeds of a line of credit made available under this section shall be available to pay debt service on project obligations issued to finance eligible project costs, extraordinary repair and replacement costs, operation and maintenance expenses, and costs associated with unexpected Federal or State environmental restrictions.

(b) TERMS AND LIMITATIONS-

(1) IN GENERAL- A line of credit under this section with respect to a project shall be on such terms and conditions and contain such covenants, representations, warranties, and requirements (including requirements for audits) as the Secretary determines appropriate.

(2) MAXIMUM AMOUNTS-

(A) TOTAL AMOUNT- The total amount of the line of credit shall not exceed 33 percent of the reasonably anticipated eligible project costs.

(B) ONE-YEAR DRAWS- The amount drawn in any 1 year shall not exceed 20 percent of the total amount of the line of credit.

(3) DRAWS- Any draw on the line of credit shall represent a direct loan and shall be made only if net revenues from the project (including capitalized interest, any debt service reserve fund, and any other available reserve) are insufficient to pay [Struck out->] debt service on project obligations [<-Struck out] the costs specified in subsection (a)(2).

(4) INTEREST RATE- The interest rate on a direct loan resulting from a draw on the line of credit shall be [Struck out->] equal to [<-Struck out] not less than the yield on 30-year marketable United States Treasury securities as of the date on which the line of credit is obligated.

(5) SECURITY- The line of credit--

(A) shall be made available only in connection with a project obligation secured, in whole or in part, by a rate covenant, coverage requirement, or similar security feature or from a dedicated revenue stream; and

(B) may have a lien on revenues described in subparagraph (A) subject to any lien securing project obligations.

(6) PERIOD OF AVAILABILITY- The line of credit shall be available during the period beginning on the date of substantial completion of the project and ending not later than 10 years after that date.

(7) RIGHTS OF THIRD PARTY CREDITORS-

(A) AGAINST FEDERAL GOVERNMENT- A third party creditor of the obligor shall not have any right against the Federal Government with respect to any draw on the line of credit.

(B) ASSIGNMENT- An obligor may assign the line of credit to 1 or more lenders or to a trustee on the lenders' behalf.

(8) NONSUBORDINATION- A direct loan under this section shall not be subordinated to the claims of any holder of project obligations in the event of bankruptcy, insolvency, or liquidation of the obligor.

(9) FEES- The Secretary may establish fees at a level sufficient to cover the costs to the Federal Government of providing a line of credit under this section.

(10) RELATIONSHIP TO OTHER CREDIT INSTRUMENTS- A line of credit under this section shall not be issued for a project with respect to which another Federal credit instrument under this chapter is made available.

(c) REPAYMENT-

(1) SCHEDULE- The Secretary shall establish a repayment schedule for each direct loan under this section based on the projected cash flow from project revenues and other repayment sources.

(2) TIMING- All scheduled repayments of principal or interest on a direct loan under this section shall commence not later than 5 years after [Struck out->] substantial completion of the project [~~Struck out~~] the end of the period of availability specified in subsection (b)(6) and be fully repaid, with interest, by the date that is [Struck out->] 20 [~~Struck out~~] 25 years after the end of the period of availability specified in subsection (b)(6).

(3) SOURCES OF REPAYMENT FUNDS- The sources of funds for scheduled loan repayments under this section shall include tolls, user fees, or other dedicated revenue sources.

**SEC. 1317. PROJECT SERVICING.**

(a) REQUIREMENT- The State in which a project that receives financial assistance under this chapter is located may identify a local servicer to assist the Secretary in servicing the Federal credit instrument made available under this chapter.

(b) AGENCY; FEES- If a State identifies a local servicer under subsection (a), the local servicer--

(1) shall act as the agent for the Secretary; and

(2) may receive a servicing fee, subject to approval by the Secretary.

(c) LIABILITY- A local servicer identified under subsection (a) shall not be liable for the obligations of the obligor to the Secretary or any lender.

(d) ASSISTANCE FROM EXPERT FIRMS- The Secretary may retain the services of expert firms in the field of municipal and project finance to assist in the underwriting and servicing of Federal credit instruments.

**SEC. 1318. OFFICE OF INFRASTRUCTURE FINANCE.**

(a) DUTIES OF THE SECRETARY- Section 301 of title 49, United States Code, is amended--

(1) in paragraph (7), by striking `and' at the end;

(2) in paragraph (8), by striking the period at the end and inserting `; and'; and

(3) by adding at the end the following: `(9) develop and coordinate Federal policy on financing transportation infrastructure, including the provision of direct Federal credit assistance and other techniques used to leverage Federal transportation funds.'

(b) OFFICE OF INFRASTRUCTURE FINANCE-

(1) IN GENERAL- Chapter 1 of title 49, United States Code, is amended by adding at the end the following:

**`Sec. 113. Office of Infrastructure Finance**

`(a) ESTABLISHMENT- The Secretary of Transportation shall establish within the Office of the Secretary an Office of Infrastructure Finance.

`(b) DIRECTOR- The Office shall be headed by a Director who shall be appointed by the Secretary not later than 180 days after the date of enactment of this section.

`(c) FUNCTIONS- The Director shall be responsible for--

`(1) carrying out the responsibilities of the Secretary described in section 301(9);

(2) carrying out research on financing transportation infrastructure, including educational programs and other initiatives to support Federal, State, and local government efforts; and

(3) providing technical assistance to Federal, State, and local government agencies and officials to facilitate the development and use of alternative techniques for financing transportation infrastructure.'

(2) CONFORMING AMENDMENT- The analysis for chapter 1 of title 49, United States Code, is amended by adding at the end the following:

113. Office of Infrastructure Finance.'

#### **SEC. 1319. STATE AND LOCAL PERMITS.**

The provision of financial assistance under this chapter with respect to a project shall not--

(1) relieve any recipient of the assistance of any obligation to obtain any required State or local permit or approval with respect to the project;

(2) limit the right of any unit of State or local government to approve or regulate any rate of return on private equity invested in the project; or

(3) otherwise supersede any State or local law (including any regulation) applicable to the construction or operation of the project.

#### **SEC. 1320. REGULATIONS.**

The Secretary may issue such regulations as the Secretary determines appropriate to carry out this chapter and the amendments made by this chapter.

#### **SEC. 1321. FUNDING.**

(a) AUTHORIZATION OF CONTRACT AUTHORITY-

(1) IN GENERAL- There shall be available from the Highway Trust Fund (other than the Mass Transit Account) to carry out this chapter--

(A) \$60,000,000 for fiscal year 1998;

(B) \$60,000,000 for fiscal year 1999;

(C) \$90,000,000 for fiscal year 2000;

(D) \$90,000,000 for fiscal year 2001;

(E) [Struck out->] \$100,000,000 [<-Struck out] \$115,000,000 for fiscal year 2002; and

(F) [Struck out->] \$100,000,000 [<-Struck out] \$115,000,000 for fiscal year 2003.

(2) ADMINISTRATIVE COSTS- From funds made available under paragraph (1), the Secretary may use, for the administration of this chapter, not more than \$2,000,000 for each of fiscal years 1998 through 2003.

(3) AVAILABILITY- Amounts made available under paragraph (1) shall remain available until expended.

(b) CONTRACT AUTHORITY-

(1) IN GENERAL- Notwithstanding any other provision of law, approval by the Secretary of a Federal credit instrument that uses funds made available under this chapter shall be deemed to be acceptance by the United States of a contractual obligation to fund the Federal credit instrument.

