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INNOVATIVE FINANCE AND STATE INFRASTRUCTURE BANKS

Mr. Chairman, I welcome this opportunity to testify on something that is one of the Department's highest priorities: how to leverage the Federal dollar to increase total funding for transportation infrastructure investment. To maximize the benefits of our limited Federal funds, the Department is pursuing multiple innovative financing strategies, including the State infrastructure bank (SIB) pilot program. All of our transportation modes have been involved, sometimes in partnership with each other, recognizing the intermodal nature of today's transportation projects. With me today are two of our key participants: Louise Stoll, Assistant Secretary for Budget and Programs, and Jane Garvey, Deputy Administrator of the Federal Highway Administration (FHWA).

Highway Innovative Finance Initiatives

Although we have invested in our Nation's infrastructure at record levels, demand continues to out pace investment. The resulting shortage of capacity has led to increased congestion and delays and threatens to erode the safety gains we have made in recent years. Conventional transportation financing for capital improvements to our Nation's highways, bridges, and transit systems by all levels of government totals $45 billion annually, but traditional public sector financing alone is not meeting our infrastructure needs. Innovative financing is an important complement to conventional forms of financing, helping to attract greater private sector and non-

Federal public sector investment in transportation projects. These strategies have made a real difference, reducing project costs and making more total money available faster to meet needs in all transportation modes.

Let me first summarize the work of FHWA to date. We launched that innovative finance effort more than two years ago, in April 1994. The FHWA asked States to bring in their high priority projects and their best proposals on how to finance them. We explained that we were not offering any "new" money. Instead, we asked States to work with the formula dollars they had available, recognizing that we were prepared to approve new ways to use those funds to finance projects.

We were extremely encouraged by the States' response. Initially, the FHWA received proposals from over 30 States with projects ranging from only a few thousand dollars up to $1 billion. These proposals showed real creativity--and brought forth a wide range of concepts and financing tools. We saw great ideas on providing incentives to increase private and non-Federal public investment and how to enable States to more flexibly use their own funds.

As of today, through FHWA's innovative finance test initiative, Test and Evaluation 045, FHWA has approved more than 74 projects in 31 States worth over $4.5 billion. The initiative has generated about $1.2 billion in increased public and private investment, above and beyond what would have been available through conventional financing. Because of the increased flexibility offered to States, many projects will advance to construction an average of 2 years ahead of schedule--some even more quickly.

The NHS Designation Act's Innovative Finance Provisions

I am particularly pleased that Congress recognized the multiple benefits offered by innovative financing and included many of the innovative finance techniques tested by the States in the National Highway System Designation Act of 1995. As a result of your action in this area, States can now receive matching credit for donations of private funds, materials, and services on federally-assisted projects through the regular Federal-aid highway program. States can also use their regularly apportioned Federal funds as loans to toll facilities and non-toll facilities with dedicated revenue sources. In addition, the principal, interest, and issuance and insurance costs of bonds and other forms of debt instruments are now eligible for reimbursement as construction expenses. Also as a result of the landmark legislation you passed late last year, the FHWA can now approve State applications for advance construction in the last year of an authorization period, provided that the approved project is included in future years of the State's transportation improvement program. Taken together, the opportunities made widely available under the NHS Designation Act promise to generate significant and sustained returns to the Nation for many years to come.

FHWA TE-045 Examples: SH 190 in Dallas, Texas and Stark Intermodal Facility, Ohio

One highway example of how well innovative finance is working is the State Highway 190 Turnpike in Dallas, Texas. One of the most exciting aspects of this project is how Texas used its apportioned Federal funds to strengthen its capacity to access the capital markets, thereby reducing its borrowing costs.

The State Highway 190 Turnpike will be the northern half of a circumferential route around the City of Dallas, linking four freeways and the Dallas North Tollway. It was initially proposed in 1964 but was stalled due to lack of financing until 1995. However, through innovative financing, this $700 million project is being jointly financed and constructed by the Texas Department of Transportation (TxDOT) and the Texas Turnpike Authority (TTA). TTA was able to issue highly-rated revenue-backed bonds because the project also received a $135 million low-interest loan of

Federal grant funds from TxDOT. The flexibility of the loan allows TTA to defer repayments on the loan until after the road has opened and has begun collecting tolls and generating revenue in 2005. This developmental period has traditionally been the deterrent to project financings. The lower interest rates on the bonds and loan also translate into lower tolls for drivers. Innovative financing enabled Texas to have the *flexibility* to use its anticipated Federal reimbursement of funds and in turn to loan those funds to TTA. And, most importantly, innovative finance has meant that project will be completed 11 years earlier than it would have been under conventional financing.

