

# **Tolls, User Fees, and Public-Private Partnerships: The Future of Transportation Finance in California?**

**An Informational Hearing of the Senate Transportation and Housing Committee**

**Wednesday, January 17, 2007  
1:30 – 4:30 pm  
Room 4203, State Capitol Building**

## **Background**

### **Introduction**

This hearing will consider the state's policy concerning the use of user fees to fund transportation projects. Questions before the Committee include whether and in what ways to expand the authority to develop toll facilities, and whether and under what conditions to allow public agencies to enter into lease agreements with private companies to do so.

As part of Governor Schwarzenegger's Strategic Growth Plan last year, the Administration proposed authorizing state and local agencies to enter into long-term lease agreements with private entities for the design, build, finance and operation of transportation facilities, arrangements known as "public-private partnerships (PPPs)." One objective of the Administration's proposal was to leverage public funds with private sector investment to enable state and local agencies to develop more transportation projects than otherwise might be possible.

It its proposal, the Administration sought broad, open-ended authority, yet failed to clearly describe to the Legislature its specific objectives or to identify potential projects that would achieve those goals. In response, the Legislature passed AB 1467 (Núñez), Chapter 32, Statutes of 2006, allowing for four transportation facilities to be developed through PPPs with the condition that projects "be primarily designed to improve goods movement." The legislation also authorized transportation authorities to operate high occupancy toll (HOT) lanes, including

exclusive lane facilities for public transit service and the administration of a value pricing program.

Due to remaining questions regarding the scope of this policy, in concert with a growing inability to fund the state's transportation needs adequately, the Senate Transportation and Housing Committee is re-examining AB 1467. In doing so, it is taking a step back from the narrow issue of PPPs and considering a broader policy on user fees, usually paid in the form of tolls, as a way to provide funding for transportation facilities.

Today's hearing has three objectives. The first is to learn about California's existing public and private transportation facilities that are financed at least in part by charging tolls to users. What lessons have been learned that the Legislature should understand as it considers a policy on user fees and private sector investment to finance transportation facilities? The second objective is to understand some of the benefits of tolling. In what ways can tolling regimes be established to achieve multiple transportation goals, such as reduced congestion, improved air quality, and increased transportation choices for the public? The third is to understand the circumstances under which PPPs serve the public's interest, and whether it is appropriate for the private sector to be involved in the development of a system that is intended to provide a benefit to the public? What criteria should be used in evaluating whether a PPP is an appropriate option for developing a needed facility? What are the benefits and risks of PPPs and what can a public agency do to maximize the benefits while reducing the risks to the public?

### **The Problem of Transportation Funding Today: Increasingly Fewer Options to Pay for Increasingly Costly Projects**

Funds for transportation projects have traditionally come from two sources: taxes and user fees. The vast majority of state and federal transportation funding comes from taxes on fuel. State and federal excise taxes are flat, and have lost much of their value to inflation and rising construction costs.

The federal excise tax on gasoline is currently 18.3 cents per gallon, and some estimates indicate that between 1996 and 2008, the real value of the tax will decline 26%. The federal government is projected to spend more on transportation than it earns from the gas tax. To address this issue, the last federal transportation act – the Safe, Accountable, Flexible, Efficient Transportation Equity Act - A Legacy for Users (SAFETEA-LU) – established the Surface Transportation Policy and Revenue Study Commission to examine options to replace or supplement the fuel tax.

California charges an 18-cent per gallon excise tax on gasoline and diesel fuel. This tax, known as the "gas tax," has not increased since 1994, and has lost approximately 40% of its value. As an indication of the growing gap between funding and needs, in 2006, gas tax revenues were insufficient to fund California's most basic highway rehabilitation needs, let alone to pay for new projects.

In 2002, voters approved Proposition 42, which dedicated the sales tax on gasoline to transportation projects. Unfortunately, these funds have not made up for the lost value of the

excise tax on gas and its dedication to transportation has been suspended on several occasions to help address the state's on-going budget deficit.

As the value of federal and state fuel taxes has eroded, continued population growth places increasing demands on the state's transportation system and the cost of construction has increased dramatically. California currently has 37 million residents. By 2025, the population will approach 50 million people. Further, according to an analysis prepared by the Public Policy Institute of California, the vehicle miles traveled (VMT) by Californians is increasing at a much faster rate than population growth. People are driving increasingly more.