(2) AVAILABILITY- Amounts authorized under this section for a fiscal year shall be available for obligation on October 1 of the fiscal year.

(c) LIMITATIONS ON CREDIT AMOUNTS- For each of fiscal years 1998 through 2003, principal amounts of Federal credit instruments made available under this chapter shall be limited to the amounts specified in the following table:

<b>Fiscal Year:</b>	<b>Maximum amount of credit:</b>
1998.....	\$1,200,000
1999.....	\$1,200,000
2000.....	\$1,800,000
2001.....	\$1,800,000
2002.....	\$2,000,000
2003.....	\$2,000,000

**SEC. 1322. REPORT TO CONGRESS.**

Not later than 4 years after the date of enactment of this Act, the Secretary shall submit to Congress a report summarizing the financial performance of the projects that are receiving, or have received, assistance under this chapter, including a recommendation as to whether the objectives of this chapter are best served--

(1) by continuing the program under the authority of the Secretary;

(2) by establishing a Government corporation or Government-sponsored enterprise to administer the program; or

(3) by phasing out the program and relying on the capital markets to fund the types of infrastructure investments assisted by this chapter without Federal participation.

## **Transportation Infrastructure Credit Act of 1997 (H.R. 2330)**

### **SECTION 1. SHORT TITLE.**

This Act may be cited as the 'Transportation Infrastructure Credit Act of 1997'.

### **SEC. 2. FINDINGS.**

Congress finds the following:

- (1) The economic vitality of the Nation and the quality of life of its citizens depend upon continued investment in surface transportation infrastructure for the movement of both people and goods.
- (2) The Nation's needs for additional infrastructure investment in both rural and urban areas exceed available resources under traditional programs.
- (3) While recent Federal initiatives have equipped States with new financing tools, large infrastructure projects of national significance cannot be adequately funded through existing programs and require new forms of assistance.
- (4) A capital investment program for constructing, reconstructing, and expanding infrastructure will create both direct and indirect jobs.
- (5) Improved surface access to seaports and airports through investing in intermodal facilities and developing trade corridors will stimulate exports and enhance the Nation's competitiveness in the world economy.
- (6) Fostering public-private partnerships will attract private capital and advance necessary projects through the development stage.

### **SEC. 3. DEFINITIONS.**

In this Act, the following definitions apply:

- (1) **DIRECT LOAN-** The term 'direct loan' means any loan, line of credit, or other similar Federal credit assistance provided to an obligor in connection with the financing of a project under section 5 or 6.
- (2) **ELIGIBLE PROJECT COST-** The term 'eligible project cost' means all amounts paid by or for the account of an obligor or insured in connection with a project, including--
  - (A) development phase activities, including planning, feasibility analysis, environmental review, permitting, preliminary engineering and design work, and other preconstruction activities;
  - (B) construction, reconstruction, rehabilitation, replacement, and acquisition of real property, and the acquisition of equipment; and

- (C) interest during construction, reasonably required reserve funds, and issuance expenses.
- (3) FEDERAL CREDIT INSTRUMENT- The term `Federal credit instrument' means a direct loan, loan guarantee, or line of credit authorized to be made available under this Act with respect to a project.
- (4) INSURED- The term `insured' means any party that is the beneficiary of project development cost insurance under section 7, whether a corporation, partnership, joint venture, trust, or governmental entity or instrumentality, except that if such entity is not a State or local government or any agency thereof, the project it is undertaking shall be publicly sponsored, as provided in paragraphs (1) and (2) of section 4(a).
- (5) LENDER- The term `lender' means any non-Federal qualified institutional buyer (as defined in section 230.144A(a) of title 17, Code of Federal Regulations (or any successor regulation), known as rule 144(a) of the Securities and Exchange Commission and issued under the Securities Act of 1933 (15 U.S.C. 77a et seq.)), including--
- (A) a qualified retirement plan (as defined in section 4974(c) of the Internal Revenue Code of 1986) that is a qualified institutional buyer; and
  - (B) a governmental plan (as defined in section 414(d) of the Internal Revenue Code of 1986) that is a qualified institutional buyer.
- (6) LINE OF CREDIT- The term `line of credit' means a commitment by the Secretary to make 1 or more direct loans at future dates subject to the occurrence of certain events.
- (7) LOAN GUARANTEE- The term `loan guarantee' means any guarantee or other pledge by the Secretary to pay all or a part of the principal of and interest on a loan or other debt obligation issued by an obligor and funded by a lender.
- (8) LOCAL SERVICER- The term `local servicer' means a State infrastructure bank established under section 350 of the National Highway System Designation Act of 1995 (109 Stat. 618), or a State or local government or any agency thereof that is responsible for servicing a direct loan on behalf of the Secretary.
- (9) OBLIGOR- The term `obligor' means any party primarily liable for payment of the principal of or interest on any direct loan made under section 5 or 6, whether a corporation, partnership, joint venture, trust, or governmental entity or instrumentality, except that if such entity is not a State or local government or any agency thereof, the project it is undertaking shall be publicly sponsored, as provided in paragraphs (1) and (2) of section 4(a).
- (10) PROJECT- The term `project' means any surface transportation facility eligible for Federal assistance under title 23 or chapter 53 of title 49, United States Code.
- (11) PROJECT OBLIGATION- The term `project obligation' means any note, bond, debenture, or other evidence of indebtedness issued by an obligor in connection with the financing of a project other than a direct loan provided under this Act.
- (12) SECRETARY- The term `Secretary' means the Secretary of Transportation.

(13) STATE- The term `State' shall have the meaning such term has in section 101 of title 23, United States Code.

(14) SUBSTANTIAL COMPLETION- The term `substantial completion' means the time at which a project opens to vehicular, passenger, or freight traffic.

#### SEC. 4. DETERMINATION OF ELIGIBILITY AND PROJECT SELECTION.

(a) ELIGIBILITY- For a project to receive financial assistance under this Act, it must meet the following criteria:

(1) The project shall satisfy the applicable statewide planning requirements of section 135 of title 23, United States Code, and the metropolitan planning requirements of section 134 of title 23, United States Code, at the time any loan or insurance agreement is entered into under this Act.

(2) The project application shall be submitted to the Secretary by a State or a local servicer.

(3) Eligible project costs must equal or exceed the lesser of \$100,000,000 or 50 percent of the most recent annual amount of Federal-aid highway funds apportioned under title 23, United States Code, to the State in which the project is located.

(4) Project financing shall be payable in whole or in part by user charges or other dedicated revenue sources.

(b) SELECTION AMONG ELIGIBLE PROJECTS- The Secretary shall establish criteria for selecting among projects that meet the eligibility criteria of subsection (a). Such selection criteria shall include--

(1) the extent to which the project is nationally significant, including the extent to which the project will transport passengers or freight at lower costs or higher efficiency, will advance multistate corridors, or will otherwise promote metropolitan, regional, interstate, or international commerce;

(2) the creditworthiness of the project;

(3) the extent to which assistance under this Act would foster innovative public-private partnerships and attract private debt or equity investment;

(4) the likelihood that assistance under this Act would enable the project to proceed at an earlier date than would be the case otherwise; and

(5) the amount of budget authority required to fund the direct loan or project development cost insurance provided under this Act.

(c) FEDERAL REQUIREMENTS- All requirements of titles 23 and 49, United States Code, shall apply to funds made available under this Act and projects assisted with such funds unless the Secretary determines that any such requirement, other than section 113 of title 23, United States Code, is inconsistent with any provision of this Act. Nothing in this subsection shall affect any responsibility or obligation of the Secretary under any other Federal law, including the National

Environmental Policy Act of 1969 (42 U.S.C. 4321 et seq.), title VI of the Civil Rights Act of 1964 (42 U.S.C. 2000d et seq.), and the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 (42 U.S.C. 4601 et seq.).

