

January 10, 2006

To: House Interim Committee on Transportation

**From: James Whitty, Oregon Department of Transportation
Oregon Innovative Partnerships Program Manager**

RE: Update on Oregon Innovative Partnerships Program

INTRODUCTION

I am here today to give you an update on the Oregon Innovative Partnerships Program (OIPP). I will give you a quick background on the program, talk about selection of projects we are pursuing under the program and how we selected a private sector partner. I will describe the current negotiations and what the contract with the private sector partner will include, talk about the advantages of working with a private sector firm and finally discuss next steps.

BACKGROUND

The 2003 Legislative Assembly enacted the Oregon Innovative Partnerships Program to allow new, cutting edge approaches to funding and financing transportation projects. The statutorily established goals for this new program direct ODOT to focus on innovation, speed and partnerships with private sector firms and other units of government. Always discussed in and around legislative hearings on the legislation was a fourth goal – leveraging private sources of capital. The Oregon Transportation Investment Act (OTIA) bonding programs notwithstanding, Oregon in 2003 through today suffers from lack of the traditional funding necessary to fund various transportation needs, one of which are the state's major transportation projects which can be several hundred million dollars apiece. The Oregon Innovative Partnerships Program may well play a large role in resolving this funding quandary.

The OIPP contracting process is an alternative to the traditional government contracting process. The program allows entry of private partners early in the project development process. Partners are selected by best value or qualifications rather than low bid, and use private sector methodology to assess project viability in terms of engineering, cost, funding and financing. Simply put, transportation projects are viewed much differently when regarded as a for-profit business. That said, not all projects attract a business interest, but some can.

The use of tolling as a way of funding road projects undertaken by the OIPP is a possibility but not yet a certainty. This is not the first time the issue has arisen in Oregon. Oregon governmental entities have used tolling to fund bridge projects for decades. To give you an understanding of the context for creation of the Oregon Innovative Partnerships Program, I will give you a brief background on tolling policy adopted by the Oregon Legislature. The first legislation for toll roads passed in 1995 (ORS 383.003 et. seq.) and allowed tolling on the Newberg Dundee By-pass and the Tualatin Sherwood Connector. The toll road statute was then amended in 1997, to add a project for the Portland area. The Legislature passed a separate requirement in 1999, that any new road capacity examine the feasibility of tolling as part of the project funding process (ORS 366.292). The toll road statute was amended a third time in 2001 to open up tolling possibilities for road projects statewide.

The 2001 legislation also required the Oregon Department of Transportation (ODOT) to form an advisory committee to investigate how Oregon might eliminate the impediments to creation of public private partnerships so that the private sector could play a stronger role in transportation infrastructure development, operation and funding. Thus, ODOT formed the Innovative Finance Advisory Committee (IFAC), consisting of individuals with extensive backgrounds in public private arrangements across the globe, and reported to the 2003 Legislative Assembly its recommendations for creation of the Oregon Innovative Partnerships Program. The 2003 Oregon Legislature approved legislation that allowed the department to move ahead with the program.

PROJECT SELECTION

One year ago, on January 20, 2005, the Oregon Transportation Commission (OTC) gave its approval for ODOT, through the Oregon Innovative Partnerships Program, to solicit proposals for three major highway projects. This approval resulted from an extensive project identification process undertaken by all of ODOT's regions and divisions, applying objective criteria to identify those projects appropriate and ready for the program. The first three projects selected are:

SUNRISE PROJECT

The proposed project is construction of a new four-lane, limited access roadway from I-205 to SE 172nd (segment 1) and additional transportation infrastructure to serve the newly incorporated City of Damascus (segment 2) in Clackamas County. Future development of this area will contribute to increased traffic volumes along the Sunrise Project Corridor.

NEWBERG-DUNDEE TRANSPORTATION IMPROVEMENT PROJECT

Over the past decade, traffic on 99W has increased by about 40 percent and congestion has reached unacceptable levels through Newberg, Dundee and the surrounding areas of Yamhill County. An identified alternative corridor

(bypass) is approximately 11 miles long, starting at the east end of Newberg and ending near Dayton at the junction with OR 18.

SOUTH I-205 CORRIDOR PROJECT

This project is a major north-south freight and commuter route in the Portland metropolitan region. The transition from six lanes to four lanes at the Willamette River crossing contributes to significant congestion along the corridor. Preliminary ODOT assessment has determined that widening the South I-205 Corridor to three lanes in each direction is feasible without undue adverse impacts.

