COMMONWEALTH of VIRGINIA

Testimony of

The Honorable Aubrey L. Layne

Secretary of Transportation

Commonwealth of Virginia

Regarding

"Leveraging Federal Funding: Innovative Solutions for Infrastructure"

Before:

Senate Environment and Public Work's Subcommittee on Transportation and Infrastructure

On

May 16, 2017

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Chairman Inhofe, Ranking Member Cardin and members of the Senate Environment and Public Work's Subcommittee on Transportation and Infrastructure, thank you for the opportunity to provide input on the topic of innovative solutions for transportation. My name is Aubrey L. Layne, Jr., and I have the pleasure to serve as Secretary of Transportation for the Commonwealth of Virginia.

My testimony today will focus mostly on the topic of public private partnerships as this is a major topic in the current infrastructure discussion at the federal government level. These partnerships have been praised in some circles as the solution to all of our transportation problems and condemned in others as a corporate give-away. The truth is much more complex and ultimately dependent on the nature of the project and degree to which the government officials involved understand how these deals work and their fiduciary responsibility to taxpayers.

Prior to being appointed by Governor McAuliffe as Virginia's Secretary of Transportation, I served former Governors Kaine and McDonnell as a member of the Commonwealth Transportation Board for five years. I also served on the Chesapeake Bay Bridge-Tunnel Commission for five years, most recently as Chairman of the Board. I have had a 30-year business career serving as President of a large retail company, and President and Principal Broker for one of the largest privately owned multi-family real estate companies in the Mid-Atlantic region. I began my career as an auditor and certified public accountant for KPMG after graduating from the University of Richmond with a degree in accounting. I also hold a master's degree in business administration from Old Dominion University.

As Secretary of Transportation, I oversee the Commonwealth's seven transportation agencies – the Virginia Department of Transportation, the Department of Rail and Public Transportation, the Virginia Port Authority, the Department of Motor Vehicles, the Department of Aviation, the Virginia Commercial Spaceflight Authority, and the Virginia Motor Vehicle Dealer Board. Collectively, these agencies employ more than 10,000 staff and have a combined annual budget in excess of $6 billion.

I am also chairman of the Commonwealth Transportation Board. This Board is responsible for the administration, programming and allocation of funds for surface transportation within the Commonwealth.

Many of the most pressing issues facing directors of state departments of transportation (DOTs) today are different from those of the past. The toughest issues I face as a Secretary of Transportation involve resource allocation, financing and risk assessment, and operations – not engineering problems. My past experience has provided me with a foundation and knowledge of financing large-scale, multi-decade deals.

The goal of my testimony today is to describe, in terms that can be understood by the public and policymakers, the real world implications of public-private partnerships that leverage private investment.

Guiding Principles

First I want to be clear that financing, whether public or private, helps leverage funding but is not a replacement for sustainable and stable public funding. The Virginia General Assembly took courageous action in 2013 to enact new taxes and fees to support our transportation program. However, this was done with the expectation that the federal government would remain a strong and reliable partner in our efforts to improve the nation's transportation system. The first order of priority for Congress should be addressing the long-term solvency and growth in the federal Highway Trust Fund.

In 2014, I testified before the U.S. Senate Finance Committee on the importance of the federal transportation program. My three main points from that testimony remain true today – (i) the federal government has and should continue to have a strong role in surface transportation; (ii) while states are stepping up and raising revenues, they need a strong and reliable partner in the federal government; and, (iii) we need increased multimodal resources to address our transportation needs. I have submitted a copy of that testimony for the record on this hearing.

The McAuliffe Administration has several guiding principles on the topic of innovative finance and public-private partnerships that have influenced our actions over the past three and a half years—

- Our fiduciary responsibility is to the taxpayers of the Commonwealth and as such our actions must deliver the best results for the taxpayers;
- Public-private partnerships are a helpful procurement tool that can benefit taxpayers, where appropriate and when negotiated well;
- Government officials should consider all options, including public finance, before making decisions, particularly those that may last decades into the future;
- We must ensure competition throughout the process to deliver the best deal for the taxpayer; and,
- We must be transparent and accountable to the public and elected officials throughout the process.

I am a capitalist and a big believer in private industry. However, this belief is premised on true, free-market competition. For competition to work, both parties entering into partnerships must have a full understanding of the issues being negotiated and there cannot be ulterior motives. Unfortunately that is not always the case. Politics and ideology often times intercede in the negotiations.

