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**ON INNOVATIVE TRANSPORTATION FINANCING**

**BEFORE THE**
**SENATE APPROPRIATIONS COMMITTEE**
**SUBCOMMITTEE ON TRANSPORTATION**

**May 7, 1997**

Mr. Chairman, Members of the Subcommittee. Thank you for the opportunity to testify on the Department of Transportation's accomplishments and proposals with respect to innovative financing of transportation infrastructure.

*Overview*

President Clinton came to office dedicated to improving the Nation's transportation infrastructure because of its contribution to economic prosperity. He had declared during the 1992 campaign: "The 1980s saw the concrete foundations of the United States crumble as the investment gap widened between America and our global competitors."

In the 21st century, Americans will compete in a truly global marketplace. This marketplace will be fiercely competitive, and our success as a Nation will be determined on how safely, reliably and cost-effectively we can move people, goods and information. Transportation accounts for about 11 percent of the United States gross domestic product -- roughly comparable to health (14 percent) and food (12 percent) -- and will affect our country's global competitiveness in the future.

Working with Congress, we have increased Federal transportation infrastructure investment to record levels. These investments have paid off in substantial improvements to the condition and performance of our highways and mass transit systems. But the Federal government alone can not close the investment gap, and President Clinton early on recognized that "the only way to lay the foundation for renewed American prosperity is to spur both public and private investment." His 1994 Executive Order setting out "Principles for Federal Infrastructure Investments," provides that:

> Agencies shall seek private sector participation in infrastructure investment and management. Innovative public-private initiatives can bring about greater private sector participation in the ownership, financing, construction, and operation of . . . infrastructure programs . . . . Consistent with the public interest, agencies should work with State and local entities to minimize legal and regulatory barriers to private sector participation in the provision of infrastructure facilities and services.

In response to the President's direction, the Department initiated the Partnership for Transportation Investment. Through that Partnership, we have supplemented our traditional surface transportation grant programs with innovative financing, stretching our transportation investments further. Our efforts, which have focused on public-private partnerships, have accelerated more than 74 projects with a total value exceeding $4.5 billion.

State Infrastructure Banks, proposed by the Administration and approved by Congress in the National Highway System Designation Act of 1995 (NHS Act), are now being established in 10 pilot states. The banks are beginning to offer new financing tools for a variety of transportation improvements -- such as toll roads and intermodal terminals. As you well know, the FY 1997 Transportation Appropriations Act gave us authority to select additional states to participate in the SIBs. We have received 26 applications from 29 states, including two multi-state applications, for additional SIBs and expect to make announcements on those applications shortly. While projects are just being initiated under the new SIBs so experience is limited, some have suggested a potential for as much as a 4-to-1 leveraging factor from funds deposited in SIBs.

With respect to other modes, financing all of our aviation system's needs -- airports, airway facilities, security, and FAA operations -- is a critical priority for us. With authority Congress provided in the Federal Aviation Reauthorization Act of 1996, we are soliciting and reviewing innovative financing proposals for airport development. We want to work with Congress to establish a reliable, *long-term* funding base so that the FAA can continue to provide the services our aviation system needs. As an interim measure until comprehensive financial reform is achieved, we are proposing $300 million in new user fees. Members have been appointed to the new National Civil Aviation Review Commission, and they are beginning their work to analyze aviation budget requirements and ways to fund them and to help us to reach a consensus on what course to take.

And we have proposed changes in the financing for Amtrak -- to provide more stability in its direct funding by requesting contract authority (beginning in FY 1999) from the Highway Trust Fund and to permit states to help meet Amtrak's financial needs from state apportionments of National Highway System and Surface Transportation Program funds where state officials see Amtrak as a key part of their transportation systems.

*Federal Investment*

As Secretary Rodney Slater discussed with you, working with this Subcommittee and the entire Congress, over the past four years (FY 1994-97) we have increased Federal investment in highways, transit systems, and other infrastructure to an average of $25.5 billion, more than 20 percent higher than the average during the previous four years. The Department is committed to a long-term infrastructure investment program and seeks the highest levels of investment within the context of a balanced budget and the President's priorities. But we recognize that Federal investment alone can never close the investment gap.

As part of Secretary Slater's commitment to bring common sense government to the Department of Transportation in order to provide the people we serve with a Department that works better and costs less, we will continue to encourage more flexible, innovative funding to leverage Federal dollars for infrastructure investment -- one subject of your hearing today.

*Innovative Financing*

Innovative financing is one of the Department's most significant success stories over the last four years. The Department initiated the Partnership for Transportation Investment in 1994. Under that initiative, we have supplemented our traditional grant programs with innovative financing. Our efforts have resulted in more than $1.2 billion in non-Federal investment in transportation infrastructure that would not have occurred without the financing concepts included under the Partnership.