## **SEC. 5. FLEXIBLE PAYMENT LOANS.**

(a) **IN GENERAL-** The Secretary is authorized to enter into agreements with 1 or more obligors to make direct loans pursuant to the Federal Credit Reform Act of 1990 the proceeds of which are used either to finance eligible project costs or refinance interim construction financing of such costs of any project selected under section 4, except that no loan agreement shall refinance interim construction financing later than 1 year after substantial completion of construction.

### **(b) TERMS AND LIMITATIONS-**

(1) A loan agreement under this section shall be on such terms and conditions and contain such covenants, representations, warranties, and requirements (including requirements for audits) as the Secretary determines.

(2) A direct loan shall have a lien on project revenues or other dedicated revenue sources, and may be subject to prior liens securing project obligations; however, any Federal claim on project assets shall not be subordinated to the claims of other lenders in the event of default by the obligor.

(3) The Secretary shall not make a direct loan exceeding 33 percent of eligible project costs.

(4) The final maturity date of a direct loan shall not exceed 30 years from the date of substantial completion.

(5) The interest rate on a direct loan shall equal the yield on marketable United States Treasury securities with a similar maturity to that of such direct loan on the date of execution of the loan agreement.

(c) **REPAYMENT-** Loan repayments on a direct loan must commence not later than 5 years after substantial completion of the project and shall be payable not less frequently than semiannually. In the event that, in the first 10 years following substantial completion, the project (after paying operation and maintenance costs or debt service on any project obligations senior to the direct loan) is unable to generate sufficient revenues to pay scheduled principal and interest, the Secretary may allow the obligor to add unpaid principal and interest to the outstanding balance of the direct loan, if the obligor demonstrates that it is using due diligence to increase revenues or decrease costs so as to become current in its payments.

### **(d) LOAN GUARANTEES-**

(1) **IN GENERAL-** The Secretary may provide a loan guarantee to a lender in lieu of making a direct loan.

(2) **TERMS-** The terms of a guaranteed loan shall be consistent with those set forth in this section for a direct loan, except that the rate on the guaranteed loan and any prepayment features shall be negotiated between the obligor and the lender, with the consent of the Secretary.

## SEC. 6. STANDBY LINES OF CREDIT.

(a) IN GENERAL- The Secretary is authorized to enter into agreements with 1 or more obligors to make direct loans pursuant to the Federal Credit Reform Act of 1990 at future dates in the form of lines of credit for any project selected under section 4. The proceeds of a line of credit provided under this section shall be available to pay debt service on project obligations issued to finance eligible project costs.

(b) TERMS AND LIMITATIONS- A line of credit provided under this section shall be subject to the following conditions:

(1) A line of credit under this section shall be on such terms and conditions and contain such covenants, representations, warranties, and requirements (including requirements for audits), as the Secretary determines.

(2) A draw on a line of credit shall only be made if net revenues from the project (including capitalized interest, any debt service reserve fund, or any other available reserves) are insufficient to pay debt service on project obligations.

(3) A line of credit shall be available during the period beginning on the date of substantial completion and ending no later than the day that is 10 years following such date.

(4) The total amount of a line of credit shall not exceed 33 percent of eligible project costs, and the amount drawn in any single year shall not exceed 20 percent of the total amount of the line of credit.

(5) Any draw on a line of credit under this section shall represent a direct loan as defined in the Federal Credit Reform Act of 1990 and shall be repaid within 30 years from the date of such draw.

(6) The interest rate on a draw shall equal the yield on 30-year marketable United States Treasury securities as of the date the line of credit is committed.

(7) No third party creditor of the obligor shall have any right against the Federal Government with respect to any draw on a line of credit.

(8) A line of credit shall not be issued for a project that is also the recipient of a flexible payment loan under section 5.

(c) REPAYMENT- Loan repayments shall commence within 5 years of a draw and shall be payable not less frequently than semi-annually. The direct loan evidencing the draw shall have a lien on project revenues or other dedicated revenue sources, and may be subject to prior liens securing project obligation; however, any Federal claim on project assets shall not be subordinated to the claims of other lenders in the event of default by the obligor. In the event that, in the first 10 years following substantial completion, the project (after paying operation and maintenance costs or any debt service on project obligations senior to the draw) is unable to generate sufficient revenues to pay scheduled principal and interest, the Secretary may allow the obligor to add unpaid principal and interest to the outstanding balance of the draw, if the obligor demonstrates that it is using due

diligence to increase revenues or decrease costs so as to become current in its payments. Unpaid interest or principal shall continue to accrue interest until the next payment date.

## **SEC. 7. PROJECT DEVELOPMENT COST INSURANCE PILOT PROGRAM.**

(a) **IN GENERAL-** The Secretary may establish a pilot program to encourage public-private partnerships and facilitate infrastructure development by entering into agreements with 1 or more insureds to provide insurance for preconstruction costs associated with any project selected under section 4. Such program shall be designed to efficiently and equitably allocate risks and responsibilities among governmental sponsors and private developers of projects anticipated to be supported in whole or in part by user charges or other dedicated revenue sources. Such program shall provide insurance for the noncommercial risks and other preconstruction costs, as defined in section 3(2)(A).

(b) **TERMS AND SCOPE OF COVERAGE-** The insurance provided under this section may cover preconstruction costs incurred by an insured for a project selected under section 4 that will not proceed to construction due to inability to secure governmental permits and approvals, challenges to such permits and approvals, events of force majeure, or other factors, as determined by the Secretary, in accordance with the following terms:

(1) The Federal share of any insurance provided under this section shall not exceed 40 percent of the project costs included in section 3(2)(A). Such costs must be incurred subsequent to the date of issuance of the insurance. In no case may the Federal share exceed \$4,000,000.

(2) The State or local government share of any insurance provided under this section shall equal at least 20 percent of the project costs included in section 3(2)(A), unless the Secretary determines otherwise.

(3) The Secretary may impose such other conditions and requirements in connection with any insurance provided under this section as the Secretary deems appropriate, including requirements for audits.

(c) **PAYMENT OF CLAIMS AND REIMBURSEMENT-** Upon determining that a project insured under this section will not proceed to construction within 5 years from the date of issuance of the insurance, the Secretary shall pay the insured the Federal share of the insurance. The Secretary may require the insured to reimburse the Secretary for any proceeds paid under this section if the project later proceeds to construction.

(d) **INSURANCE FEES-** The Secretary may charge such fees and obtain other compensation for providing insurance coverage under this section as the Secretary deems appropriate, payable upon execution of the insurance agreement. Such fees and compensation shall be deposited into the Highway Trust Fund (other than the Mass Transit Account).

## **SEC. 8. PROJECT SERVICING.**

The State in which a project receiving financial assistance under this Act is located shall identify a local servicer to assist the Secretary in servicing the direct loan or insurance provided under this Act. Such local servicer shall act as the agent for the Secretary, and may receive a servicing fee,

subject to approval by the Secretary. Such local servicer shall not be liable for the obligations of the obligor to the Secretary.

## SEC. 9. OFFICE OF INFRASTRUCTURE FINANCE.

(a) DUTIES OF THE SECRETARY- Section 301 of title 49, United States Code, is amended--

(1) in paragraph (7), by striking 'and' at the end;

(2) in paragraph (8), by striking the period at the end and inserting '; and'; and

(3) by adding at the end the following: '(9) develop and coordinate Federal policy on financing transportation infrastructure, including the provision of direct Federal credit assistance and other techniques used to leverage Federal transportation funds.'

