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The Honorable Joseph F. Markosek
Majority Chairman
Committee on Transportation
Pennsylvania House of Representatives

The Honorable Richard A. Geist
Minority Chairman
Committee on Transportation
Pennsylvania House of Representatives

Subject: Highway Public-Private Partnerships: More Rigorous Up-Front Analysis Could Better Secure Potential Benefits and Protect the Public Interest

In February 2008, GAO released a report entitled *Highway Public-Private Partnerships: More Rigorous Up-Front Analysis Could Better Secure Potential Benefits and Protect the Public Interest* ([GAO-08-44](#)) that reviewed: (1) the benefits, costs, and trade-offs of highway public-private partnerships; (2) how public officials have identified and acted to protect the public interest in these arrangements; and (3) the federal role in highway public-private partnerships and potential changes in this role.

The enclosed statement discusses these issues. If you or your staff have any questions, please contact Katherine A. Siggerud at (202) 512-2834 or siggerudk@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Individuals making key contributions to this report were Phillip Herr (Director), Steve Cohen (Assistant Director), Carol Henn, Bert Japikse, Richard Jorgenson, and Matthew Rosenberg.

Katherine A. Siggerud
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Mr. Chairmen and Members of the Committee:

As you know, America's transportation system is the essential element that facilitates the movement of both people and freight within the country. Nevertheless, the current federal approach to addressing the nation's surface transportation problems is not working well. Despite large increases in expenditures in real terms for transportation, the investment has not commensurately improved the performance of the nation's surface transportation system, as congestion continues to grow and looming problems from the anticipated growth in travel demand are not being adequately addressed. We have called for a fundamental reexamination of federal surface transportation policies, including creating well-defined goals based on identified areas of national interest, incorporating performance and accountability into funding decisions, and more clearly defining the role of the federal government as well as the roles of state and local governments, regional entities, and the private sector.

The private sector has long been involved in surface transportation, as contractors in the design and construction of highways. In recent years, the private sector has become increasingly involved in assuming other responsibilities including planning, designing, and financing. Under some of these arrangements, the private sector is being looked to not only to construct facilities, but also to finance, maintain, and operate facilities under long-term concession agreements—up to 99 years in some cases. In some cases, this involves a constructing a new facility and operating and maintaining it. In other cases, this involves operating and maintaining an existing toll road and the right to collect tolls in exchange for an up-front payment provided to the public sector.

In February 2008 we issued a report on public-private partnerships in the highway sector.¹ This statement is based on this report and focuses on (1) the benefits, costs, and tradeoffs to the public sector associated with highway public-private partnerships, (2) how public officials have acted to protect the public interest in highway public-private partnerships, and (3) the federal role in highway public-private partnerships. We did not review the potential concession of the Pennsylvania Turnpike as a part of this report and, therefore, are not providing views in this statement on the proposed public-private partnership involving this facility. We performed our work in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

¹GAO, *Highway Public-Private Partnerships: More Rigorous Up-front Analysis Could Better Secure Potential Benefits and Protect the Public Interest*, [GAO-08-44](#) (Washington, D.C.: Feb. 8, 2008).

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We limited the term “highway public-private partnerships” to highway-related projects in which the public sector enters into a contract, lease, or concession agreement with a private sector firm or firms, and where the private sector provides transportation services such as designing, constructing, operating, and maintaining the facility, usually for an extended period of time. This definition included long-term concessions for toll roads in which the private sector firm(s) receives some or all toll revenues over the life of the lease or concession agreement with the public sector. There are numerous other types of arrangements classified as “public-private partnerships” that we did not include. For example, we did not include fee-for-service arrangements in which effective ownership of a transportation facility does not transfer to the private sector. We also recognize that there may be other forms of highway public-private partnerships. We did not include these types of public-private partnerships in the scope of our work, and the findings and conclusions of our work cannot be extrapolated to those or other types of public-private partnerships.