As a result, projects like State Highway 190 in Texas cost less and will bring benefits to the economy sooner. In that case, the Texas DOT loaned $135 million in Federal-aid funds to the Texas Turnpike Authority, which was combined with almost $500 million in bond proceeds from the private sector. Construction on this project will be initiated over a decade earlier than originally planned and is expected to relieve existing congestion on other highways in the north Dallas area.

Also, the Massachusetts Bay Transportation Authority was granted advance construction authority to issue bonds to rebuild its heavy rail maintenance facility. This $236 million project was undertaken 30 months earlier as a result, with immediate construction savings of over $50 million. Each repair and overhaul from 1997 onward will take up to one-third less time to complete.

The Partnership initiative was based on the use of innovation within existing authority by the Federal Transit Administration and on the use of test and evaluation authority provided to the Federal Highway Administration under Section 307(a) of Title 23 of the United States Code. That section permits FHWA to engage in a wide range of research projects, including those related to infrastructure finance. As part of this research effort, FHWA provided states with flexibility on certain policies and procedures so that specific transportation projects could be advanced through the use of non-traditional financing concepts. The Partnership was designed and operated to give states the opportunity to propose and test those concepts that best met their needs. Projects that were advanced were those that were identified by state-level decision makers facing real world barriers to financing needed transportation improvements. No new Federal funds were made available; the focus of the Partnership has been to foster the identification and implementation of new, flexible strategies to overcome fiscal, institutional, and administrative obstacles faced in funding transportation projects.

The 74 projects have been both highway and intermodal projects. Because ISTEA broadened the availability of Federal-aid highway funds for non-highway projects, many of the projects that have been advanced have also involved other modes. For example, they have included installation of Intelligent Transportation System technologies, ferry purchases, intermodal facilities for truck-to-rail transfers, construction of a commuter rail station, and bike/pedestrian projects.

There have been eight major financing tools tested under the Partnership for Transportation Investment; those tools can be generally characterized as investment tools and cash flow tools. Investment tools are those that draw new sources of funds to transportation investment; cash flow tools aim to accelerate construction and completion of projects.

The most popular tools have been flexible match and advance construction, both of which were made a basic part of the Federal-aid highway program by the NHS Act. Prior to that, private contributions toward a project were deducted from the total project cost, and states had to provide the matching share of the remaining cost. Under the Partnership initiative, we permitted such contributions to be counted toward the state matching share. This innovation encouraged states to seek private partners since the states got the total benefit of the contributions. We also allowed some states to use tapered match where the Federal share is allowed to vary during the life of the project.

Under advance construction, states use state and local funds to construct projects while preserving those projects' eligibility for future Federal-aid reimbursement. However, conversion of such projects was to be made by the end of the ISTEA authorization period – that is, by the end of this fiscal year-- and, when the project is converted, obligation of the full amount of Federal funds to be committed to the project was required. The requirement to convert by the end of this year made advance construction less and less available as a tool as we got closer to the end of the ISTEA period. The requirement to obligate the full amount of Federal funds at the time of conversion limited the states' flexibility in using this tool. We allowed (and the NHS Act made the authority permanent) states to rely, within certain limits, on likely future-year apportionments beyond the current authorization period and to make partial conversions of such projects.

Tax advantaged leasing is another finance tool that has provided significant additional revenues to transit systems in several States. Since 1994, over $2.2 billion in equipment and facilities leasehold transactions (cross-border leases, domestic leases, and lease/leaseback) have provided over $143 million in cash benefits for the transit systems involved. This non-Federal cash has been used for these transit providers' long term capital investment programs.

A few states used other innovative financing tools such as lending some of their regularly apportioned Federal funds to revenue producing projects or using those funds to reimburse the cost of retiring bonds. Although these tools leveraged the greatest amount of non-Federal funds, they have been utilized less frequently because in many cases legal and institutional impediments must be overcome and because states chose not to divert grant funds previously programmed for other uses.

In addition to leveraging more non-Federal investment, the Partnership initiative has accelerated construction of these projects -- by an average of 2.2 years. That means the benefits of these projects -- typically, travel time savings, safety improvements, reduced vehicle operating costs for transportation users, and environmental and other social benefits for communities – are realized sooner.

The Partnership for Transportation Investment provided clear evidence of the potential for innovative financing tools to generate more total investment and accelerate construction of transportation projects that deliver benefits to transportation users and communities in general. It also demonstrated that there is strong interest at the state and local level in using these tools. That evidence contributed to inclusion of a number of new authorities to use innovative financing tools and of a State Infrastructure Bank pilot program in the NHS Act -- an important step in making these tools broadly available to better meet the Nation's transportation needs.