Many of the other innovative finance projects managed under the FHWA's program have been equally creative. The projects have spanned the United States, affecting rural, suburban, and urban areas, and many of the projects are multimodal, involving highways, rail, transit, or airports. One intermodal project of particular interest is the Stark County Intermodal Facility project. Ohio DOT has constructed an intermodal truck-rail interchange through a public-private partnership. The intermodal facility enables the loading and unloading of truck trailers and freight containers onto railroad flat cars. The overall development was $35.2 million. The truck off-loading fees will function as a dedicated revenue source to re-pay the loan under the provisions of section 129 of title 23, United States Code. The project has attracted $24 million in private funds and could create as many as 1,000 manufacturing jobs in the State.

Rail Innovative Finance Initiatives

We have also used innovative financing techniques to strengthen our railroad transportation system which serves as a vital link in our multi-modal system. On September 24, 1994, the Federal Railroad Administration (FRA) published its Innovative Financing Request for Assistance. This notice described the Department's ongoing efforts to identify innovative financing techniques and specifically focused on FRA's efforts to identify State and locally supported rail and rail-related projects that were potentially eligible for Intermodal Surface Transportation Efficiency Act (ISTEA) funding but were stalled due to regulatory or administrative limitations or a lack or financing.

FRA has worked very closely with FHWA and the Federal Transit Administration (FTA) to identify publicly beneficial projects with rail components. In response to the notice, FRA received recommendations from a number of State, local, and private sources. Rail projects can involve: new or enlarged publicly owned intermodal terminals and new access roads to public or private facilities; elimination of double stack clearance restrictions; and closings of highway-rail grade crossings or construction of grade separations that provide a safer and less congested driving environment and improved rail reliability and air quality.

Rail projects represent an important opportunity for private-public partnerships that can effectively leverage limited public funds and offer State and local officials another source of funding to address critical public sector infrastructure issues. To date, about a dozen rail and rail-related projects have been approved under this initiative. One notable example involved the City of Cincinnati where for many years four railroads tried to cross the Ohio River using two tracks. Trains were backed up as far as 60 miles and delays were frequent for railroads and for highway traffic at grade crossings. Using $5.1 million of Congestion Mitigation and Air Quality funds, this project leveraged $9.9 million in private rail funds. The State has completed construction of 3.5 miles of a third track that was two-thirds paid for by private railroads. Rail and highway congestion has been eliminated, transportation is flowing more efficiently, and air quality is improved.

Transit Innovative Finance Initiatives

On September 12, 1994, the FTA launched a similar innovative financing initiative for transit projects. To date, FTA has funded eight innovative financing projects with a total of $2.4 million in discretionary funding. This level of funding is projected to leverage over $7.6 million in local public and private funding for transit infrastructure. That is a leverage rate of 3:1.

In addition to this initiative, FTA has actively supported turnkey contracts for several major transit projects. One of the largest is the Tren Urbano super turnkey project in San Juan, Puerto Rico, which innovatively uses Federal funds in partnership with the Puerto Rico Highway and Transportation Authority. The Tren Urbano project, estimated to cost $1.2 billion, consists of a 10.4-mile long rapid transit line between downtown San Juan and the major residential center of Bayamon. The project will be built with several turnkey component contracts involving design, build, operation, and transfer of the system. This approach will allow greater opportunity for smaller local contractors to participate in this large project. The contractor that is selected to carry out the systems design and construction will also serve as overall turnkey management contractor for the entire project. The project financing will come from three major sources: Surface Transportation Program (STP) funds, FTA New Start funds, and local funds. The $300 million of STP funds will be used to secure long term bonds to reduce the cost of borrowing. The $307 million in New Start FTA funds was appropriated in fiscal year 1996. An additional $509 million will come from the Puerto Rico Highway and Transportation Authority that derives revenue from gasoline and oil taxes, vehicle licensing fees, tolls, and investment income.

Aviation Innovative Finance Initiatives

In the area of aviation finance, we've taken several steps. First, we've submitted a study to

Congress on the pros and cons of several types of specific financing tools, such as using Airport Improvement Program (AIP) funds for credit enhancement, debt service reserves, or to back loan guarantees. Second, following up on that study, and as part of the 1996 AIP reauthorization, we have asked Congress to authorize the test and evaluation of innovative finance techniques.