The cost of construction to accommodate the growth in population and the number of miles they drive has risen at a steep, and often unpredictable rate. Between January 2000 and December 2006, for example, the cost of construction has increased by approximately 30%.

Last year, voters approved Proposition 1B, which authorized the sale of approximately \$20 billion in bonds for transportation purposes. While an important step in strengthening California's infrastructure, Proposition 1B represents a one-time investment to address a backlog of transportation projects. To realize fully the benefits of this investment, it will be critical for the state to develop a stable, sustainable source of revenue for future transportation projects.

Despite the calls by many to increase fuel taxes, or at a minimum, index them to inflation, the cost of construction, or some other measure, there is not much will to increase taxes at this time. This political reality brings us to the other traditional source of transportation funding: user fees. User fees are most commonly paid by motorists in the form of tolls on highways.<sup>1</sup>

## **Toll Roads, Express and HOT Lanes, and Public-Private Partnerships**

### Toll Roads

Publicly owned and operated toll facilities are generally financed by issuing tax-exempt bonds to raise funds for the project. Bond holders are later repaid with toll revenues. The federal government has been increasingly supportive of building toll roads and lanes, and state interest in tolling has grown. According to the Federal Highway Administration (FHWA), 26 states have undertaken toll road projects since 1992 to build 2,719.5 miles of new roads.

California has five toll roads, all located in the County of Orange. In 1986, the Legislature gave the Transportation Corridor Agencies (TCA) authority to develop and operate a series of toll roads in Orange County, including San Joaquin Hills Toll Road (SR 73), Foothill Toll Road (SR 241), and the Eastern Toll Roads (SR 241, 261, and 133). The Transportation Corridor Agencies is made up of two public agencies: the San Joaquin Hills Corridor Agency and the Foothill/Eastern Transportation Corridor Agency. Each agency is governed by a board of

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<sup>1</sup> In the realm of goods movement, user fees have been paid in the form of "container fees." The Alameda Corridor Transportation Authority, for example, charges railroads \$18.04 per twenty-foot equivalent unit (TEU) (TEU is a measure of container size) to use the Alameda Corridor, which is a 20-mile freight rail expressway between the neighboring ports of Los Angeles and Long Beach and the transcontinental rail yards and railroad mainlines near downtown Los Angeles.

directors consisting of elected officials from the County of Orange and each city through which the toll roads operate.

An important advantage of publicly operated tolls roads is the presence of a public body that may be held accountable for the impacts the facility has on users. A second advantage is that excess toll revenues are often reinvested into the corridor to increase the capacity of the facility or provide other transportation options such as bus rapid transit.

The principal criticism of toll roads, relative to non-tolled roads, is that users of the facility are being “double-taxed.” Members of the public have already paid taxes on fuel to support transportation; by paying a toll, users would be burdened by an additional fee. Further, by facilitating the movement of people and goods, an effective transportation system supports the economy as a whole. Is it fair for individual users of a facility to bear the full costs of a facility that ultimately benefits an entire region?

#### Express Lanes and High Occupancy Toll (HOT) lanes

Express lanes and HOT lanes are located in the median or adjacent to free lanes, but charge a toll for their use. Express lanes are simply designed to provide a reliable, congestion-free trip. HOT lanes began as high occupancy vehicle (HOV) lanes (i.e., carpool lanes), but as many HOV lanes were under-utilized and congestion increased on the non-HOV lanes, legislation was passed to allow single-occupant vehicles to use the HOV lanes for a fee.

To manage congestion on these toll facilities, toll authorities began to employ a pricing method known as “congestion pricing.” Congestion pricing, also referred to as value pricing, variable pricing, or dynamic pricing, refers to adjusting the price of tolls throughout the day according to the volume of traffic using the facility. As volume and the potential for congestion increases, for example at peak commute times, the toll increases accordingly. Congestion pricing is based on the principle that increasing the toll will cause some drivers to choose not to use the toll lanes, thus reducing traffic volume and preventing congestion.

There are two primary advantages of this tolling method. The first is the ability to provide the guarantee of a reliable trip on those lanes for those who need it. This is helpful not only to individuals, but also, to businesses who depend on a schedule for the delivery of goods and services. Second, preventing congestion-induced delays on one lane may allow a greater number of vehicles to pass through the corridor as a whole.