*State Infrastructure Banks*

A SIB is a state or multi-state fund that can offer loans and credit enhancements to a wide variety of project sponsors. They are intended to support certain highway, transit, or rail projects that can be financed -- in whole or in part -- with loans or that can benefit from the provision of credit enhancement. As loans are repaid or the financial exposure implied by a credit enhancement expires, a SIB's initial capital is replenished, and it can support a new cycle of projects.

With the authority provided in the NHS Act, DOT selected ten states from among 15 applicants. We have established cooperative agreements with nine of those states: Arizona, Florida, Missouri, Ohio, Oklahoma, Oregon, South Carolina, Texas, and Virginia. California is still considering the best structure for its SIB.

With just five months having passed since most states signed cooperative agreements with us for chartering their SIBs, financial activity within the SIBs has gotten underway. Federal outlays to the SIB pilots (from regularly apportioned Federal-aid highway funds) totaled $65 million as of the end of February. Three loans have been made – two by Ohio totaling $20 million and one by Missouri for $1.2 million. Three other states -- Florida, Oklahoma, and Oregon – intend to make project loans this fiscal year. Texas and Virginia may be able to offer loans this year, too.

This is a new way of advancing infrastructure improvements -- for us and for the states, and, as we move forward, we are finding impediments as we thought we would and we are solving them. Arizona, Oklahoma, and Texas have found limitations in their enabling legislation for SIBs and are actively seeking remedies. South Carolina and Virginia are developing procedures for SIB operations and project selection and do not expect to request Federal capitalization funds until late in FY 1997 or FY 1998. California is exploring structural options for its SIB, including the possibility of solely providing third-party credit enhancements. This strategy would require California to obtain an investment grade rating for its SIB. The process to do so is underway but not yet completed.

While we are still in the start-up phase, our expectations are for a healthy level of SIB activity within the first ten pilots. Based on the states' plans, we expect to see $260 million in SIB assistance offered this fiscal year to support $940 million worth of projects. By the end of FY 1998, we expect $324 million in assistance to be committed in support of $1.6 billion worth of projects. If those expectations hold true, by the end of FY 1998, each SIB dollar would be supporting nearly $4 of non-Federal infrastructure investment.

As with the Partnership initiative, highway projects will likely form the bulk of SIB-assisted projects – about 75 percent of them based on current plans. But SIBs will also assist in construction of other projects such as intermodal facilities and improvement of rail transit infrastructure. For example, Missouri's SIB will use a Missouri DOT grant to capitalize its SIB transit account. The initial capitalization will support a loan for the Kiehl Center, a multi-modal terminal serving St. Louis, Missouri's transit system, the Bi-State Development Agency. The loan will be followed by a debt service line of credit, which will reduce the project's borrowing costs by over 200 basis points. This will be the first SIB transit account to be capitalized.

We expect that SIBs will be an important contributor to meeting the Nation's transportation needs. They can support locally and regionally significant projects that have access to a dedicated revenue stream but need flexible financial assistance to clear hurdles that would otherwise obstruct or delay their implementation. SIBs can do this by offering: lower cost financing than might otherwise be available, flexible repayment terms that can be tailored to a project's revenue stream, or credit enhancements that improve access to, or lower the cost of, debt financing. And the fact that SIB resources are recycled means that the benefits of SIB assistance – leveraging of other investment, lower project costs, and accelerated construction -- can be realized repeatedly.

The FY 1997 Transportation Appropriations Act authorized us to permit more States to establish SIBs and provided $150 million in seed money. Twenty-nine States have applied to establish additional SIBs. We expect to be announcing our decisions on those applications very shortly. At the same time, we will be announcing how the $150 million will be distributed among the first 10 pilot states and the new SIB states we are selecting with the authority in the Appropriations Act.

*Proposals for FY 1998 and Beyond*

The President's FY 1998 budget and our proposal for ISTEA reauthorization -- the National Economics Crossroads Transportation Efficiency Act of 1997, or NEXTEA -- expand the innovative financing opportunities available to state and local governments by authorizing all states to establish SIBs, by providing $150 million in seed money for SIBs per year, and by creating a new Transportation Infrastructure Credit Enhancement Program funded at $100 million per year. This program is intended to assist in the funding of nationally significant transportation projects that otherwise might be delayed or not constructed at all because of their size or uncertainty over timing of revenues.