(b) OFFICE OF INFRASTRUCTURE FINANCE-

(1) IN GENERAL- Chapter 1 of title 49, United States Code, is amended by adding at the end the following:

### 'Sec. 113. Office of Infrastructure Finance

'(a) ESTABLISHMENT- The Secretary of Transportation shall establish within the Office of the Secretary an Office of Infrastructure Finance.

'(b) DIRECTOR- The Office shall be headed by a Director who shall be appointed by the Secretary not later than 180 days after the date of enactment of this section.

'(c) FUNCTIONS- The Director shall be responsible for--

'(1) carrying out the responsibilities of the Secretary described in section 301(9);

'(2) carrying out research on financing transportation infrastructure, including educational programs at a designated academic center and other initiatives to support Federal, State, and local government efforts; and

'(3) providing technical assistance to Federal, State, and local government agencies and officials to facilitate the development and use of alternative techniques for financing transportation infrastructure.'

(2) CONFORMING AMENDMENT- The analysis for chapter 1 of title 49, United States Code, is amended by adding at the end the following:

'113. Office of Infrastructure Finance.'

## SEC. 10. RULES AND REGULATIONS.

The Secretary is authorized to make such rules and regulations as deemed necessary or appropriate to carry out the purposes and provisions of this Act.

## **SEC. 11. STATE AND LOCAL PERMITS.**

The provision of financial assistance under this Act shall not--

- (1) relieve any recipient of such assistance of any obligation to obtain any required State or local permits and approvals;
- (2) limit the right of any State or local governmental unit to approve or regulate rates of return on private equity invested in a project; or
- (3) otherwise supersede any State or local law or regulation applicable to the construction or operation of such project.

## **SEC. 12. FUNDING.**

(a) DETERMINATION OF BUDGET AUTHORITY- The Secretary shall estimate the budget authority associated with providing financial assistance to projects under this Act utilizing credit models of 1 or more independent, nationally-recognized rating agencies.

(b) USE OF UNOBLIGATED BALANCES- Notwithstanding any limitation on obligations for Federal-aid highways and highway safety construction programs, a State may obligate in a fiscal year the unobligated balances of funds apportioned to the State in the preceding 3 fiscal years under section 104(b)(1), 104(b)(2), 104(b)(3), 104(b)(5)(B), 144, or 160 of title 23, United States Code, or funds allocated to the State in the preceding 3 fiscal years under section 157 of such title or section 1013(c) or 1015 of the Intermodal Surface Transportation Efficiency Act of 1991, for the budget costs of providing financial assistance under this Act, as estimated by the Secretary under subsection (a).

(c) REESTIMATES OF BUDGET COSTS- Any reestimates of costs resulting in increases in budget authority necessary to fund the financial assistance provided under this Act shall be funded from the General Fund of the Treasury.

(d) LIMITATIONS ON OBLIGATIONS-

(1) IN GENERAL- Obligations authorized under subsection (b) of this section to fund estimated budget costs shall be limited to \$100,000,000 for each of fiscal years 1998 through 2003.

(2) BUDGET COSTS OF INSURANCE- Not more than 10 percent of the obligational authority made available annually under this section shall be used to fund the budget costs of insurance under section 7 of this Act.

(e) LIMITATIONS ON CREDIT AMOUNTS- Principal amounts of Federal credit instruments and the Federal share of insurance coverage provided under this Act shall not exceed \$2,000,000,000 for each of fiscal years 1998 through 2003.

(f) SPECIAL RULE FOR URBANIZED AREAS- Funds apportioned or allocated under section 104(b)(2), 104(b)(3), or 160 of title 23, United States Code, or under section 1013(c) or 1015 of the Intermodal Surface Transportation Efficiency Act of 1991, and attributed to an urbanized area with a population of over 200,000 under section 133(d)(2) of such title, may be obligated for the budget

costs of projects receiving financial assistance under this title only if the metropolitan planning organization designated for such urbanized area concurs, in writing, with such obligation.

**SEC. 13. REPORT TO CONGRESS.**

Not later than 5 years after the date of the enactment of this Act, the Secretary shall transmit to Congress a report on the benefits, if any, of transferring the operation of the programs established by this Act to a Government corporation or other Government-sponsored enterprise.

**TRANSPORTATION INFRASTRUCTURE CREDIT ACT  
VS.  
TRANSPORTATION INFRASTRUCTURE FINANCE AND INNOVATION ACT**

**TICA**

\$600 million federal investment over six years for projects of “national significance.”

Supports up to \$12 billion in nominal amount of federal credit, and up to \$36 billion in total investment.

Contains Direct Loans available through the U.S. Department of Transportation to cover up to one-third of the cost of a project.

Contains Stand-by Lines of Credit that provide partial credit enhancement by making loans to pay debt service on project debt, if needed. This helps investors ensure that debt is covered during the first ten years after projects are constructed, when the revenue stream (tolls, user fees) is being established.

Contains Guaranteed Loans that would cover 100 percent of the principal and interest on the federal portion of project debt (up to one-third) of project costs.

Contains Development Cost Insurance that would insure up to 40 percent of projects’ pre-construction costs, such as preliminary engineering and environmental impact studies.

Draws upon existing budget authority to pay the “subsidy costs” of federal credit through each state’s unobligated balances of Federal-aid highway trust funds.

Establishes an Office of Infrastructure Finance within DOT to administer credit assistance.

**TIFIA**

\$530 million federal investment over six years for projects of “national significance.”

Supports up to \$10 billion in nominal amount of federal credit, and up to \$30 billion in total investment.

Contains Secured (Direct) Loans available through the U.S. Department of Transportation to cover up to one-third of the cost of a project.

Contains Stand-by Lines of Credit that provide partial credit enhancement by making loans to pay debt service on project debt, if needed. This helps investors ensure that debt is covered during the first ten years after projects are constructed, when the revenue stream (tolls, user fees) is being established.

Contains Guaranteed Loans that would cover 100 percent of the principal and interest on the federal portion of project debt (up to one-third) of project costs.

Contains no such provision.

Draws upon new budget authority to pay the “subsidy costs” of federal credit.

Establishes an Office of Infrastructure Finance within DOT to administer credit assistance.



# Appendix F: Case Studies

## Alameda Corridor Project

In January 1997, DOT and the Alameda Corridor Transportation Authority (ACTA) entered into a loan agreement that will provide \$400 million in project financing for the Alameda Corridor Project. The project is comprised of rail and road improvements that, once completed, will consolidate port-related freight traffic onto a 20-mile high speed, high capacity and fully grade-separated transportation corridor linking the San Pedro Bay Ports with key transcontinental rail yards near downtown Los Angeles (see Figure F1).