SELECTION OF PRIVATE PARTNER

Through the Oregon Innovative Partnerships Program, ODOT issued a Request for Proposals (RFP) on April 29, 2005 on these three projects. The RFP sought private sector interest in a two-phase contracting process. The first contract is for “pre-development” services to develop the project to the point it can be financed by either borrowing from firms that are capital market lenders (e.g. similar to bonds) or investing by firms that are private equity providers (e.g. similar to stocks). By satisfactorily completing and delivering the work tasks under the contract so that the projects are demonstrated to be technically and financially feasible and acceptable to the public, the private partner would earn the exclusive right to enter into negotiations with ODOT on the “implementation contract” to actually build and perhaps operate and maintain the new facilities.

The RFP closed on August 29th. ODOT received proposals from two firms on Newberg Dundee and one each on South I-205 and Sunrise. ODOT began an extensive evaluation process that involved internal and external subject matter experts and consultation with local government representatives. The proposals were evaluated on (1) the qualifications and experience of the proposers; (2) their approach and understanding of the project; (3) their plans for gaining public support for the project; and (4) the proposed compensation arrangements. Reviews included analysis by nationally recognized firms under contract with ODOT, Carter and Burgess, Wilbur Smith Associates and Public Financial Management, Inc. The Oregon Department of Justice provided additional oversight. Consultations with local partners also informed the evaluation process.

The ODOT evaluation team unanimously invited the Oregon Transportation Improvement Group (OTIG) to interview, as the top ranked proposer on all three projects. OTIG is led by Macquarie Infrastructure Group (MIG), based in Sydney, Australia. Macquarie is one of the largest public infrastructure companies in the world. Macquarie’s technical advisor is Hatch Mott MacDonald, an engineering consulting firm with 33 offices across North America and staff resources of 12,000

worldwide. Macquarie worked with Hatch Mott MacDonald most recently on the Sea-to-Sky Highway Project in British Columbia in preparation for the 2010 Winter Olympics. Macquarie purchased toll roads in Chicago in 2004 and Virginia in 2005 and has nearly completed development of a new toll road in Southern California.

The ODOT interview process included local representatives from each of the project areas and an Oregon Transportation Commissioner. Following the interview, including debriefings from the local representatives and the OTC commissioner, the ODOT evaluation team found that the Macquarie-led consortium had the qualifications, experience and approach needed to successfully pursue all three projects and recommended selection of the OTIG consortium to the Oregon Transportation Commission for approval. On October 19, 2005, the OTC gave its approval for ODOT commence negotiations with the consortium on a contract for pre-development services.

Macquarie is eminently qualified to develop and operate transportation projects. The team proposed investment of substantial up-front capital to develop the projects to the point of project financing by the capital markets and, most importantly, a willingness to assume the risk that the revenues will develop sufficiently to pay the cost of financing. Macquarie has proposed to finance, construct and operate these new facilities as toll facilities for a period of years (yet to be negotiated). For a number of the early years, these projects are projected to operate at a loss. Macquarie would operate the new facilities in exchange for the right to receive a return on its investment in the later years of its lease term. No other firm offered anything even close to this financial offer.

NEGOTIATIONS

When the Oregon Transportation Commission authorized ODOT to enter into negotiations with the Macquarie Infrastructure Group, the Commission provided two conditions for successful negotiations.

1. ODOT's financial exposure under the pre-development contracts, in the event any or all of the projects do not proceed successfully, will at no time exceed the net funds available from the \$20 million set-aside amount for projects of statewide significance or other committed sources of funding for the three projects.
2. The work plan for each project will be structured around specific milestones and will include "off ramps" that will allow termination of the contracts if milestones are not achieved or either party finds reason to exit.

Negotiations began November 1st and are nearing conclusion. The negotiated contracts must receive the Commission's approval in order for the work to begin. The OTC is scheduled to consider approval at its next meeting on January 18.

THE CONTRACTUAL ARRANGEMENT

You have heard that these projects may be built as toll roads. We will know a lot more about the financial and political viability of these projects as privately run toll roads after about the first six months of work by Macquarie. Progress under the contract is marked by milestones. The first milestone will determine the feasibility of each project. Prospects for tolling will be evaluated as well as other potential funding sources such as direct contributions from private beneficiaries, development levies and tax increment financing. The objective is to determine whether these projects can be developed with stand-alone funding (i.e. funded by its own revenues) or whether there will be a funding gap. If a gap exists, work will be completed to determine how much that funding gap is expected to be. We expect to have this information by about September 2006.