In summary:

- Highway public-private partnerships have the potential to provide numerous benefits to the public sector as well as potential costs and trade-offs. Highway public-private partnerships created to date have resulted in advantages from the perspective of state and local governments, such as the construction of new infrastructure without using public funding and obtaining funds by extracting value from existing facilities for reinvestment in transportation and other public programs. The public can potentially obtain other benefits, such as sharing risks with the private sector, more efficient operations and management of facilities, and, through the use of tolling, increased mobility and more cost effective investment decisions. There are also potential costs and trade-offs—there is no “free” money in public-private partnerships—they are potentially more costly to the public and it is likely that tolls on a privately operated highway will increase to a greater extent than they would on a publicly operated toll road. There is also the risk of tolls being set that exceed the costs of the facility, including a reasonable rate of return, should a private concessionaire gain market power because of the lack of viable travel alternatives. By leasing existing facilities, the public sector may give up more than it gains if the net present value of the future stream of revenues (less operating and capital costs) given up exceeds the concession payment received. Additionally, because large up-front concession payments have in part been used to fund immediate needs, it remains to be seen whether these agreements will provide long-term benefits to future generations who will potentially be paying progressively higher toll rates throughout the length of a concession agreement.
- Highway public-private partnerships we have reviewed sought to protect the public interest in many ways, largely through concession agreement terms prescribing performance and other standards. While these protections are important, governments in other countries, including Australia and the United Kingdom, have developed systematic approaches to identifying and evaluating public interest before agreements are entered into, including the use of public

interest criteria, as well as assessment tools, and require their use when considering private investments in public infrastructure. For example, a state government in Australia uses a public interest test to determine how the public interest would be affected in eight specific areas, including whether the views and rights of affected communities have been heard and protected and whether the process is sufficiently transparent. While similar tools have been used to some extent in the United States, their use has been more limited. Using up-front public interest analysis tools can also assist public agencies in determining the expected benefits and costs of a project and an appropriate means to deliver the project. Not using such tools may lead to certain aspects of protecting public interest being overlooked.

- Direct federal involvement in highway public-private partnerships has generally been limited to projects in which federal requirements must be followed because federal funds have or will be used. While direct federal involvement has been limited, the United States Department of Transportation (DOT) has done much to promote highway public-private partnerships, but comparatively little either to assist states and localities in weighing potential costs and trade-offs, or to assess how potentially important national interests might be protected in such arrangements. Given the minimal federal funding in highway public-private partnerships to date, little consideration has been given to potential national public interests in them. Highway public-private partnerships may pose national public interest implications such as interstate commerce that transcend whether there is direct federal investment in a project. GAO has called for a fundamental reexamination of federal programs to address emerging needs and test the relevance of existing policies. Such a reexamination provides an opportunity to identify emerging national public interests, the role of the highway public-private partnerships in supporting and furthering those national interests, and how best to identify and protect national public interests in future public-private partnerships. We believe DOT has the opportunity to play a targeted role in ensuring that national interests are considered, as appropriate and have recommended that Congress direct the Secretary of Transportation to develop and submit objective criteria for identifying national public interests in highway public-private partnerships, including any additional legal authority, guidance, or assessment tools that would be appropriately required. We recognize this is no easy task—any potential federal restrictions on highway public-private partnerships must be carefully crafted to avoid undermining the potential benefits that can be achieved.

Highway Public-Private Partnerships Can Potentially Provide Benefits But Also Entail Costs, Risks, And Trade-Offs

Highway public-private partnerships have the potential to provide numerous benefits to the public sector. There are also potential costs and trade-offs.

Potential Benefits

Highway public-private partnerships created to date have resulted in advantages from the perspective of state and local governments, such as the construction of new infrastructure without using public funding and obtaining funds by extracting value from existing facilities for reinvestment in transportation and other public programs. For example, the state of Indiana received \$3.8 billion from leasing the Indiana Toll Road and used those proceeds to fund a 10-year statewide transportation plan. As we reported in 2004, by relying on private sector sponsorship and investment to build roads rather than financing the construction themselves, states (1) conserve funding from their highway capital improvement programs for other projects, (2) avoid the up-front costs of borrowing needed to bridge the gap until toll collections became sufficient to pay for the cost of building the roads and paying the interest on the borrowed funds, and (3) avoid the legislative or administrative limits that govern the amount of outstanding debt these states are allowed to have.² All of these results are advantages for the states.

