

**Testimony of Bryan Grote
Principal, Mercator Advisors LLC**

And

Member, National Surface Transportation Infrastructure Financing Commission

**Before the
United States House of Representatives
Committee on Transportation and Infrastructure
Subcommittee on Highways and Transit**

Improving and Reforming our Nation's Surface Transportation Programs

March 30, 2011

Chairman Duncan, Ranking Member DeFazio, and members of the Subcommittee, thank you for inviting me to testify this morning. My name is Bryan Grote and I'm a Principal of Mercator Advisors. We provide financial consulting services to sponsors of major infrastructure projects and capital programs involving a blend of public and private sector resources and utilizing innovative procurement, financing or management techniques.

My prior experience includes working in a variety of positions for the federal government – including at the U.S. Department of Transportation, where I helped implement the TIFIA credit program and served as the first director following its enactment in TEA-21.

I also was privileged to serve on the National Surface Transportation Infrastructure Financing Commission (“Financing Commission”), which was authorized in SAFETEA-LU to explore alternative funding and financing mechanisms for surface transportation.

My testimony today reflects these multiple perspectives and focuses on federal financing tools that can stimulate greater infrastructure investment in this fiscally-constrained environment.

Federal Credit and Tax Incentives

Obviously there is a larger context dealing with surface transportation investment needs, revenue sources to fund those needs, and the federal role in helping address those needs as expressed through various policies and programs. But in the near term, especially with a fragile economy and a looming fiscal crisis, there is a benefit to looking carefully at federal credit and tax financing incentives that can significantly help sponsors of major projects and capital programs accelerate their initiatives with a minimal federal budget impact.

Credit assistance and tax incentives help maximize the financial capacity of state, local and project revenue streams by reducing borrowing costs. These financing tools can be quite efficient because:

- a) Project sponsors must identify revenue streams;
- b) The "market discipline" of private and other non-federal investment helps ensure that projects are economically sound and financially viable;
- c) They are applicable to both public and private projects; and
- d) They have a much smaller budgetary impact than traditional grants.

TIFIA Credit Assistance

One way for the federal government to leverage scarce resources and attract private investment is to be a provider of or credit enhancer to long-term debt. The majority of surface transportation infrastructure projects can attain an investment grade rating and access the capital markets. But certain projects – especially large, complex initiatives with new or uncertain revenue streams – may not be able to readily do so on cost-effective terms. They may be desired investments with significant benefits, but require some level of financial subsidy to advance. By being a provider of a limited amount of subordinate or supplemental "patient" capital, the federal government can enhance the creditworthiness of the senior debt and enable the project to access the capital markets for the balance of its financing needs. This is the TIFIA proposition, which was developed back in the mid 1990s.

TIFIA assistance provides powerful leverage – greater than 30:1 in terms of the amount of the capital investment compared with the cost of the federal subsidy – for two reasons:

- 1) The nominal amount of TIFIA assistance (face amount of the loan, guarantee or line of credit) is limited to 33 percent of the total project costs; and
- 2) The fiscal charge (subsidy cost) is based not on the face amount of the loan but on the present value of expected losses resulting from defaults. The weighted average budget score of TIFIA loans has been about 10 cents on the dollar.

To date, the TIFIA program has made \$7.9 billion in credit commitments for 23 projects representing \$29.4 billion in capital investment. Six of those commitments, totaling \$1.6 billion and representing \$6.0 billion in capital investment, have been retired.

As you know, the U.S. Department of Transportation announced earlier this month that it received 34 letters of interest from project sponsors seeking \$14.0 billion in new TIFIA credit commitments for project investments totaling \$48.2 billion. However, the current (SAFETEA-LU) level of TIFIA funding can support only about \$1.2 billion in credit assistance each year (assuming the historical average subsidy rate) – less than 10 percent of the expressed demand.

Some specific recommendations for enhancing the TIFIA credit program and increasing its effectiveness are:

1. Increase TIFIA Program Funding. Based on the current demand and the anticipated future pipeline of major projects, Congress should consider significantly increasing the TIFIA program funding level. Two years ago, the Financing Commission recommended a funding level of \$300 million per year (nearly a three-fold increase). Given the credit demand that has been expressed since that time and the continued relative lack of long-term capital for infrastructure projects, it might be appropriate to consider an even higher level. Annual funding of \$300-500 million, for example, could support \$15-25 billion of new loans and leverage \$45-75 billion in total investment over the next five years.