California has two HOT lane facilities currently in operation - the SR 91 Express Lanes in Orange County and an 8-mile segment of I-15 in San Diego County – and two others in development - a 14-mile segment of I-680 in Alameda County and a 20-mile extension of the I-15 HOT lanes in San Diego. The Riverside County Transportation Commission recently approved a proposal to pursue projects that would extend the SR 91 Express Lanes into Riverside County and add two HOT lanes in either direction on I-15.

The principal criticism of express and HOT lanes is reflected in the term, “Lexus Lanes,” which is used to suggest that affluent users are given advantages over lower-income drivers who may

not be able to afford the cost of tolls. Opponents of toll lanes believe that transportation agencies should invest in facilities in ways that provide benefits to all users.

### Public-Private Partnerships

As the debate concerning how to involve the private sector in transportation has evolved in recent years, the term “public-private partnerships” has been applied to a broad array of arrangements and engendered much confusion. Indeed, there are many ways to involve the private sector, including in project design and construction (e.g., design build method of construction procurement), financial planning, operations, toll collection, or maintenance. For example, the Bay Area Toll Authority, a public agency, has a contract with ACS State and Local Solutions, a private company, to manage toll operations on the Bay Area’s six state-owned toll bridges.

For purposes of financing transportation facilities, the most relevant form of PPPs occurs when a public entity enters into a long-term concession (or lease) agreement with a private entity that finances, operates, and maintains the facility for a profit. While not new, the concession of transportation facilities in the United States is in its early stages. Twenty-one states, including California, have statutes in place allowing for PPPs in some form, but the scope of the policy, level of private sector involvement, and other conditions placed on the concession vary greatly from state to state.

In general, there are two types of concession arrangements. The first concerns the “sale” of an existing asset to a private company. Under this arrangement, the private entity pays a negotiated price in return for the right to charge tolls or other fees for a specified period of time in order to earn a reasonable rate of return on its investment. An example of this type of arrangement was the 99-year lease of the Chicago Skyway to the Macquarie Infrastructure Group-Cintra Consortium for \$1.83 billion in 2004.

The second type of concession arrangement, and one that is most relevant to today’s hearing, occurs when a public agency enters into a long-term agreement with a private entity for the design, build, finance, and operation of a new facility. This is known as a development concession. As will be discussed in a subsequent section of this report, California has experience with development concessions for two facilities: the State Route 91 Express Lanes in Orange County and State Route 125 in San Diego County.

The concessionaire, or leaseholder, raises its own money to finance the development of the facility. To pay underlying project debt, which includes providing a reasonable rate of return to investors, the project must have a dedicated source of revenue. This revenue source is most often found in the form of user fees (tolls). Although in a very limited number of projects, a public agency has agreed, as part of the concession agreement, to make payments to the concessionaire on a periodic basis based on usage of the facility or the attainment of specified performance goals.

An important advantage of development concessions is that private companies use their own capital to finance the construction of a facility, relieving a public agency from the burden of raising sufficient funding. Because of this advantage, state and local agencies may be able to

build a larger number of projects and/or projects that are larger in scope. A second advantage of private concessions is that they may shift responsibility for raising tolls to meet ongoing operation and maintenance costs away from public officials, who may feel reluctant to do so.

While PPPs may be a tool to help state and local agencies meet growing transportation needs, they raise a number of questions, concerns, and criticisms among the public. These include:

- With an expanded authority to toll, a public agency may be able to generate sufficient funds to develop transportation facilities on its own without relying on private capital.
- An individual project may cost the public (i.e., the users) more if it were developed by a private company, which has a duty to provide a reasonable rate of return to its investors, than if it were developed by a public agency, which has no such duty.
- The capacity of a project to generate revenue may dictate which transportation projects are developed and which are not, potentially leading to a fragmented transportation system that may not, over time, meet the needs of the state as a whole.
- Concession agreements may limit the ability of a public agency to adapt to the changing transportation needs of a region. For example, clauses in a lease agreement which require a public agency to pay “just compensation” to a private entity for the development of a nearby, competing facility constrains the ability of the public agency to make improvements to the area’s transportation system and increases the cost of those projects for the public agency.
- Working with a private entity may be a contentious, potentially litigious endeavor for public agencies because private companies will work to protect their investment over the public interest.
- Public officials are “outsourcing” political will to address funding shortfalls.

### **California’s Experience with PPPs**

In 1989, the Legislature approved AB 680 (Baker), Chapter 107, which authorized the Department of Transportation to enter into contractual agreements with private entities for the construction and operation of toll roads. Four demonstration projects were authorized in order to augment or supplement public sources of revenue because “(p)ublic sources of revenue to provide an efficient transportation system have not kept pace with California’s growing transportation needs.”