ODOT views this new contracting approach as having great potential, yet the agency is proceeding cautiously as well. For example, as I mentioned earlier, both parties are able to exit the relationship at the end of each milestone. These "off-ramps" are built into the contract. While less than half of Macquarie's internal expenses are subject to reimbursement should the contract end early, there are specific caps placed on the amounts that can be reimbursed at a given milestone and an overall expenditure cap for all three projects. Most importantly, ODOT will pay only for work determined to be valuable to advance each project. So, even if the projects don't move into a construction phase under the Oregon Innovative Partnerships Program, the work completed will benefit the development of these three projects and the state nevertheless.

ADVANTAGES TO MACQUARIE APPROACH

There are strong advantages for ODOT to pursue the Macquarie approach to developing the three projects.

1. ODOT accesses a substantial source of private sector capital to develop the projects to the point of financing. As I mentioned, ODOT will be obligated to reimburse less than half of the Macquarie internal investment in project development should this creative experiment end prematurely.
2. ODOT shifts the risk that revenues will be sufficient to repay the debt and recoup an equity investment for the projects to Macquarie. If the identified revenues come short, investors will suffer the loss, not the taxpayers of Oregon.
3. Macquarie provides a source of investment beyond the revenues of the projects to enable them to successfully proceed to financing. This investment is equity capital, essentially other Macquarie assets. Without Macquarie's

involvement, it is unlikely ODOT could put up the necessary investment beyond project revenues to enable the projects to proceed to financing by this nation's capital markets.

4. ODOT accesses the highly specialized expertise and entrepreneurial attitude of one of the world's largest financiers of transportation infrastructure. Macquarie will bring a broad understanding of the full spectrum of private road financing into its analysis including accessing revenue sources other than tolling.

NEXT STEPS

Should the Oregon Transportation Commission approve the pre-development contracts with Macquarie for the three projects on January 18th, work will begin immediately. The projects will proceed according to milestones based on each project's state of readiness.

- Milestone 0 – Scoping Study. A determination of whether a project is ready to be fully developed now or is fatally flawed or whether development should be deferred. I-205 and Sunrise will go forward into Milestone 0. This work should be complete by six months after start (about July 2006). For Newberg-Dundee, a streamlined version of scoping will be completed under Milestone 1.
- Milestone 1 – Commercial and Financial Viability. A determination of how the projects will be funded and developed and whether there is a gap in available funding and how much the gap is. Only Newberg Dundee will go forward initially to Milestone 1. This work should be complete by 8 to 10 months after start (about Autumn 2006).
- Milestone 2 – Implementation Plan Development. A determination of how the project will be financed, how to contract with a construction firm and development of a terms sheet for negotiating the Implementation Agreement between ODOT and Macquarie. This work may be complete for Newberg Dundee by 18 months after start (about July 2007).
- Milestone 3 – Implementation Agreement Negotiations and Closing. ODOT and Macquarie negotiate to an Implementation Agreement and the project proceeds to financing following completion of the environmental process. This work may be complete for Newberg Dundee by 24 months after start (about December 2007).

These estimated dates of completion can be altered by events not within the control of ODOT or Macquarie. Unknown issues may arise for each project that may either speed up or delay project development. For example, regulatory approvals or local, state and national politics or local, state, national or worldwide economics can all alter a project's timeline.

Additional legislation may be needed to move ahead into negotiation of an Implementation Agreement with Macquarie. We are looking at whether all the elements that allow the operation of a highway by a private sector firm can occur under existing laws and whether additional enforcement authority is needed if tolls are used to finance the three projects. These are items you may need to consider during the 2007 Legislative Session.

SUMMARY

By embracing public private partnerships for these three projects, the State of Oregon is heading in a bold, new direction to provide the transportation infrastructure necessary to support our economy and our quality of life. Oregon is taking this path because we are currently unable to meet the transportation needs of our citizens and businesses for large infrastructure improvements in the foreseeable future.

It is yet to be known whether Oregonians will accept this new approach. Nevertheless, the public must be engaged in order find out. ODOT, through its Oregon Innovative Partnerships Program, has created a relationship with a private sector firm that minimizes the state's risk during the developmental stage. If the private effort proves unacceptable to Oregonians, ODOT has numerous opportunities to back out at limited and affordable cost. At the same time, this effort also provides Oregon the best opportunity to build the Newberg Dundee By-pass, the Sunrise Corridor and to expand South Interstate 205.