The proposed new Credit Enhancement Program would provide grants (limited to 20 percent of project costs), which could be supplemented by contributions from states or other entities, to establish a Revenue Stabilization Fund for each project selected. That Fund would be used to secure external debt financing or would be drawn upon if needed to pay debt service costs in the event project revenues are insufficient. These debts will not be considered "federally guaranteed" under the Internal Revenue Code, thus allowing the Program to be used in connection with either taxable or tax-exempt bond issues. Our vision is that the Credit Enhancement Program will complement the SIBs by encouraging the development of large, capital-intensive infrastructure facilities through public-private partnerships consisting of a state or local government and one or more private sector firms involved in the design, construction, or operation of the facility. Candidate projects that meet threshold eligibility criteria -- relating to
project size, access to user charges or other dedicated revenue streams, inclusion in a State's Transportation Improvement Program, ability to provide benefits of national significance, and
demonstrated need that it cannot otherwise obtain financing on reasonable terms -- would then be evaluated and selected based on the extent to which they would leverage private capital, their overall credit worthiness, and other program goals.

*Other Modes*

I have focused my remarks on surface transportation infrastructure, but I want to tell you briefly how we are applying innovative concepts for financing of our aviation programs and Amtrak.

Based on the success of the Partnership initiative in surface transportation, we asked Congress for authority similar to FHWA's test and evaluation authority to test innovative financing techniques for airport development. The Federal Aviation Reauthorization Act of 1996 permitted us to select ten airport development projects to demonstrate innovative financing techniques that were not otherwise permitted by statute. Although FAA's innovative financing options available in this demonstration program are more limited than FHWA's have been under its test and evaluation authority, we are optimistic that the results will be positive.

In response to its invitation, FAA has received 12 written expressions of interest that contained sufficient detail on which to base a preliminary concept decision. A panel with expertise in airport financing has reviewed the proposals and recommended that five be advanced to the next step. I am pleased to announce today that these five applicants will be invited to provide additional detail to support formal applications for Airport Improvement Program funds.

The proposed projects include construction of a safety-related building, new runways to provide additional airport capacity, and mitigation of airport noise impacts. In addition, each of the three innovative financing mechanisms authorized under the 1996 Act -- payment of interest, credit enhancement, and flexible non-Federal share -- would be tested by at least one of the proposals.

We anticipate finding that these financing innovations will lead to greater leveraging power for limited Federal funds, acceleration of needed capital improvements, and overall cost savings in developing airport infrastructure. We look forward to sharing preliminary data on innovative financing benefits with the National Civil Aviation Review Commission later this summer.

As you know, we have been proposing for some time to change the financing structure for FAA from aviation excise taxes to cost-based user fees. In the long run, we believe that is the best way to promote efficiency in both the provision and consumption of FAA services and ensure that FAA will receive the resources it needs to be able to continue to provide the services that aviation users demand. FAA is critical to the operation of the civil aviation system in this country and for much of the airspace beyond our borders. Our economy, in turn, is dependent on the efficient and unconstrained use of that airspace. Congress has given us the authority to charge for the air traffic services provided to those flying through our airspace but not taking off or leaving from a U.S. airport. We have issued an interim final rule to collect those fees, and the fees will be effective May 19, 1997. In the President's FY 1998 Budget, we propose to collect an additional $300 million in new fees next year. This proposal is an interim measure to provide the FAA with needed resources until comprehensive financial reforms can implemented based on the work of the National Civil Aviation Review Commission. The FAA provides a variety of services the costs of which are not fully recovered under the current system of excise taxes (e.g., security, inspections, and air traffic services provided to general aviation jet aircraft and international air cargo carriers). These represent possible fees that could be authorized for FY 1998.

We look forward to the recommendations of the National Civil Aviation Review Commission regarding the long-term financing of the FAA and to working with Congress on FAA financing.

We believe Amtrak is a key part of the Nation's intercity transportation system and that a combination of cost savings, revenue generation, and capital support is essential if Amtrak is to achieve eventual operating self-sufficiency. Our NEXTEA proposal requests contract authority (beginning in FY 1999) for Amtrak from the Highway Trust Fund. The total level of capital support is directly tied to Amtrak's ability to reduce spending and increase revenues so as to reduce its reliance on Federal operating grants. The intent of this arrangement is to encourage Amtrak to operate in the most efficient and effective manner. Our NEXTEA proposal would also let states, for the first time, use their National Highway System and Surface Transportation Program funds for Amtrak infrastructure. We believe that is the right kind of expansion of the flexibility

ISTEA provided six years ago. More and more, state officials see the individual transportation modes as part of a network to meet transportation needs, and permitting them to use Federal funds in the most effective way to meet those needs is the best use we can make of the funds.

*Conclusion*

As the President has said, when times change, so government must change. We recognize that there must be more investment in transportation infrastructure and the Federal government can and must find new ways to promote that investment. The success of the Partnership for Transportation Investment encouraged us to change our grant programs so that innovative financing tools are available to encourage more non-Federal investment. We appreciate Congress' support in helping make those tools available. They are the right way to ensure the Nation's transportation system is ready to meet the demands of the 21st Century.