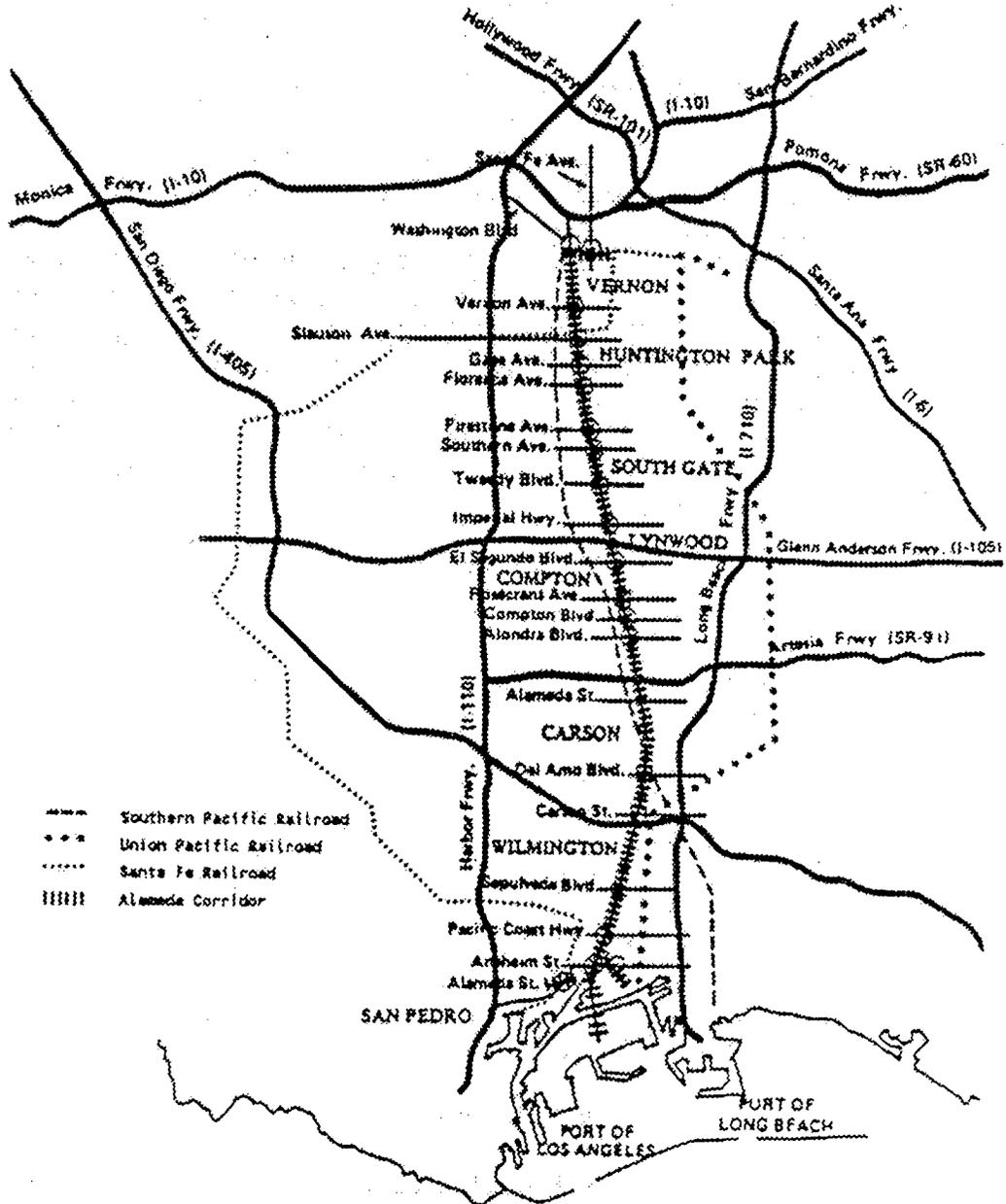
The San Pedro Bay port complex consists of the adjacent Ports of Los Angeles and Long Beach. Together, they represent the Nation's largest port facility, handling about 25 percent of the Nation's international waterborne trade valued at \$120 billion per year. The ports are a key gateway to the burgeoning Pacific Rim, handling cargo for numerous industries that is shipped to virtually every region of the country. In addition to relieving local congestion and creating 10,000 construction-related jobs, the project will expedite the nationwide delivery of freight and generate far-reaching economic benefits.

### Project Background and Description

As the San Pedro Bay seaports have grown as centers of international commerce, the current transportation infrastructure has become increasingly unable to accommodate approximately 108 million tons of freight cargo passing through the ports on an annual basis. That is why, after 20 years of discussion and analysis, city leaders and port officials, with the help of the Federal Government, are beginning construction on rail and road facilities that will vastly improve the connection between the two ports and the region's rail hub near downtown Los Angeles. Once completed, the two billion dollar Alameda Corridor will include the following features:

- A 30-foot-deep trench running alongside Alameda Street accommodating two parallel rail lines;
- An additional rail line at ground level accommodating local traffic;
- A bridge spanning the Los Angeles River;
- Improvements to street access across the corridor;
- The expansion of portions of Alameda Street from four to six lanes; and
- Grade-separations to Amtrak and MetroLink passenger lines.

Figure F1  
Alameda Transportation Corridor



## **Financial Obstacles to Project Development**

The high cost of the Alameda Corridor (\$2.04 billion) and the project's unusual revenue sources (container fees and port charges) presented a substantial barrier to ACTA's ability to advance the project in a timely manner. Though the Alameda Corridor was designated as a High Priority Corridor on the National Highway System, the size and scope of the project made it difficult for ACTA to attract sufficient capital from traditional sources. Thus, the need to find a supplementary means of financing the project became a priority. Initially, ACTA sought Federal assistance in the form of a special \$700 million grant. Due to Federal budgetary constraints, however, the grant was not deemed to be a fiscally or politically viable option.

## **Direct Federal Loan**

The fiscal year 1997 Omnibus Consolidated Appropriations Act (Public Law 104-208) provided \$58.7 million for DOT to pay the capital charges (subsidy costs) associated with making a direct loan of up to \$400 million to ACTA for the Alameda Corridor Project. This represents a budgetary cost of only 14.7 percent subsidy cost of the face value of credit assistance. The legislation also provided that the loan be repaid within 30 years from the date of project completion and that the interest rate on the loan not exceed the 30-year Treasury rate.

The Federal loan represents permanent financing for approximately 20 percent of project costs. The first \$140 million of loan proceeds were drawn down in September 1997. The loan is secured by a rate covenant, but is structured to include flexible repayment provisions that allow scheduled principal and interest payments to be deferred (with interest), in the event of insufficient project revenues. The Federal loan's claim on revenues is junior to that of ACTA's senior bonds, which are expected to be issued in 1998. The combination of the flexible payment structure and the subordinate-lien will enhance the coverage ratio on ACTA's senior bonds. This will facilitate ACTA's ability to obtain a favorable rating on its senior debt, and substantially reduce its interest expenses and transaction costs.

At a budgetary cost of \$59 million, the Federal Government is providing a \$400 million loan that will help advance a \$2 billion project with significant local, regional, and national benefits. With regard to the Federal credit assistance, this represents a leveraging ratio of 35 to 1 in terms of capital investment induced to budgetary resources consumed.

As shown in Table F1, the Federal loan is but one piece of a complex financial package. The Los Angeles and Long Beach port commissions have already paid \$400 million in right-of-way costs for the property located along the corridor route. Additionally, ACTA plans to issue approximately \$785 million of senior revenue bonds in 1998, a portion of which will be tax-exempt and a portion of which will be taxable. The Los Angeles County Metropolitan Transportation Authority is supplying another \$348 million from its allocation of the State's regular Federal-aid funds.