Under that bill, a private entity could obtain an exclusive development agreement for 35 years to construct a toll road facility. These agreements required that toll revenues be applied to “payment of the private entity’s capital outlay costs for the project, the costs associated with operations, toll collection, and administration of the facility, reimbursement to the state for the costs of maintenance and policy services, and a reasonable rate of return.”

Supporters of the measure saw it as an innovative way to address the problem of traffic congestion, contending that private roadways could serve as an important component of the state highway system. Only two projects have been constructed with this authority: SR 91 toll lanes in Orange County and SR 125 in San Diego County.

#### State Highway Route 91 Toll Lanes

The SR 91 project consisted of toll lanes in the median of existing SR 91 extending 10 miles. State Route 91 is an 8-lane, non-tolled freeway extending from I-405 in Los Angeles County to Interstate 15 in Riverside County. California Private Transportation Company (CPTC) entered into a franchise lease agreement with Caltrans to construct and operate toll lanes in the median of SR 91. The toll lanes were constructed for \$139 million and opened in 1995.

The SR 91 toll lanes generated substantial controversy. A clause in the lease agreement between Caltrans and CPTC prohibited the department from granting similar franchise rights to third parties or developing any public transportation facility within an “Absolute Protection Zone.” This zone was comprised of the area 1 ½ miles on either side of the centerline of the toll road facility. This restriction, commonly referred to as the “non-compete clause,” was deemed necessary to protect the toll road’s profitability and CPTC’s investment. Caltrans proposed to make a number of “safety” improvements totaling \$30.6 million, in order to curb the growing number of congestion-related accidents. Caltrans’ accident statistics indicated that the accident rate on this portion of the freeway was approximately 72% higher than on comparable freeways in the state. In response to the proposal, CPTC filed a lawsuit against Caltrans for violating the non-compete clause of its franchise agreement, arguing that the proposed project was not safety related, but in fact designed to increase capacity. Caltrans settled on October 12, 1999.

Additionally, although usage of the toll lanes increased from 1995 to 1998, the toll lanes experienced only one profitable year, 1998. The CEO of CPTC suggested in a newspaper article that the company would not turn a profit until 2004 unless the company could refinance its debt or find a buyer. CPTC was purportedly involved with the formation of NewTrac, a nonprofit company that could use tax-exempt bonds to buy the SR 91 toll road project. The sale raised a number of concerns about the nonprofit company and the propriety of the sale, and the sale was ultimately abandoned.

Meanwhile, congestion on SR 91 continued to worsen, reaching intolerable levels. In 2002, AB 1010 (Correa), Chapter 688, allowed the Orange County Transportation Authority (OCTA) to purchase the franchise rights to the toll lanes from CPTC, effectively repealing the non-compete clause and facilitating improvements along the corridor. OCTA acquired the SR 91 toll lanes for \$207.5 million, making California’s first operational private toll project a public facility.

#### State Highway Route 125

The SR 125 highway project consists of a 3.2-mile public, non-tolled segment (referred to as the “Gap and Connector” project that will be operated by the San Diego Association of Governments) and a 9.3-mile privately operated, tolled segment. Together, this highway will connect SR 905 near the international border to SR 54. Both segments are being constructed by California Transportation Ventures, Inc. (CTV), a wholly-owned subsidiary of Macquarie Infrastructure Group, but CTV is only responsible for the costs of the private segment. Under

the franchise lease agreement with the state, CTV will charge tolls for 35 years in order to recoup its costs and earn a reasonable rate of return on its investment. CTV's rate of return is capped at 18.5% over the 35-year period of the lease.

The extension of SR 125 has been included in the state's freeway plans since 1959, and the route was added to San Diego's 20-year regional transportation plan in 1984. Following the enactment of AB 680 in 1989, plans were initiated for this facility. In 1991, a lease agreement was completed and initial project studies and design were begun. Development and project approval proved lengthy and final environmental clearance was not granted until 2001. In 2003, the project received financing from Macquarie Infrastructure Group and construction began.

The cost for the Gap and Connector project (public, non-tolled segment), which CTV is building, is \$138 million. The 9.3-mile private segment that CTV will operate was originally estimated to cost approximately \$400 million, but the actual costs today are closer to \$635 million, representing a 70% increase. The project as a whole is currently estimated to cost approximately \$786 million, and delays have pushed the opening of the facility to the summer of 2007.