In addition to advantages from the perspective of state and local governments, highway public-private partnerships potentially provide other benefits, including the transfer or sharing of project risks to the private sector. Such risks include those associated with construction costs and schedules and having sufficient levels of traffic and revenues to be financially viable. Various government officials told us that because the private sector more reliably analyzes its costs, revenues, and risks throughout the life cycle of a project and adheres to scheduled toll increases, it is able to accept large amounts of risk at the outset of a project, although the private sector prices all project risks and bases its final bid proposal, in part, on the level of risk involved. In addition, the public sector can potentially benefit from increased efficiencies in operations and life-cycle management, such as increased use of innovative technologies.

Highway public-private partnerships can also potentially provide mobility and other benefits to the public sector, through the use of tolling. The highway public-private partnerships we reviewed all involved toll roads. These benefits include better pricing of infrastructure to reflect the true costs of operating and maintaining the facility and thus improved condition and performance of public infrastructure, as well as the potential for more cost effective investment decisions by private investors. In addition, through congestion pricing, tolls can be set to vary during congested periods to maintain a predetermined level of service, creating incentives for drivers to consider costs when making their driving decisions, and potentially reducing the demand for roads during peak hours.

Potential Costs, Risks, And Trade-Offs

²GAO, *Highways and Transit: Private Sector Sponsorship of and Investment in Major Projects Has Been Limited*, [GAO-04-419](#) (Washington, D.C.: March 25, 2004).

Although highway public-private partnerships can be used to obtain financing for highway infrastructure without the use of public sector funding, there is no “free money” in highway public-private partnerships. Rather, this funding is a form of privately issued debt that must be repaid. Private concessionaires primarily make a return on their investment by collecting toll revenues. Though concession agreements can limit the extent to which a concessionaire can raise tolls, it is likely that tolls will increase on a privately operated highway to a greater extent than they would on a publicly run toll road. Tolls are generally set in accordance with concession agreements and, in contrast to public sector practices; allowable toll increases can be frequent and automatic. The public sector may lose control over its ability to influence toll rates, and there is also the risk of tolls being set that exceed the costs of the facility, including a reasonable rate of return if, for example, a private concessionaire gains market power because of the lack of viable travel alternatives. In addition, highway public-private partnerships also potentially require additional costs to the public sector compared with traditional public procurement, including the costs associated with (1) required financial and legal advisors, and (2) private sector financing compared with public sector financing.

In addition to potentially higher tolls, the public sector may give up more than it receives in a concession payment in using a highway public-private partnership with a focus on extracting value from an existing facility. In exchange for an up-front concession payment, the public sector gives up control over a future stream of toll revenues over an extended period of time, such as 75 or 99 years. It is possible that the net present value of the future stream of toll revenues (less operating and capital costs) given up can be much larger than the concession payment received. Concession payments could potentially be less than they could or should be. Conversely, because the private sector takes on substantial risks, the opposite could also be true—that is, the public sector might gain more than it gives up.

Using a highway public-private partnership to extract value from an existing facility also raises issues about the use of those proceeds and whether future users might potentially pay higher tolls to support current benefits. In some instances, up-front payments have been used for immediate needs, and it remains to be seen whether these uses provide long-term benefits to future generations who will potentially be paying progressively higher toll rates to the private sector throughout the length of a concession agreement. Both Chicago and Indiana used their lease fees, in part, to fund immediate financial needs -- both also established long-term reserves from the lease proceeds. Conversely, proceeds from the lease of Highway 407 ETR in Toronto, Canada, went into the province’s general revenue fund.