Third, perhaps the most important recent development has been the issuance of investment grade airport revenue bonds supported solely by Passenger Facility Charges (PFCs). Working with the bond rating agencies and the airport community, FAA has developed safeguards that have permitted rating agencies to provide investment grade ratings to stand alone PFC-backed bonds for the first time since PFCs were authorized in 1990. Little Rock issued the first PFC stand alone debt in March 1996, and Chicago is likely to issue this month.

Finally, at the same time that we are pursuing reauthorization of the revenues that fund the Aviation Trust Fund, our FAA reauthorization proposal calls for establishing a Select Panel to comprehensively evaluate a wide range of methods for financing the FAA in the future.

State Infrastructure Banks

As a direct outgrowth of these project-oriented innovative financing efforts, the Department has been working to implement the SIB pilot program authorized in section 350 of the NHS Designation Act. The pilot program permits State transportation departments to put initial "seed" money into a special "bank" established specifically to finance transportation infrastructure investments.

Section 350 enables each State to capitalize its SIB with up to 10 percent of its regularly apportioned transit capital and Federal-aid highway funds, subject to specified outlay limitations. States are required to match these funds with a minimum 20 percent local share. The States can then use these seed funds to loan money to transportation projects, or use the funds as a credit enhancement, or to subsidize the interest rates for a project. Loans will be repaid to the SIB through project revenue streams. Then, with the replenished funds, the State could use the SIB to advance a new round of projects, and so on, to "re-cycle" these funds and further increase transportation infrastructure investment.

Since we first asked States to apply for the pilot through a *Federal Register* notice published last December 28, we have seen an unexpected level of enthusiasm from States. Fifteen States have applied for the 10 pilot designations available. On April 4, eight States were selected to participate in the pilot: Arizona, Texas, Oregon, Florida, South Carolina, Ohio, Oklahoma, and Virginia. The remaining seven applicants were asked to supplement their initial applications and, as a result of these revised applications, on June 21 the Secretary designated California and Missouri to participate in the pilot. Each of the 10 States is currently in the process of entering into a cooperative agreement and will soon begin to capitalize its SIB. With the projects identified in all applications, these States anticipate assisting over $6 billion in total construction value.

The Department is particularly pleased to note that of the 10 States designated as SIB pilot States, nine plan to establish both transit and highway accounts. Two of the notable examples in this regard are Virginia and Ohio.

Virginia will use existing State authority under its Public Private Partnership Transportation Act of 1995, and its Toll Facilities Revolving Fund, to establish a SIB with both transit and highway accounts. Projects that will be supported by the Virginia SIB include construction of an additional parking deck at the Vienna Station on the Washington Metro's Orange line. This project will be privately built and operated for profit by a private developer on property leased to it by Washington Metro. At the end of the lease term, the property and improvements will revert to Washington Metro. The increased transit ridership generated should help reduce congestion along the I-66 corridor.

Ohio proposes that its SIB use existing legislative authority and State general revenue funding to support a wide variety of projects in many modes. As of March 1, 1996, Ohio had identified 10 projects worth over $300 million for support from its SIB. Of these projects, just over half would begin to produce revenue within three years, thus enabling a quick turnaround of the funds in the revolving fund program. Of the 10 projects identified, five are for transit, multimodal, or air cargo facilities. For example, Ohio's SIB will provide a $12 million construction loan for the I-670 Development Cap/Platform Project. This will be a multi-use platform to be constructed using the air rights over I-670 in downtown Columbus to accommodate private-public development of transit-related amenities, parking facilities, retail space, and a hotel. The SIB financing will be repaid with private take-out financing of $9 million and an additional $3 million in subordinate financing.

We are also pleased that every application went beyond the initial SIB concept of a revolving loan fund and included the possibility of offering credit enhancements. Through credit enhancement, a SIB can serve as a capital reserve, subsidize interest rates, ensure letters of credit, and finance purchase and lease agreements. For example, Oregon contemplates providing credit enhancement to a revenue bond issue for at least one project. Such credit enhancements, as in the Oregon bond issue, may reduce a project's borrowing cost by as much as 2 full percentage points. On a $100 million project, that is a reduction in interest costs of $2 million per year.