Both the tolled and non-tolled segments have experienced significant cost overruns and now project additional future costs, which have been and will continue to be borne by both SANDAG and CTV. Who bears responsibility for these increased costs – SANDAG or CTV – is subject to dispute between the two parties. The total amount in dispute is \$72 million.

Last year, the Legislature passed SB 463 (Ducheny), Chapter 446, to extend CTV's lease agreement and the period of time that tolls may be charged for use of the facility. The purpose of this bill was to provide a mechanism for SANDAG and CTV to determine how these increased costs will be addressed, regardless of who is ultimately deemed responsible.

The increased costs that remain to be resolved are due to several factors. The principal drivers of the cost increases, and those for which revenue from the extension period would be used, include the following:

*Compensation for competing facilities.* The franchise agreement included a "just compensation" clause requiring CTV to be compensated for loss of revenue due to the expansion or construction of competing transportation facilities. SANDAG is currently planning three projects in the adjacent I-805 corridor, which are not included in the lease agreement. These projects are expected to be completed in 2012, 2015, and 2030. Under the current lease agreement, CTV will be due compensation for any traffic and revenue reductions that these three projects create.

*Increased costs of rights-of-way.* Over the course of the project, the costs of acquiring rights-of-way have increased. SANDAG estimates that approximately \$18-\$20 million will be needed to complete the purchase of the necessary rights-of-way for the project. About \$10 million is for rights-of-way for the tolled segment that CTV is required to pay for, and \$8-\$10 million is for the non-tolled segment that CTV is constructing on behalf of Caltrans (though paid for by SANDAG) and for which it is seeking reimbursement.

*Increased costs for environmental and community mitigation measures.* Three mitigation measures seem to be driving the cost increase. The first concerns an alignment change of the non-tolled highway segment that CTV is constructing. The original alignment would have traversed an environmentally sensitive area, so the alignment was changed. The new alignment, however, went over rock that was especially difficult to build through. This caused construction delays and increased costs. The second environmental challenge concerned the Cedar Fires of 2004, which burned the habitat preservation CTV had completed as part of its responsibility to mitigate the environmental impacts of the project. Finally, the process of acquiring rights-of-way and necessary property has been ongoing and the costs of community mitigation measures (e.g., the construction of ball fields) have been higher than originally anticipated.

The cost over-runs, project delays, and the ongoing dispute between SANDAG and CTV give some pause as to whether and how the private sector can effectively provide a public facility. The facility is not yet in service and already increased costs are being transferred to motorists who will be paying tolls for a longer period of time.

### **Relevant Legislation**

**AB 521 (Runner), Chapter 542, Statutes of 2006** amended AB 1467 (Núñez), stipulating that the Legislature has 60 legislative days to act after submittal of a negotiated lease agreement with a private entity for the design, build, finance, and operation of a transportation facility. The agreement will be deemed approved unless both houses of the Legislature concur in the passage of a resolution rejecting the agreement.

**SB 463 (Ducheny), Chapter 446, Statutes of 2006** allowed for the extension of the franchise lease agreement between the state and the private entity that is constructing and operating State Highway Route (SR) 125 in San Diego County for up to ten years. This bill also authorized the San Diego Association of Governments (SANDAG), upon expiration of the franchise lease agreement, to continue charging tolls on SR 125, provided specified conditions are met.

**AB 1467 (Núñez), Chapter 32, Statutes of 2006** authorized Caltrans to enter into up to four lease agreements with private entities for transportation projects related to goods movement. The measure also authorized regional transportation agencies to develop and operate high-occupancy toll lanes, including the administration and operation of a value pricing program and exclusive or preferential lane facilities for public transit.

**AB 2032 (Dutra), Chapter 418, Statutes of 2004** authorized SANDAG, the Sunol Smart Carpool Lane Joint Powers Authority, the Santa Clara Valley Transportation Authority, and the Alameda County Congestion Management Agency to allow single-occupant vehicles to use the high occupancy vehicle lanes for a fee and to undertake value pricing programs.

**AB 1010 (Correa), Chapter 688, Statutes of 2002** reduced the number of public-private partnership agreements authorized under AB 680 from four to two, and prohibited Caltrans from entering into any new agreement with private entities to develop and operate toll facilities after January 1, 2003.

**AB 680 (Baker), Chapter 107, Statutes of 1989** authorized Caltrans to enter into up to four lease agreements with private entities for the construction and operation of transportation projects.