SPECIAL FEATURE

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Study reveals surface tension

A recently released report on the US surface transportation system could lead to further opportunities for the private sector in financing transport infrastructure. But as Barry Parker reports, opinion is divided among the authors

Across the waterways from New York's downtown financial centre there hangs a long- simmering question.

It concerns the financing of much needed maintenance and upkeep on the New Jersey Turnpike, an important strand in the heavily trafficked Interstate 95 highway connecting Boston, New York, Washington, DC and Miami.

New Jersey's governor, Jon Corzine, with the ultimate free-marketer background - he was co-chairman of Wall Street powerhouse Goldman Sachs in the 1990s before entering the political arena - was unable to sell voters on the idea of privatising the turnpike throughout 2007. So, three years after Macquarie/Cintra's ground-breaking investments in two United States motorways - the Chicago Skyway and Indiana Toll Road - Corzine's newly ann¡ounced 2008 budget considers paying for New Jersey highway upkeep the old-fashioned way: by raising tolls.

In mid- to late 2005, almost a year after Macquarie and Cintra jointly splashed down USD1.8 billion on the 99-year Chicago concession, the US Department of Transportation (DOT) received a five-year authorisation for surface transportation. The legis¡lation - called the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (Safetea-lu), also known as Public Law 109-59 - contained a little-known section authorising an extensive study of the US surface transportation system and requirements for the future.

The USD3.8 billion 75-year Indiana concession was completed in mid-2006 after work on the study had begun. In mid-January 2008, the 12-member National Surface Transportation Policy and Revenue Study Commission released its findings, nearly two years in the making. The new report, entitled 'Transportation for Tomorrow', will guide legislators in setting the course for the US transport system - a course in which, potentially, the private sector could have an expanded role.

The commission, independent from the DOT, had conducted hearings around the US, gaining the input of numerous experts from government and academia, but also from real-world supply chain and finance experts.

Funding shortfall

Not surprisingly, the top-line conclusion is that massive investment will be required in US infrastructure going forward, and that current financing mechanisms fall vastly short of the funding that will be necessary out to 2035 and beyond. Although many scenarios are presented, a requirement for an estimated USD301 billion annually is projected through 2035 for surface transport, with USD250 million targeted for highway transportation. These numbers represent an overall funding gap, compared to what could be generated using present mechanisms, of USD215 billion annually over the time period.

Interstate highway transportation funding is currently split between the federal government - which collects money principally through fuel taxes - and individual states; intrastate shorter-haul roads are funded directly by the states.

Railroad freight, a mode of surface transportation addressed briefly in the report, has long been financed by private companies using operating cashflows and capital markets to fund equipment and maintain tracks. Lately, railroads have been undergoing what analyst Anthony Hatch, principal of New York-based ABH Consulting, who provided input to the commission in 2006, called a "rail renaissance" at a January 2008 freight conference held near Manhattan's World Financial Centre.

A seemingly obvious conclusion is that more private sector investment would be desirable across all transport modes. Intuitively, innovative approaches - where facilities are operated by the private sector and variable pricing schemes exist that reduce congestion and raise money - would make sense. It is unlikely, going forward, for the broader transport picture, that voters rather than rail or maritime cargo interests will elect the officials who create the laws.

Indeed, the commission itself could not agree on the principal problems facing the US transport network. While it exhorts all concerned not to base transportation investments on political factors, the report acknow¡ledges that politics will continue to drive financing decisions, particularly with a "lack of transparent analyses of costs and benefits of alternative investments". Prognosticators of US political winds in an election year will instantly recognise battle lines being drawn.

Bankers seeking insights into market-responsive investment opportunities and dealflow resulting from possible changes in freight and passenger movements should probably start with a section of the report termed 'Minority Views'. Here, three of the 12 commissioners, including DOT Secretary Mary Peters, present a harsh rejoinder to the majority view.

The trio excoriates the commission for seeking to expand the existing funding templates, mainly through increases in taxes on fuel. Highway transportation, encompassing the heavily used interstate motorways, has traditionally been funded through cost-sharing formulae that have existed since the 1950s when the interstate highway system was originally conceived by the Eisenhower administration. Generally, the federal government pays 40 per cent, with states paying the balance. Present forecasts have the Highway Trust Fund, financed by fuel tax proceeds, facing a shortfall by 2010.

'Bold alternatives'

The minority position suggests that the study "fails to adequately consider the potential of more effective and bold alt¡ernatives". In essence, the latter would include forms of congestion pricing to reduce traffic and potentially shift it to other modes, rather than using highway tolls, which might be fixed or dynamically priced through electronic sys¡¡tems, for expanding existing networks.

Criticising the report for failing to consider "direct pricing of highways to offset the need for a gas tax increase", the three minority view commissioners refer to opinions expressed in a soon to be published study accounting for changes in land use, which has been prepared by Clifford Winston, economist and senior fellow at Brookings Institution (a thinktank based in Washington, DC), and the University of California's Ashley Langer.

The three commissioners suggest that: "Utilising congestion pricing in 98 metropolitan areas would generate approximately USD120 billion a year in revenues while simultaneously solving the recurring congestion problem in those areas."