The applications to participate in the SIB pilot reveal a diversity of innovative financing ideas. States have outlined a variety of approaches to developing their SIBs. No applicants have identical approaches; each one emphasizes the financial assistance features best suited to its State's transportation needs. Including additional participants in the program would enable States to explore an even wider variety of creative solutions to their financing needs. In addition to the 15 applications received, four other States have expressed interest in the concept through letters to the Department, and numerous other States have directly communicated their interest in the SIB concept but were unable to prepare applications in the short time frame allotted.

Without an increase in the 10-State limit, a number of these worthy applications have been and will continue to be turned down. We have therefore proposed to increase the number of pilot participants to 20, with an eventual goal of having well-functioning SIBs in every State wishing to establish and support them. In order to accommodate the number of States interested in the SIB pilot and to ensure that the pilot is fully effective, we have also proposed that an additional $250 million be authorized to expand the pilot. We submitted legislation to the Congress on May 17 to implement these two proposals. Under the SIB program authorized by the NHS Designation Act, the pilot States are permitted to capitalize their SIBs with a portion of their regular Federal-aid funds, but most of these funds are already committed to projects approved under the planning process required by ISTEA. Without further catalytic funding by the Federal government to capitalize the banks and allow the initial projects to proceed, effective implementation of the pilot program will be slower than we would like. Such a delay will either defer increased investments in transportation infrastructure or will force States to pull back from prior project commitments in order to capitalize their SIBs. Both of these consequences run counter to the aim of the SIB pilot to maximize the benefits of each dollar invested in transportation projects. We expect that an expanded and funded SIB pilot program will better enable the Department to evaluate this new infrastructure investment opportunity in advance of ISTEA reauthorization next year.

The Department and the States are excited about the possibilities that SIBs offer for expanding investment in transportation and for partnering with the private sector. The States have identified many specific projects that they will advance with SIBs, and many of them involve the private sector. We will continue to provide technical assistance and support to the States to help realize these possibilities.

Innovative Finance Proposals for Reauthorization

We have learned from the States that they would like more information on the potential of the innovative financing provisions that Congress provided in the NHS Designation Act. To meet this need and to ensure that the provisions are fully utilized, FHWA and FTA are providing training to over 1,700 participants on those provisions this year alone. As the innovative financing provisions of the NHS Designation Act become more familiar to the States, there may be value in further tailoring some of the innovative financing techniques such as the loan provision.

If the SIB pilot program is a success--and I am very optimistic that it will be--we will propose to you next year that the SIB pilot program be extended. We will be exploring the potential of financing opportunities provided by the SIBs in the coming months and expect to learn the areas to which the SIBs are best suited and where the innovative financing provisions might provide other complementary solutions.

We have encountered various issues raised by the 10 designated States in setting up the cooperative agreements. We have been reviewing a number of those questions in the Department, such as whether artificial annual limits on disbursements of Federal funds to capitalize the SIBs should continue; many of the States have said such limits prevent them from capitalizing their SIBs in the amounts they would like to.

In addition to the SIB pilot program, recent innovations in public-private ventures have raised additional questions from States, particularly the direct Federal role in helping to finance unique projects sponsored by the Orange County Transportation Corridor Agencies and the

Alameda Corridor Transportation Authority in California. Specifically, one issue is whether there is an ongoing Federal role in providing direct assistance to transportation investments of national significance, beyond the recently expanded financing mechanisms. Although the potential of SIBs and other innovative provisions of the NHS Designation Act is just now being explored, some observers have suggested that the Federal government could play an even more valuable leveraging role by targeting direct credit--such as flexible loans or lines of credit--to certain types of beneficial investments that otherwise would have difficulty in obtaining financing through the markets. As part of our reauthorization process, we will examine the possibility of providing limited direct Federal assistance to leverage opportunities available through the capital markets.

Conclusion

This year as we celebrate the 40th anniversary of the Interstate Highway System and the 35th anniversary of Federal transit assistance we are reminded that the United States has created one of the finest transportation systems in the world through an aggressive combined effort of all governmental levels and the private sector. As we move into the 21st Century, economic prudence and concerns for efficiency strongly reinforce the need for continued vigilance to ensure that the value of these earlier investments is not lost. While grant reimbursement will continue as a major Federal-aid financing tool, there are real opportunities for States to take innovative approaches to meeting transportation finance needs.

Thank you. My colleagues and I will be happy to answer any questions you may have.