**Table F1**  
**Alameda Corridor Funding Sources**  
**(In \$Millions)**

Ports	\$ 411
Federal Loan	400
MTA	348
Prop. 116, EDA, ISTEPA	109
Bond Financing	785
<b>Total</b>	<b>\$2,053</b>

### **Transportation Corridor Agencies (TCA) Toll Roads in Orange County, California**

The Transportation Corridor Agencies (TCA) are multi-jurisdictional authorities charged with construction of new toll road facilities in Orange County, California. The TCA has funded the pre-construction costs of these facilities largely with development impact fees. Little (or no) direct State and Federal financial assistance has been provided for this project phase. To finance construction of its toll roads, TCA has sold two separate bond issues, each raising well in excess of one billion dollars for the San Joaquin Hills Transportation Corridor in 1993 (\$1.2B) and the Foothill/Eastern Transportation Corridor (\$1.5B) in 1995.

In each case, project financing was supported with Federal credit enhancement provided in the form of a standby line of credit. This pioneering and novel credit enhancement mechanism provided important assistance in attracting private capital to the project bond issues. In the underlying legislative provisions, the Department of Transportation (DOT) was authorized to provide a credit line of up to \$120 million to the San Joaquin Hills Transportation Corridor and another line of up to \$120 million to the Foothill/Eastern Transportation Corridor as partial security underpinning each bond issue. These Federal lines of credit, available for a ten-year period upon completion of each facility are intended to provide limited supplemental capital for extraordinary repair and replacement of facilities; unexpected Federal or State environmental restrictions; operations and maintenance expenses; and, debt service in the event that traffic shortfalls arise with an adverse impact on revenues (impairing debt service coverage) during the ramp-up phase.



## SAN JOAQUIN HILLS CORRIDOR

### Project Description

The San Joaquin Hills Transportation Corridor (SJHTC) toll road is the first new public toll facility being developed by TCA. The SJHTC is a 15-mile, six-lane, limited access highway in southwestern Orange County (see previous map). The new toll road is designed to relieve congestion on the heavily traveled I-405, I-5, and Pacific Coast Highway, as well as other major arterial roads in the county. The toll road's initial design includes six travel lanes (three in each direction) and associated facilities with a median to allow for the future construction of general purpose, high occupancy vehicle (HOV) lanes or transit options.

The project was constructed pursuant to a design/build contract with a guaranteed maximum price and guaranteed completion date. The corridor will operate as a toll facility until the bonds are retired. The State of California assumed ownership of the SJHTC with the opening of the toll road to commercial traffic in November 1996 and its formal acceptance by the California Department of Transportation (Caltrans). Caltrans is responsible for traffic operations, maintenance, and liability, pursuant to a Cooperative Agreement between TCA and Caltrans. The toll collection facilities and equipment have been provided by Lockheed Martin IMS. Lockheed is responsible for system design, installation, operations, and maintenance of the toll facilities under purchase and operations contracts with TCA. The TCA will continue to own or lease the toll collection facilities.

### Project Financing

Total costs for the initial project were approximately \$1.45 billion. Financing sources included a combination of senior- and junior-lien tax-exempt toll revenue bonds, vendor financing, development impact fees, and Federal and State funding as outlined in Table F2.

Nearly \$1.1 billion of senior-lien toll revenue bonds were issued in 1993, consisting of \$766 million in Current Interest Bonds, \$150 million in Convertible Capital Appreciation Bonds, and \$163 million in Capital Appreciation Bonds. The senior bonds were rated BBB by Fitch Investors Service, Inc. An additional \$91 million of non-rated bonds were issued on a junior-lien basis and sold to institutional investors.

**Table F2**  
**San Joaquin Hills Corridor**  
**Sources of Funds (In \$Millions)**

Senior-lien Revenue Bonds	\$1,079
Junior-lien Revenue Bonds	91
Project Revenue Certificates	38
Advance-funded Development Impact Fees	31
California Transportation Commission Grant	40
State and Local Transportation Partnership Program	71
Interest Earnings	106
<b>Total</b>	<b>\$1,456</b>

Almost \$38 million of third-lien vendor financing notes were purchased by the project's developers as part of their compensation under the design/build contract in lieu of cash. This served to align the interest of the developers with those of the senior and junior bond holders in seeking a commercially successful project.

State and local funding support for the project was provided through the 1992 State Transportation Improvement Program (STIP) and the California State and Local Transportation Partnership Program (SLTPP). Approximately \$40 million was allocated under the STIP for the purpose of funding a portion of the construction costs of connecting the SJHTC to I-5. The SLTPP contributed approximately \$71 million.

On September 25, 1997, TCA sold \$1.45 billion of Toll Road Revenue Bonds, which refunded all but \$220 million of the outstanding 1993 Toll Road Revenue Bonds. The 1997 issue consists of \$605 million in Current Interest Bonds, \$404 million in Convertible Capital Appreciation Bonds, and \$439 million in Capital Appreciation Bonds. Of the bonds issued, 51 percent are insured by MBIA and carry ratings of AAA, Aaa, and AAA from Fitch, Moody's and Standard & Poor's, respectively. The refinancing lowered the debt interest rate by 1.8 percent and will generate \$270 million in cash flow savings between 2000 and 2012.

### **Federal Line of Credit**

The SJHTC was able to secure Federal support for the project in the form of a standby line of credit. In the 1987 Surface Transportation Act, Congress designated this toll road as one of a limited number of projects eligible for up to 35 percent Federal funding. In Fiscal Year 1993, acting on that designation, Congress appropriated \$9.6 million to fund the subsidy costs of a \$120 million Federal line of credit available to TCA to help cover debt service, if necessary, during the first five years of the toll road's operation. This represents a budgetary cost of only eight percent of the face amount of credit assistance. Because of uncertainty as to whether the line would be deemed a "Federal guarantee," TCA informed bond holders it would not utilize the line unless it obtained an unqualified legal opinion from bond counsel. A provision in the Fiscal Year 1996 DOT Appropriations Act subsequently extended the availability of the credit line to ten years and broadened the purposes for which the line could be used. The Federal line of credit is available in the event toll revenues and standard reserves (including the Use and Occupancy Fund) are not sufficient to cover debt service, costs of extraordinary repair and replacement, costs of complying with unexpected Federal or State environmental restrictions, and operating and maintenance expenses. The broadened purposes enabled bond counsel to render an approving opinion.

Only ten percent of the line (\$12 million) is available in any one year. Any draws for capital expenditures, debt service, or other expenses (excluding operations and maintenance) must be repaid within 30 years at the rate on the 30-year Treasury bond at the time the draw is made. Draws for operations and maintenance expenses must be repaid within three years at the corresponding three-year Treasury rate at the time the draw is made.

At a budgetary cost of only \$9.6 million, therefore, the Federal Government is providing a \$120 million line of credit that is helping advance a \$1.4 billion transportation facility. This represents a leveraging ratio of 146 to 1 in terms of capital investment induced to budgetary resources allocated.

## FOOTHILL/EASTERN TRANSPORTATION CORRIDOR

### Project Description

The Foothill/Eastern Transportation Corridor (F/ETC) is the second new public toll facility being constructed by TCA and it comprises 52 miles of the overall 67 mile beltway system being implemented by the TCA. The F/ETC is comprised of two principal segments, the Eastern Transportation Corridor and the Foothill Transportation Corridor. The Eastern Transportation Corridor is a 24-mile limited access toll road consisting of three segments connecting with the northern segment of the Foothill Transportation Corridor (see previous map).

Upon its completion, the Foothill Transportation Corridor will be a 28 mile toll road, connecting the Eastern Transportation Corridor with I-5 near the Orange County and San Diego County line.

The Foothill Transportation Corridor's 12 mile northern segment is made up of two completed and operating portions totaling 7.5 miles plus two extensions of 4.5 miles which are currently under construction. The 16 mile Foothill-South segment, currently in the environmental review stage, will be financed by a future bond issue and is currently expected to begin construction in 2000 and be operational by 2003.

