TESTIMONY OF MAX I. INMAN
SENIOR ADVISOR OF MERCATOR ADVISORS, LLC
BEFORE THE COMMITTEE ON ENVIORNMENT AND PUBLIC WORKS
UNITED STATES SENATE

MARCH 11, 2010

Federal, State and Local Partnerships to Accelerate Transportation Benefits

Good morning. My name is Max Inman, presently a senior consultant for Mercator Advisors LLC. I currently serve on the Taxation and Finance Committee of the Transportation Research Board. Prior to joining Mercator Advisors, I spent 33 years working at the Federal Highway Administration (FHWA), including 12 years as Chief of the Federal Aid Financial Management Division when I was responsible for overseeing the development and implementation of FHWA's innovative finance programs. This included responsibility for reviewing GARVEE bonds, state infrastructure banks, TIFIA credit instruments and public-private partnerships. I thank the Chairman and members of the Committee for the opportunity to testify.

In the mid-1990's, FHWA, under the leadership of Deputy Administrator, Jane Garvey, began to explore innovative finance techniques that would help state and local governments advance transportation projects. With the assistance of this Committee, many of these techniques were included in authorizing legislation helping to accelerate projects through more efficient use of federal funds. At FHWA during that time, I saw firsthand the value of federal, state and local agencies along with Congress all working together to find solutions to financing transportation projects.

Many project sponsors have taken advantage of initiatives such as state infrastructure banks, GARVEE bonds, TIFIA loans, enhanced advance construction procedures and more flexible state matching share provisions. We have made great progress in the last decade by providing a much wider array of financial tools than the standard 80% grant program that was the mainstay of the federal highway program until just a few years ago. We need to continue developing other beneficial finance techniques and looking for ways to improve the current techniques. But while these tools can be valuable, even more important is the over-riding need for sustainable <u>sources of revenue -- user charges and taxes</u> -- to make these financing techniques viable.

I would like to make a few comments about some possible next steps:

State Infrastructure Banks

Since their inception in 1995, state infrastructure banks have shown limited success. Almost forty states established banks due in large part to a modest $150 million in federal seed funds. Many of those states failed to capitalize the banks much beyond this initial infusion. To date, only eight states have exceeded $100 million in executed loan agreements. However, these states have shown how successful the banks can be, especially in providing assistance to local governments often resulting in local projects being completed well ahead of the projected date and at lower overall cost, compared to using a pay-as-you-go strategy.

I believe more states would benefit by having an active state infrastructure bank, although I recognize it is difficult for states to commit federal and state funds to a bank when the demand for direct grants far exceeds available funding. I would recommend that Congress provide incentive funds to encourage states to create or expand state infrastructure banks. Unlike the initial seed funds which created a feeding frenzy, the incentive funds might provide some level of matching funds for states that capitalize a bank using their federal or state program funds. Also, the states should be given more flexibility to use bank funds for any eligible transportation project.

GARVEE Bonds

Grant Anticipation Revenue Vehicles (GARVEE bonds) have been very successful in allowing states to advance large projects without seriously impacting their current program of projects. Allowing states to use federal funds to pay debt service payments conforms to the standard business practice of paying for capital improvements over the life of the asset. Using GARVEE bonds on major projects that result in accelerated benefits, including increased economic activity for the state, will likely result in greater state revenues during the period in which the bond payments are being made.

It is important to recognize that GARVEE bonds depend on the prospect of a long-term and reliable source of federal funds. Recurring short-term authorizations or temporary disruptions to federal payments because of shortages in the Highway Trust Fund could raise the risk of a default on bond payments. Uncertainty regarding the future of the Federal-aid Highway Program may impact states' ability to issue GARVEE bonds on favorable terms.

TIFIA Assistance

While experiencing a slow start after the enactment of the Transportation Infrastructure Finance and Innovation Act of 1998 (TIFIA), project sponsors are now recognizing the advantage of including TIFIA financing as part of a project's financial plan. The flexibility of the program that allows subordinate claims on pledged revenues and loan payments to be deferred until five years after the project is completed is tailor-made for long-term transportation projects. Unfortunately, the program is now unable to meet the demand for credit assistance, due to program funding constraints.

Because of its ability to help advance projects of national or regional significance, as well as its favorable budget scoring, the TIFIA program is a prime candidate for increased funding to help leverage federal resources. I believe the program would benefit from several technical changes – such as increasing the loan size up to 50 percent of project costs, incorporating the ability to provide incentive grants to help sponsors assess project feasibility and close funding gaps, and perhaps eliminating the so-called "springing lien" provision. I note that these, as well as other, changes were recommended by the National Surface Transportation Infrastructure Financing Commission. I also note that the investment goals contained in the Administration's Fiscal Year 2011 Budget proposal for a National Infrastructure Innovation and Finance Fund (NIIFF) probably could be accomplished by growing and refining the existing TIFIA program rather than creating a new entity within the Department of Transportation having similar if not overlapping responsibilities.

Private Activity Bonds

The use of private activity bonds (PABs) for highway/intermodal projects has been very limited since authorized in 2005, with only two projects totaling less than $1 billion issued from the $15 billion authorized. My initial view of this program was that it would allow states to increase their use of private operators on highway/intermodal projects but would not result in a significant increase in the issuance of tax exempt debt. Under current market conditions, PABs require ½% to ¾% higher yield than conventional tax-exempt bonds, somewhat diminishing their cost-effectiveness. I would recommend that this program remain in place to see if future market conditions might become more favorable to the use of private operators.

Build America Bonds

The federal stimulus legislation, The American Recovery and Reinvestment Act of 2009 (ARRA) enacted over a year ago established a new method of tax-advantaged borrowing by state and local issuers for governmental activities—Build America Bonds, or BABs. These taxable rate bonds are eligible for a 35% interest subsidy from the Treasury, resulting in a net cost to issuers as much as 1% below conventional tax-exempt rates today. In 2009, approximately 22% of the $64 billion issuance volume was for transportation purposes. These taxable bonds appeal to new categories of investors, such as pension funds and life insurance companies, who were not major investors in tax-exempt bonds. Not only have BABs helped stabilize the municipal market during a time of great turmoil, they also may be an important part of the infrastructure project finance landscape going forward. The President has proposed extending the BABs program beyond the current expiration date of December 2010, albeit at a lower 28% interest subsidy. I would recommend that Congress also consider the authorization of higher-subsidy BABs for certain kinds of desired transportation investments requiring a larger financial subsidy.

Other Federal Policies

There are other federal policy changes that may result in the acceleration of projects and encourage non-federal investment in transportation. For example:

- Reduce the number of federal programs (currently numbering over 100) and increase their flexibility to help states direct funds to their highest priorities. For instance, there may be only a few federal programs to assist states in meeting national objectives such as enhanced safety, reduced congestion or Interstate maintenance along with a program that provides incentive funds for states that are making progress in meeting those objectives.

- Consider providing the states with greater flexibility in matching federal funds on a program-level basis. The current project-level matching policies are complicated making it difficult to determine their effectiveness.

- Reduce and streamline the federal restrictions on tolling Interstate highways.

- Allow states to privatize Interstate highway rest areas.

Conclusion

Legislation initiated by this Committee has significantly enhanced the financing options available to state and local governments allowing for the acceleration of projects and more opportunities for participation by the private sector. This results in reduced construction costs and expedited benefits to the users of the transportation systems. But the effectiveness of any of these finance techniques depends on the establishment of a reliable and substantial source of funding. I am confident the Committee will meet this challenge.