Winston tells *Jane's* that the rev¡enues "account for changes in land use. The revenues themselves come from setting efficient congestion tolls".

Another Washington-based thinktank, The Reason Foundation, noted in a report on privatisation that more than 21 (of 50) states had passed laws enabling public-private partnerships (PPPs), setting the stage for more toll roads on the interstate system.

The commission's report provides support for PPPs at a high level. However, the minority position expresses concern that, even without specific projects in mind, the commission is already looking at tightening the regulatory noose on PPPs. The report contains a number of particularly galling suggestions for free market thinkers and infrastructure investors who might consider backing PPP investments such as toll roads, including a prescriptive that "customers' interests be protected by capping the rate of increase in tolls", as well as straightjacket-like restrictions on the reinvestment of toll proceeds.

One commission suggestion likely to gain traction is for a national freight fee that could be used to "fund pro¡jects that remediate chokepoints and increase throughput". The report acknowledges that a delicate interplay exists between the future national fee - which might raise USD2 billion annually if pegged at a hypothetical USD30 per teu - and local levies, with precedents that enable self-sustaining funding of particular projects.

A highly successful initiative from the freight arena is an USD18 per teu user fee on containers at the California ports of Los Angeles and Long Beach to fund debt repayments on the USD2.4 billion Alameda Corridor. The 20-mile (32 kg) trench, which opened in 2002, links deepwater container berths with inland rail hubs, moving approximately 5 million teu per year below ground level. Similarly, in New York, a rail link enabling containers to be moved from the docks to the inland rail system - put in place by bi-state transport agency Port Authority of New York and New Jersey - is maintained through a USD45 per teu lift fee.

The commission also recommends that a tax credit be implemented on investments in freight-handling facilities. Railroad lobbying for an infrastructure investment tax credit, pegged at 25 per cent of capital expenditures, led to S1125, a Senate bill introduced in 2007. ABH Consulting's Hatch tells *Jane's*: "Given the current outlook, the rails look to struggle over the long term to maintain capacity at current rates of market share; if we want to have them gain share - and relieve congestion and tax burden and emissions and keep global goods economical - then we might consider a stimulus like investment tax credits."

Short sea shipping

Short sea shipping (SSS), a much ballyhooed concept that benefited from US energy legislation in December 2007, is given short shrift by the commission. Construction of SSS tonnage will now qualify for a tax deferral mechanism - the Capital Construction Fund (CCF) programme - which was previously unavailable to owners of vessels operating in US intracoastal trades.

Shipyard and finance interests have consistently touted the benefits of SSS in relieving road congestion, and suggest that it would benefit in turn from an elimination, on certain shipments, of the Harbour Maintenance Tax: a 0.125 per cent levy collected on imports and exports that is mentioned briefly by the commission.

In spite of the report's suggestion that DOT programmes be restructured across all modes - including the development of a National Freight Transportation Plan with a focus on elim¡inating chokepoints on motorways - SSS has, so far, fallen below the radar. Brookings economist Winston, discussing a 2006 article co-authored with Langer, told *Jane's*: "Congestion pricing on highways may actually lead to more truck traffic. The reason... is that truckers and shippers place a higher value on the time savings than motorists [do]. Diversion of truck traffic onto coastal barges or newly constructed vessels is not a given."

The commission's omission is in stark contrast to the European 'Motorways of the Sea' network initiatives, introduced formally in 2001 and embodied in the October 2007 EU logistics package.

The European seaborne network "should absorb a significant part of the expected increase in road freight traffic, improve the accessibility of peripheral and island regions and states, and reduce road congestion", according to an EC working document.

Give and take

The disconnect between politics and finance is being closely watched in New York. Former bond trader Mayor Michael Bloomberg has been seeking to initiate congestion pricing over the past year. The DOT has offered to fund USD354 million of improvements for passenger transportation, provided that New York City puts a plan in place to reduce motor traffic entering central areas in mid-town and lower Manhattan during the working week. In spite of the successful implementation of congestion pricing in London, Bloomberg's plan has encountered stiff opposition.

Meanwhile, DOT Secretary Peters has demonstrated her free market mettle in the air transport arena by enacting capacity restrictions at New York area airports. Congestion in New York has led to unprecedented slowdowns across the country, with attendant economic consequences.

Peters has also floated a plan, currently in a mandatory comment period, in which US airports would adjust landing fees by time of day rather than aircraft weight. Such a measure would allow the market to drive the actions of individual companies but within a broad framework that achieves social benefit.

On this theme, Hatch points out an important irony, noting: "The railroads also solve numerous social problems... such as congestion, emissions, safety and tax spending. Ironically, some of the re-regulation adherents in Congress, the same body that received the commission report portending a coming transportation and infrastructure crisis, would actually limit returns. This would reduce this desirable spending."

Referring to the funding gap highlighted by the recent report, Hatch says: "Transport players know where to spend... I think that economic stimulus, a stable regulatory policy, continued good economic returns plus technical innovation... would go a long way towards narrowing the gap identified by the commission."