Highway Public-Private Partnerships Have Sought To Protect Public Interest In Many Ways, But Use Of Public Interest Criteria Is Mixed In The United States

The public interest in highway public-private partnerships can and has been considered and protected in many ways. State and local officials in the projects we reviewed heavily relied on concession terms. Most often, these terms were focused on, among other things, ensuring performance of the asset, dealing with financial issues, and maintaining the public sector's accountability and flexibility. Included in the protections we found in agreements we reviewed were:

- Operating and maintenance standards: These standards put in place to ensure that the performance of the asset is upheld to high safety, maintenance, and operational standards and can be expanded when necessary. For example, based on documents we reviewed, the standards on the Indiana Toll Road detail require the concessionaire to maintain the road's condition, utility, and level of safety including a wide range of roadway issues, such as signage, use of safety features such as barrier walls, snow and ice removal, and the level of pavement smoothness that must be maintained.
- Expansion trigger requirements: These triggers require that a concessionaire expand a facility once congestion reaches a certain level. Some agreements can be based on forecasts. For example, on the Indiana Toll Road, when service is forecasted to fall below certain levels within 7 years, the concessionaire must act to improve service, such as by adding additional capacity at its own cost.
- Revenue-sharing mechanisms: These mechanisms require a concessionaire to share some level of revenues with the public sector. For example, on one Texas project, if the annual return on investment of the private concessionaire is at or below 11 percent, then the state could share in 5 percent of all revenues. If it is over 15 percent, the state could receive as much as 50 percent of the net revenues.

While these protections are important, governments in other countries, including Australia and the United Kingdom, have developed systematic approaches to identifying and evaluating public interest before agreements are entered into, including the use of public interest criteria, as well as assessment tools, and require their use when considering private investments in public infrastructure. These tools include the use of qualitative public interest tests and criteria to consider when entering into public-private partnerships. For example, a state government in Australia uses a public interest test to determine how the public interest would be affected in eight specific areas, including whether the views and rights of affected communities have been heard and protected and whether the process is sufficiently transparent. These tools also include quantitative tests such as Value for Money and public sector comparators, which are used to evaluate if entering into a project as a public-private partnership is the best procurement option available.

While similar tools have been used to some extent in the United States, their use has been more limited. For example, Oregon hired a consultant to develop public sector comparators to compare the estimated costs of a proposed highway public-private partnership with a model of the public sector's undertaking the project. While this study was conducted before the project was put out for official concession, it was prepared after substantial early development work was done by private partners. Neither Chicago nor Indiana had developed public interest tests or other tools prior to the leasing of the Chicago Skyway or the Indiana Toll Road. Using up-front public interest analysis tools can also assist public agencies in determining the expected benefits and costs of a project and an appropriate means to undergo the project. Not using such tools may lead to certain aspects of protecting public interest being overlooked. For example, concerns by local and regional governments in Texas resulted in statewide legislation requiring the state to involve local and regional governments to a greater extent in future highway public-private partnerships. Elsewhere, in Toronto, Canada, the lack of a transparency about the toll rate structure and misunderstanding about the toll structure of the 407 ETR facility was a major factor in significant opposition to the project.

Direct Federal Involvement With Highway Public-Private Partnerships Has Generally Been Limited, But Identification Of National Interests In Highway Public-Private Partnerships Has Been Lacking

Direct federal involvement in highway public-private partnerships has generally been limited to projects in which federal requirements must be followed because federal funds have or will be used. However, minimal federal funding has been used in highway public-private partnerships to date. While direct federal involvement has been limited, the administration and the DOT have actively promoted highway public-private partnerships through policies and practices, including the development of experimental programs that waive certain federal regulations and encourage private investment. For example, until August 2007, federal regulations did not allow private contractors to be involved in highway contracts with a state department of transportation until after the federally mandated environmental review process had been completed. Texas applied for a waiver to allow its private contractor to start drafting a comprehensive development plan to guide decisions about the future of the corridor before its federal environmental review was complete. These flexibilities were pivotal to allowing highway public-private partnership arrangements in both Texas and Oregon to go forward while remaining eligible for federal funds. FHWA and DOT also promote highway public-private partnerships by developing publications to educate state transportation officials about highway public-private partnerships and to promote their use, drafting model legislation for states to consider to enable highway public-private partnerships in their states, creating a public-private partnership Internet Web site, and making tolling a key component of DOT's congestion mitigation initiatives.

