Public Works Financing

Published monthly since 1988
by William G. Reinhardt, editor
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Reprinted from July-August 2009

Transportation Policy Review

Lessons from the Texas PPP Debacle

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The Texas Legislature, called back for a special session on transportation, failed to re-authorize long-term highway public-private partnerships (called comprehensive development agreements, or CDAs, in Texas) last month. So at least until 2011, when the Legislature next convenes, the only new toll projects that can go forward in Texas will be those developed by public-sector toll authorities.

I continue to get questions from journalists and others about how and why Texas changed from the state most aggressively using tolling and PPPs to a place where these terms have become politically radioactive. And about whether what happened in Texas bodes ill for tolling and PPPs in other states. As a member of Texas's 2008 Legislative Study Committee on Private Participation in Toll Projects, I have given a lot of thought to these questions.

First of all, both the enactment of sweeping policy changes for tolling and PPPs and their all-out embrace by the Texas DOT were a product of unique circumstances. Heavy-duty backing from Gov. Rick Perry, forceful leadership by a Transportation Commission led by (now-deceased) Ric Williamson, as well as strong support from the business community led to enactment of HB 3588 in 2003. Texas DOT went into full marketing mode to the public and also to the global toll/PPP industry. Dozens of projects were proposed, and competitions were held for quite a few of those, and more than half a dozen CDAs were awarded.

Alas, several factors created a populist backlash, which led to an unexpected coalition opposing both tolling and PPPs. First, Gov. Perry's overly ambitious plans for the Trans-Texas Corridor called for several multi-modal super-corridors running north-south and several more running east-west. To accommodate all the modes, a right-of-way 1,200 feet wide would be needed, far more than if the plan had been just for new toll roads. (And ironically, toll roads turned out to be the only viable use in these corridors.) That stirred up powerful opposition from conservative, mostly Republican, ranchers. And since the first corridor was to parallel congested I-35, from the Mexican border to Oklahoma, it fell afoul of right-wing conspiracy theorists who portrayed it as the "NAFTA Superhighway" that in their view was part of a master plan to merge Canada and Mexico with the United States and eliminate border controls. And when a team led by Cintra, from Spain, won a concession contract to plan that initial corridor, this only fanned the flames of populist, anti-foreign company sentiment. (One anti-PPP blog even claimed that Cintra is "controlled by the Spanish royal family.")

Yet those mostly right-wing populist groups would not have been sufficient to bring about the legislature's 2007 moratorium on CDA projects. The additional political boost came about when the public-sector toll agency in Dallas, the North Texas Tollway Authority (NTTA), decided to contest the award of a concession to a Cintra-led team for the SH 121 toll road project. That battle ended up with both NTTA and its Houston counterpart, HCTRA, deciding that private sector CDAs were a mortal threat to their continued growth. CDA's, they assumed, would siphon off the most lucrative new toll projects and leaving the toll authorities with the dogs. So they mobilized local legislators of both parties from the state's two largest metro areas. And that provided the critical mass to enact the moratorium (as well as termination of the original plan for a whole set of multimodal Trans-Texas Corridors).

The moratorium legislation also created the Study Committee, and I was one of Gov. Perry's three appointees, along with three each from the state Senate and House. We spent most of 2008 researching the issues that had arisen over CDAs, reached a number of conclusions, and made what I thought were sensible recommendations.

First, we concluded that the highway funding gap in Texas is so enormous that the state needs tolling and private capital (a position seconded by the "2030 Committee," which reported shortly thereafter).

Next, we showed that start-up toll roads, especially stand-alone ones, are high-risk propositions poorly suited to inexperienced public agencies such as the many new Regional Mobility Authorities being created around Texas.

Third, we said that truly toll-viable projects will be relatively few, so that people who don't like toll roads need not fear that most or all roads will end up tolled.

And fourth, we tried to disabuse people of the notion that most new toll roads are so lucrative that they would generate multi-billion-dollar up-front payments that could be used for all manner of locally popular projects.

In our recommendations, we argued against upfront payments altogether, suggesting that revenue-sharing is a better alternative, since it aligns the interests of both private and public sectors as long-term partners. One committee member, concerned over potential windfall profits, pushed to include a "termination for convenience" requirement in all CDAs that would let the state buy out the concession at a pre-determined price. Finance experts pointed out that such a provision would, in effect, give the government most of the upside (if the revenue came in higher than projected) while leaving the private sector with all of the downside (if revenue were below forecast)—and would hence make Texas projects unattractive. So we again recommended revenue-sharing, as the better way to deal with windfall profits.

The most contentious issue we dealt with was "local primacy"—the idea (advanced by friends of NTTA and HCTRA) that if CDAs continued, they should be used as a last resort, only if the local toll authority (including the brand-new RMAs) didn't want to do the project. Instead, we researched and recommended the use of value-for-money analysis such as the Public Sector Comparator model used in Australia, Canada, and the U.K. And to de-politicize the analytical process, we called for creation of a Partnerships Texas entity, modeled after Partnerships BC and Partnerships Victoria.

Unfortunately, all this was ignored during the contentious 2009 legislative session. The bill to extend CDA authority was amended to include both the termination-for-convenience provision and the local primacy provision. Fortunately, in my view, that bill died in the regular session, and no further action was taken on CDAs in the subsequent special session.

So does the Texas debacle mean PPP toll roads are on the way out in the United States? Absolutely not. First, the same huge highway funding shortfall that still faces Texas exists just about every place else, especially in fast-growing states like Arizona, California, Georgia, and Virginia. This spring both Arizona and California enacted sweeping new enabling legislation for PPP toll roads (as did Puerto Rico). Both Arizona and California were early pioneers in this area but suffered backlashes that led to no projects getting authorized in the former and only two in California (and the later repeal of its pilot program legislation). And given the interest and need for funding of large new projects in Michigan, New York, and Pennsylvania, I expect PPP toll road legislation to be enacted soon in at least two of the three. And progress continues on large-scale concession projects in Florida and Virginia.

As for Texas, it could go either way over the next few years. The optimistic case would be that already-authorized CDA projects get completed or are well along in construction by the time of the next legislative session in 2011 while the funding gap widens even further. The demonstration value of billion-dollar-scale PPP toll roads being built while other needed highway projects languish for want of funding could be powerful. And if large new PPP investments are occurring in California, Arizona, Michigan, Florida, and Virginia by then, cooler heads may be able to argue that Texas should be getting its share of this investment. That could bring back a CDA program, hopefully reformed along the lines of our 2008 committee's recommendations.

The case for pessimism is based on a different set of possible events:

- Sen. Kay Bailey Hutchison, who continues to make populist arguments against tolling and PPPs, gets elected governor on a platform that includes those themes and fills the Transportation Commission with anti-CDA people.

- The big public-sector toll agencies (especially NTTA) pull through financially, despite taking on far more debt than is prudent, by traditional standards.

- And none of the fledgling RMAs gets into big trouble with a failing toll project, allowing people to ignore the high-risk nature of start-up, stand-alone toll projects. In this case, the legislature may decide to ignore CDAs, at least for another two years.

The latter scenario would be tragic for Texas, since it would mean less highway investment, and, therefore, more congestion and its attendant economic costs. And it would be unfortunate for companies that had hoped to do significant toll-road business in the Lone Star State. But it would be only a bump on the road for concession companies and their suppliers, since I expect the number of states with PPP enabling legislation and good projects to keep on growing. That's clearly what the underlying fundamentals suggest.