The 52 mile Foothill/Eastern Transportation Corridor system will provide direct access between Riverside County's residential areas and Orange County's central and southern suburbs as well as northern San Diego County. The facility is designed for two to three lanes initially in each direction, depending upon the segment, with future expansion capacity in the median available for general purpose, HOV lanes, or transit use.

As with the SJHTC, the F/ETC is being developed by a design/build consortium pursuant to a contract guaranteeing a maximum price and completion date. Upon completion of the project and acceptance by Caltrans, the toll road will become part of the existing State highway system. The road will, however, operate as a toll facility until the bonds are retired. As with the SJHTC, Caltrans will be responsible for traffic operations, maintenance, and liability, pursuant to a Cooperative Agreement between TCA and Caltrans. Pursuant to the terms of an agreement between Lockheed Martin IMS and TCA, Lockheed will design, construct, operate and maintain the integrated toll collection and management system. TCA will retain ownership of the toll collection system and equipment for the F/ETC.

### Project Financing

Total current project costs of \$1.8 billion were financed in 1995 through a variety of sources, including a combination of fixed and variable rate revenue bonds, State funds, vendor financing, and a contribution from TCA. The sources of funds are outlined in Table F3.

A total of \$1.26 billion of tax-exempt fixed rate toll revenue bonds were issues in 1995, consisting of \$907 million in Current Interest Bonds, \$152 million in Convertible Capital Appreciation Bonds, and \$205 million in Capital Appreciation Bonds. The fixed rate bonds were rated BBB, Baa3, and BBB- by Fitch, Moody's and Standard & Poor's, respectively. An additional \$246 million variable rate bonds were secured by development impact fees and further backed by direct pay letters of credit provided by a consortium of banks.

**Table F3**  
**Foothill/Eastern Transportation Corridor**  
**Sources of Funds (In \$Millions)**

Fixed Rate Bond Proceeds	\$1,263
Variable Rate Bond Proceeds	246
State & Local Transportation Partnership Program	35
Project Revenue Certificates	24
1993 Bond Funds	36
TCA Contribution	6
Interest Earnings	198
<b>Total</b>	<b>\$1,808</b>

The California State and Local Transportation Partnership Program provides State matching funds for certain locally funded and constructed highway and mass transit projects. Funding for the SLTPP is provided from the State Highway Account and is made available on a pro rata basis among all the projects which satisfy specific programmatic requirements. Approximately \$35 million was allocated under the SLTPP for the purpose of funding a portion of the construction costs.

The Project Revenue Certificates are notes issued by TCA to the contractor for a portion of the design/build contract price (up to \$16 million) and for potential design/build contract price increases (\$8 million) as deferred compensation. These certificates issued for the design/build contract will be repaid from the project contingency funds, to the extent funds are available, or from net toll revenues subordinate to any payments made with respect to the revenue bonds.

#### **Federal Line of Credit**

As in the case of the SJHTC, the F/ETC was able to secure Federal support for the project in the form of a standby line of credit. In the 1987 Surface Transportation Act, Congress also designated this toll road as one of a limited number of projects eligible for Federal funding. In the Fiscal Year 1995 DOT Appropriations Act, Congress appropriated \$8 million to fund the subsidy costs of a \$120 million Federal line of credit available to TCA for the F/ETC. This represents a budgetary cost of only 6.7 percent of the face value of credit assistance.

Similar to the amended SJHTC line, the F/ETC line of credit can be used to help pay debt service, the costs of extraordinary repair and replacement, costs of complying with unexpected Federal or State environmental restrictions, operating and maintenance expenses, and capital expenditures in the event that toll operation's revenues, capitalized interest, and reserve funds are not sufficient to cover such costs during the first ten years of the toll road's operation.

Only 10 percent of the line is available in any one year. Any draws for capital expenditures, debt service, or other expenses (excluding operations and maintenance) must be repaid within 30 years at the rate on the 30-year Treasury bond plus 48 basis points at the time the draw is made. Draws for operations and maintenance expenses must be repaid within three years at the rate on the three-year Treasury bond plus 48 basis points at the time the draw is made.

In this case, at a budgetary cost of only eight million dollars, the Federal Government is providing a \$120 million line of credit that is helping advance the \$1.8 billion F/ETC. This represents an even larger leveraging ratio of 225 to 1 in terms of capital investment induced to budgetary resources consumed.

# Appendix G: Glossary of Terms

**Basis Point** – A shorthand financial reference to one-hundredth of one percent (.01 percent) used in connection with yield and interest rates.

**Bond Counsel** – A lawyer or law firm, with expertise in bond law, retained by the issuer to render an opinion upon the closing of a municipal bond issue regarding the legality of issuance and other matters including the description of security pledged and an opinion as to the tax-exempt status of the bond.

**Bond Insurance** – A financial guarantee provided by a major insurance company (usually AAA rated) as to the timely repayment of interest and principal of a bond issue.

**Budget Authority** – Authority provided by law to enter into financial obligations that will result in immediate or future outlays of federal government funds. Budget authority includes the credit subsidy costs for direct loan and loan guarantee programs. Basic forms of budget authority include appropriations, borrowing authority, contract authority, and authority to obligate and expend offsetting receipts and collections.

**Budget Scoring** – Estimating the budgetary effects of pending and enacted legislation and comparing them to limits set in the budget resolution or legislation. With regard to federal credit assistance, budget authority and outlays are scored on a present-value basis, according to estimated default risks and interest subsidies, rather than a cash-flow basis.

**Call Risk** – Risk to the investor associated with prepayments by the issuer of the principal amount of the bonds prior to the stated maturity date, in accordance with the bonds' redemption provisions.

**Capital Appreciation Bonds** – Long-term bonds which pay no current interest, but accrete or compound in value from the date of issuance to the date of maturity. CABs differ from zero coupon bonds in that they are issued at an initial amount and compound in value, in contrast to zeroes, which are issued at a deep-discount and compound to par.

**Capitalized Interest** – A specified portion of the original bond proceeds which will be used to pay interest on the bonds until revenue from planned sources becomes available upon completion of construction.

**Contract Authority** – A form of budget authority that permits obligations to be made in advance of appropriations or receipts. Contract authority therefore is unfunded and requires a subsequent appropriation or offsetting collection to liquidate (pay) the obligations. The federal-aid highway program has operated under contract authority since 1921.

**Coverage Margin** – The margin of safety for payment of debt service on a revenue bond, reflecting the number of times (e.g., 1.2) by which annual revenues after operations and maintenance costs exceed annual debt service.

**Credit Enhancement** – Financial guarantees or other types of assistance that improve the credit of underlying debt obligations. Credit enhancement has the effect of lowering interest costs and improving the marketability of bond issues.

**Discretionary Spending** - Outlays controllable through the congressional appropriation process. Such outlays result from the provision of budgetary resources (including appropriations and obligation limitations but excluding mandatory spending authority) in appropriation acts. The Budget Enforcement Act establishes annual spending limitations or caps on discretionary appropriations and resulting outlays.

**Executive Order 12893** - An executive order issued by President Clinton in January 1994, establishing infrastructure investment as a priority for the Administration and directing federal agencies to establish programs for more effective capital investment from current federal funds.

**Face Amount** - The par value (i.e., principal or maturity value) of a security.

**Force Majeure** - Events that are beyond the control of a contractor, such as earthquakes, epidemics, blockades, wars, acts of sabotage, and archeological site discoveries.