Recent highway public-private partnerships have involved sizable investments of funds and significant facilities and could pose national public interest implications such as interstate commerce that may transcend whether there is direct federal

investment in a project. For example, both the Chicago Skyway and the Indiana Toll Road are part of the Interstate Highway System; the Indiana Toll Road is part of the most direct highway route between Chicago and New York City and, according to one study, over 60 percent of its traffic is interstate in nature. However, federal officials had little involvement in reviewing the terms of either of these concession agreements before they were signed. In the case of Indiana, minimal federal funds were used to construct the toll road, and those funds were repaid to the federal government. FHWA played no role in reviewing either the lease or national public interests associated with leasing the highway, such as potential impacts on interstate commerce, nor did it require the state of Indiana to review these interests. Texas envisions constructing new international border crossings and freight corridors, which may greatly facilitate North American Free Trade Agreement-related truck traffic to other states. However, no federal funding has been expended in the development of the project to date. Given the minimal federal funding in highway public-private partnerships to date, few mechanisms exist to consider potential national public interests in them. For example, FHWA officials told us that no federal definition of public interest or federal guidance on identifying and evaluating public interest exists.

The absence of a clear identification and furtherance of national public interests in the national transportation system is not unique to highway public-private partnerships. We have called for a fundamental reexamination of our surface transportation policies, including creating well-defined goals based on identified areas of national interest, incorporating performance and accountability into funding decisions, and more clearly defining the role of the federal government as well as the roles of state and local governments, regional entities, and the private sector. Such a reexamination provides an opportunity to identify emerging national public interests, the role of the highway public-private partnerships in supporting and furthering those national interests, and how best to identify and protect national public interests in future public-private partnerships.

Concluding Observations

Highway public-private partnerships show promise as a viable alternative, where appropriate, to help meet growing and costly transportation demands. The public sector can acquire new infrastructure or extract value from existing infrastructure while potentially sharing with the private sector the risks associated with designing, constructing, operating, and maintaining public infrastructure. However, highway public-private partnerships are not a panacea for meeting all transportation system demands, nor are they without potentially substantial costs and risks to the public—both financial and nonfinancial—and trade-offs must be made.

Highway public-private partnerships are fairly new in the United States, and although they are meant to serve the public interest, it is difficult to be confident that these interests are being protected when formal identification and consideration of public and national interests has been lacking, and where limited up-front analysis of public interest issues using established criteria has been conducted. Consideration of

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highway public-private partnerships could benefit from more consistent, rigorous, systematic, upfront analysis. Benefits are potential benefits—that is, they are not assured and can only be achieved by weighing them against potential costs and trade-offs through careful, comprehensive analysis to determine whether public-private partnerships are appropriate in specific circumstances and, if so, how best to implement them.

Despite the need for careful analysis, the approach at the federal level has not been fully balanced, as DOT has done much to promote the benefits, but comparatively little either to assist states and localities weigh potential costs and trade-offs, or to assess how potentially important national interests might be protected in highway public-private partnerships. We have recommended that the U.S. Congress direct the Secretary of Transportation to develop and submit objective criteria for identifying national public interests in highway public-private partnerships, including any additional legal authority, guidance, or assessment tools that would be appropriately required. We are pleased to note that in a recent testimony before the U.S. House of Representatives, the Secretary indicated a willingness to begin developing such criteria. This is no easy task, however. The recent report by the National Surface Transportation and Revenue Study Commission illustrates the challenges of identifying national public interests as the Policy Commission's recommendations for future restrictions—including limiting allowable toll increases and requiring concessionaires to share revenues with the public sector—stood in sharp contrast to the dissenting views of three commissioners.³ We believe any potential federal restrictions on highway public-private partnerships must be carefully crafted to avoid undermining the potential benefits that can be achieved. Reexamining the federal role in transportation provides an opportunity for the U.S. DOT, we believe, to play a targeted role in ensuring that national interests are considered, as appropriate.

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³*Transportation for Tomorrow*, National Surface Transportation Policy and Revenue Study Commission, Dec. 2007.

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