2. Broaden TIFIA Eligibility to Include Programs of Related Projects. TIFIA was originally conceived as a "project finance" tool with credit commitments tied to project-specific milestones, including environmental approvals. Today, however, transportation agencies are recognizing that a *capital program of large, inter-related projects* can produce systemic regional benefits in terms of improved mobility, air quality and economic development. Explicitly extending TIFIA eligibility to multi-project capital improvement programs involving major reconstruction, rehabilitation or renewal would help state and local sponsors improve system performance by supporting a state of good repair.

3. Authorize Upfront Contingent Commitments. Sponsors of large capital programs of related projects would benefit if TIFIA credit commitments were more predictable over a multi-project / multi-year delivery period. This could be achieved by authorizing the use of upfront conditional commitments, with subsequent loan (or other credit instrument) obligations and disbursements subject to individual projects meeting all relevant federal requirements, including environmental approvals under the National Environmental Policy Act. The contingent commitment would be available only if the program sponsor already had access to dedicated revenue sources that could be pledged to repayment of the TIFIA loan(s). The use of contingent commitments would mitigate financing risk for TIFIA-eligible projects and programs with the greatest scope and complexity. TIFIA commitments could further reduce financing risk for large initiatives if there was an authorization to use a limited portion of TIFIA funding for partial interest rate buy-downs, in the event rates rose between the time of the contingent commitment and the date of the loan obligation, when the interest rate is established. To control costs and share risks, Congress could limit the use of any interest rate subsidies and require some form of cost-sharing responsibility by the TIFIA borrower.

4. Eliminate or Modify the Springing Lien. TIFIA loans are intended to be subordinate to other lenders to induce co-investment and reduce financing cost. But under current law, in the event of a bankruptcy-related event, the federal loan "springs" to equal status with other loans. Because of this murky status, the rating agencies and senior lenders do not view the TIFIA loan as truly junior, eroding the intended credit enhancement of the senior debt and reducing the benefit of the TIFIA subsidy. In addition, TIFIA's murky lien status hinders the ability of some project sponsors – which have already issued other bonds under an existing trust indenture secured by the same revenue sources intended to be used with TIFIA commitments – to make effective use of the program. The Financing Commission recommended eliminating the springing lien provision, stating that any perceived increase in credit risk (resulting from potential losses in a bankruptcy-related

event) should be reflected in the subsidy cost estimates of the TIFIA credit instruments. Alternatively, Congress could consider waiving the springing lien for very secure loans with investment grade revenue streams not dependent on project performance or utilization and leaving the springing lien in place for other projects and credit structures (e.g., project financings backed by relatively speculative user fees).

5. Strengthen the TIFIA Institutional Platform. An enhanced TIFIA program will benefit from a stronger organizational structure to manage the increased volume and complexity. TIFIA credit commitments are associated with some of the largest projects and most complicated capital structures. It is important for the federal government to devote sufficient resources – both internally and externally – to properly evaluate proposals, negotiate deals, and monitor and enforce long-term agreements.

Tax Incentives

Another way the federal government can leverage scarce resources and attract private investment is to subsidize the cost of desired investments through tax incentives. Like credit assistance, tax incentives can support greater investment at just a fraction of the scored cost of traditional grants. Although tax code changes are not under this Committee's jurisdiction, they should be considered in developing any comprehensive federal financing strategy for surface transportation.

1. Private Activity Bonds. Congress should continue and expand the highway / intermodal Private Activity Bond (PAB) program. Project sponsors increasingly will explore public-private partnerships (P3) in advancing major initiatives. And highway / intermodal PABs will grow in importance as a P3 financing tool – especially as the credit crisis recedes and the economy gradually recovers. The Financing Commission recommended increasing the national volume cap from \$15 billion to \$30 billion. It also suggested some technical amendments that would improve the use of this tool – notably exempting the interest on PABs from the Alternative Minimum Tax (AMT).

2. Tax Credit Bonds. Congress should consider authorizing a Qualified Tax Credit Bond (QTCB) program targeted specifically at surface transportation infrastructure investments. There are several existing QTCB programs with total authorizations exceeding \$36 billion for forestry conservation, renewable energy projects, energy conservation, qualified zone academies and school construction projects. The Build America Bonds authorized in the Recovery Act were another form of tax credit bond that was broadly applied without limitation (other than having a December 31, 2010 expiration date). In contrast, the Financing Commission recommended that any such tax incentive be structured narrowly to facilitate the financing of major projects that benefit the public. A more targeted tax credit bond program for surface transportation, like the existing QTCB programs, would have its:

- Permitted purposes carefully defined;
- Issuance volume legislatively capped;

- Maximum interest rate subsidy set daily by the Treasury; and its
- Maximum bond term set monthly by the Treasury.