**Government Sponsored Enterprise** - A shareholder owned and operated financial institution, chartered by the federal government, that facilitates the flow of investment funds to specific economic sectors, thereby providing access to national capital markets. The activities of these private entities are not included in federal budget totals. But because of their special relationship to the government, GSEs provide detailed statements as supplementary information for budget presentation. Examples of GSEs include the Federal National Mortgage Association (Fannie Mae), the Student Loan Marketing Association (Sallie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac).

**Governmental Purpose Bond** - A term in the Internal Revenue Code for a tax-exempt bond which is secured by governmental revenues or whose proceeds are used for a general governmental purpose (as opposed to a private activity bond).

**Institutional Investor** - A financial institution such as a mutual fund, insurance company, or pension fund that purchases securities in large quantities.

**Intelligent Transportation Systems** - The application of advanced electronics and communication technologies to enhance the capacity and efficiency of surface transportation systems, including traveler information, public transportation, and commercial vehicle operations.

**Interest Subsidy** - The net present value cost to the federal government of providing credit assistance (e.g., direct loans or loan guarantees) at a rate below the rate of U.S. Treasury securities issued for a comparable term.

**Investment Grade** - Describes the top four rating categories of relatively secure bonds suitable for a conservative investor. Standard & Poor's rating service looks upon all bonds between the AAA and BBB ratings as investment grade. Generally speaking, any bonds rated below BBB are considered to have speculative features and are deemed sub-investment grade or junk bonds.

**Junior Debt** - Debt having a subordinate or secondary claim on an underlying security or source of payment for debt service, relative to another issue with a higher priority claim. (See Subordinate Claim.)

**Letter of Credit** - An instrument or document issued by a bank guaranteeing bondholder payment by enabling the bond trustee to draw from the bank the full amount of principal and interest due on each bond payment date.

**Leveraging Ratio** – Measures the extent to which a given investment attracts additional capital. In the context of this report, the leveraging ratio of federal funds is equal to the total project costs divided by the budgetary cost of providing federal credit assistance.

**Liquidity** – Refers to an investor's ability to sell an investment as a means of payment or easily convert it to cash without risk of loss of nominal value.

**Loan Servicer** – A public or private entity that is responsible for collecting, monitoring, and reporting loan payments. In the context of this report, a loan servicer would also assist in originating the loan.

**Mandatory Spending** – Outlays generally not controllable through the congressional appropriation process. Mandatory amounts are budget authority or outlays that cannot be increased or decreased in a given year without a change in substantive law. Entitlement programs (e.g., food stamps, Medicare, veterans' pensions) are chief examples of mandatory programs, whereby Congress controls spending indirectly, by defining eligibility and setting benefit payment rules, rather than directly through the appropriation process. With regard to the federal-aid highway program, mandatory spending refers to outlays resulting from obligations of contract authority programs not subject to annual obligation limitations, such as Minimum Allocation, Emergency Relief, and Demonstration Project spending.

**Obligation Authority** – The amount of budgetary resources (including new budget authority, balances of unobligated budget authority carried over from prior years, and obligation limitations) available for obligation in a given fiscal year. With regard to the federal-aid highway program, obligation authority often refers to the amount of federal-aid obligation limitation, established annually by Congress in appropriation acts, that is allocated to the states and controls the amount of apportioned contract authority that can be obligated by the states in a given fiscal year.

**Parity Debt** – Debt obligations issued or to be issued with an equal claim to other debt obligations on the source of payment for debt service.

**Pay-As-You-Go Financing** – Describes government financing of capital outlays from current revenues or grants rather than by borrowing.

**Preliminary Rating** – A credit opinion from a rating agency based on a preliminary assessment assigned to a proposed bond issue.

**Ramp-up Phase** – The phase in a project's life cycle immediately following construction. It is during this phase, the early years of operation, that a project's revenue stream is established.

**Rate Covenant** – A contractual agreement in the legal documentation of a bond issue requiring the issuer to charge rates or fees for the use of specified facilities or operations at least sufficient to achieve a stated minimum debt service coverage level.

**Rating Agency** – An organization that assesses and issues opinions regarding the relative credit quality of bond issues. The three major municipal bond rating agencies are Fitch Investors Service, Moody's Investors Service, and Standard and Poor's.

**Senior Debt** – Debt obligations having a priority claim on the source of payment for debt service.

**Start-up Project** – A separate, free-standing and new facility dependent on its own revenue stream to generate earnings to cover operating and capital costs.

**State Infrastructure Bank** – A state or multi-state revolving fund that provides loans, credit enhancement, and other forms of financial assistance to surface transportation projects.

**State Transportation Improvement Program** – A short-term transportation planning document covering at least a three-year period and updated at least every two years. The STIP includes a priority list of projects to be carried out in each of the three years. Projects included in the STIP must be consistent with the long-term transportation plan, must conform to regional air quality implementation plans, and must be financially constrained (achievable within existing or reasonably anticipated funding sources).

**State Transportation Plan** – The transportation plan covers a 20-year period and includes both short- and long-term actions that develop and maintain an integrated, intermodal transportation system. The plan must conform to regional air quality implementation plans and be financially constrained.

**Stress Test** – A financial test applied by rating agencies to assess the claims-paying ability of municipal bond insurers. The stress test subjects a bond insurer's portfolio to a severe and prolonged economic downturn that produces an extraordinary level of bond defaults. In order to receive a AAA rating on its claims-paying ability, a bond insurer must be able to pay all projected claims through the peak years of the stress period and be left with sufficient resources to write new business when more stable economic conditions resume.

**Subordinate Claim** – A claim on an underlying source of payment for debt service which is junior or secondary to that securing another debt obligation. (See Junior Debt.)

**Subsidy Cost** – The estimated long-term cost to the federal government of providing credit assistance (e.g., direct loans or loan guarantees), calculated on a net present value basis at the time of disbursement and excluding administrative costs.

**TE-045 Innovative Finance Initiative** – A research program begun by the Federal Highway Administration in 1994 in response to Executive Order 12893. This finance initiative is designed to increase investment, accelerate projects, promote the use of existing innovative finance provisions, and establish the basis for future initiatives by waiving selected federal policies and procedures, thus allowing specific transportation projects to be advanced through the use of non-traditional finance mechanisms.

**Title 23 of the United States Code** – Highway title that includes many of the laws governing the federal-aid highway program. The title embodies substantive provisions of law that Congress considers permanent and need not be reenacted in each new highway authorization act.

**Title 49 of the United States Code** – Transportation title that includes laws governing various transportation-related programs and agencies, including the Department of Transportation, general and intermodal programs, interstate commerce, rail and motor vehicle programs, aviation programs, pipelines, and commercial space transportation.

**Turnkey** – A generic term for a variety of public/private partnership arrangements whereby a public sector entity awards a contract to one or more private firms to undertake the development, construction, and/or operation of an infrastructure project for a predetermined period of time before turning the project back over to the public entity. Turnkeys may take various forms, including design-build-transfer and build-operate-transfer.

**Unobligated Balance** - The portion of obligation authority (including new budget authority and balances of unobligated budget authority carried over from prior years) that has not yet been obligated. With regard to the federal-aid highway program, the term generally refers to balances of apportioned contract authority that the states have been unable to obligate due to annual obligation limitations imposed by Congress.

**Zero Coupon Bond** - A bond that is originally issued at a deep discount from its par or face amount and which bears no current interest. The bond is bought at a discount price which implies a stated rate of return calculated on the basis of the bond being payable at par at maturity. (See Capital Appreciation Bond.)