A tax credit bond program for surface transportation could meaningfully supplement the existing federal program supported by the Highway Trust Fund with a modest scored budget impact. For example, Congress could authorize the issuance of \$50 billion in tax credit bonds over a five- or ten-year period for qualified surface transportation projects. The bonds would have a term of perhaps 30 years, commensurate with the useful life of the projects they finance. The federal government, by paying the annual interest due on the bonds through tax credits, would amortize its subsidy cost over the term of the bonds in the form of tax expenditures – effectively achieving a quasi capital budgeting approach. The federal interest subsidy on long-term bonds would provide a very significant financial benefit to state and local project sponsors. Through this kind of tax credit bond program, the federal government could generate \$50 billion in total investment for a scored budget cost of only about \$10-15 billion (depending on the pace of bond issuance and other technical assumptions).

Authorization of a large tax credit bond program for surface transportation would also broaden the market for U.S. infrastructure investment. It would provide an attractive vehicle for private capital from pension funds, life insurance companies and other corporate / taxable-rate investors which have longer-term investment horizons matching the financing needs of most infrastructure projects but which do not benefit from holding tax-exempt debt or face other constraints.

Conclusion

Both TIFIA-style credit assistance and targeted tax subsidies (such as provided through a QTCB program) can be effective federal policy tools in helping project sponsors monetize revenue streams to generate greater investment. They also can be used to encourage private sector participation in surface transportation – through providing investment capital, accelerating project delivery, and life-cycle costing of infrastructure assets. And they have a relatively modest budget impact compared with their investment potential – which is critically important in the current fiscal environment.

Thank you for allowing me to offer a few specific recommendations for improving and expanding the federal financing tools available to surface transportation. As the Financing Commission and many other groups have noted, the fundamental twin challenges to addressing the nation's infrastructure crisis are prioritizing the most critical investments and identifying the most suitable revenues for making those investments. But providing financing incentives that help state and local project sponsors raise new revenue and generate more investment in major projects and capital programs will support the ultimate federal policy goals.

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
Truth in Testimony Disclosure

Pursuant to clause 2(g)(5) of House Rule XI, in the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include: (1) a curriculum vitae; and (2) a disclosure of the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by the witness or by an entity represented by the witness. Such statements, with appropriate redaction to protect the privacy of the witness, shall be made publicly available in electronic form not later than one day after the witness appears.

(1) Name:

Bryan P. Grote

(2) Other than yourself, name of entity you are representing:

Mercator Advisors, LLC

(3) Are you testifying on behalf of an entity other than a Government (federal, state, local) entity?

YES

If yes, please provide the information requested below and attach your curriculum vitae.

NO

(4) Please list the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by you or by the entity you are representing:

Signature

Bryan P. Grote

Date

3-25-11

Attachment

Bryan P. Grote
Truth in Testimony Disclosure

Please list the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by you or by the entity you are representing:

FY 2011: Contract (\$11,628) with the Research and Innovative Technology Administration (Volpe National Transportation Systems Center)

FY 2011: Subcontract (\$10,000) with GRA, Inc., which holds a contract with the Federal Aviation Administration

FY 2011: Subcontract (\$68,340) with Battelle Memorial Institute, which holds a contract with the Federal Highway Administration (Program Support for Highway Policy Analysis)

FY 2010: Subcontract with Cambridge Systematics, which holds a contract with the Federal Highway Administration (IDIQ contract with the Office of Freight Management and Operations – no task orders executed)

Bryan Grote

Principal, Mercator Advisors LLC

Bryan has over 20 years of experience in government finance and infrastructure policy, with particular expertise in federal budget issues, credit policies and financial management practices. He co-founded Mercator Advisors in 2001 with David Seltzer. The firm provides a broad array of financial consulting services to government, corporate and non-profit sponsors of major infrastructure projects and programs. Mercator specializes in large or complex capital investments involving a blend of public and private sector resources and utilizing innovative procurement, financing or management techniques.

Bryan's prior experience includes helping design and implement TIFIA (the Transportation Infrastructure Finance and Innovation Act); he was the credit program's first director.

His other notable work experience includes serving as:

- Financial Policy Advisor in the Office of the Secretary of Transportation;
- Policy Analyst with the Federal Aviation Administration;
- Program Coordinator with the Federal Highway Administration;
- Credit Analyst with the Congressional Budget Office; and
- Program Evaluator with the General Accounting Office.

In 2007 Bryan was appointed to the National Surface Transportation Infrastructure Financing Commission. He also is a member of the Board of Directors of the Public-Private Partnership Division of the American Road and Transportation Builders Association.

Bryan graduated from the University of Minnesota's Humphrey Institute with an MA in Public Affairs, and from the University of North Carolina with a BA in Geography.