If the above noted principles are followed, the public sector can realize significant benefits through the use of public-private partnerships.

Virginia is a leader

The Commonwealth has long been recognized as a leader in the field of transportation public-private partnerships. Our enabling legislation, the Public-Private Transportation Act, was enacted in 1995 and has served as a model for many other states.

Since 2007, we have closed 5 public-private partnership deals that transfer design, construction, finance, operations and maintenance responsibilities to the private sector. Collectively these deals are worth more than $9 billion, with more than $2.5 billion coming from private equity, less than $1 billion in public funds, and the remaining from privately backed debt. In addition we are currently negotiating contracts for an additional $1 billion in public-private partnership improvements along the I-95/I-395 corridor. Projects that have reached commercial close in the Commonwealth include—

2007 – Pocahontas Parkway, Richmond area - $672 million total value

- $0 upfront public funding
- $172 million in private equity
- $195 million TIFIA loan
- $305 million in private debt

2008 – I-495 Express Lanes, Northern Virginia - $2.1 billion total value

- $533 million upfront public funding
- $349 million in private equity
- $589 million TIFIA loan
- $589 million in private activity bonds
- $46 million in interest income

2011 – Downtown/Midtown Tunnels, Hampton Roads - $2.1 billion total value

- $308 million upfront public funding, at financial close
- $272 million in private equity
- $422 million TIFIA loan
- $675 million in private activity bonds
- $368 million in toll revenue during construction
- $46 million in interest income

2012 – I-95/I-395 Express Lanes, Northern Virginia - $923 million in total value

- $83 million upfront public funding
- $280 million in private equity
- $300 million TIFIA loan
- $253 million in private activity bonds
- $7 million in interest income

2016 – I-66 Express Lanes, Northern Virginia - $3.3 billion in total value

- $0 upfront public funding
- $1,522 million in private equity
- ~$1,800 million in debt; TIFIA and private activity bond amounts to be determined at financial close

Public-Private Partnerships – not the typical DOT transaction

Public-private partnerships are complex business transactions and unlike any other transaction a state DOT is typically involved. These deals last for decades instead of years. The longer term is necessary to provide time for the private sector to recoup the hundreds of millions of its own funds invested to build the project and repay an even larger amount of debt, plus a profit for their efforts.

Due to the significant amount of risk the private partners are taking, the contracts contain provisions to ensure that the private sector is held harmless if the government changes its mind on major business terms during the life of the deal. A DOT may choose to 'change its mind' after learning from an experience or because a new Governor disagrees with a decision of his or her predecessor. These changes usually involve compensation from the public to the private partner.

The normal citizen-government relationship may change due to the long duration of these contracts. Most contracts expire upon completion of the construction of a project or after a limited number of years. This provides the public with the opportunity to evaluate outcomes and, if necessary, ask government officials for changes. This is not the same with a 50-year concession contract with a private partner.

These deals also tend to involve some of the largest construction projects a state will ever deliver. The average value of the public-private partnership deal in Virginia is $1.8 billion compared with an average contract value of less than $5 million.

For these two reasons, it is imperative that the public sector understand the fiduciary responsibility of each party involved in a deal. The private sector is responsible to its shareholders and investors. Their goal is to make the deal as profitable as possible for the benefit of shareholders. This is understandable from the private sectors perspective. However, these deals involve public assets and repayment streams paid by the public. The public sector needs to make sure the public's interest is protected and advanced. The hard part is to find the opportunities where both interests are aligned.

Is a P3 the right procurement?

As I noted earlier, public-private partnership can be a useful tool to advance large-scale projects or a package of projects. However, they are not the silver bullet to solve the bulk of transportation needs a state faces.

The majority of work of a state DOT is akin to 'blocking and tackling' in football. This is not the type of work that press conferences are held for or that the newspaper writes stories about. But without on-going maintenance and operations the system will not work. More than half of the Commonwealth's surface transportation budget is dedicated to maintaining our existing assets.

A public-private partnership requires a repayment stream, such as tolls or taxes on adjacent property, that allows the private sector the opportunity to recoup the funds it provided to build the transportation project. This limits the pool of potential projects for P3s to a discrete number of projects unless a state is willing to pledge existing tax revenues to re-pay the private sector.

Not all projects that have an associated revenue source are good candidates for a P3 procurement. Another major consideration is whether there are risks that can be transferred to the private sector. Key risks in transportation include construction, long-term maintenance and operations, and financing (including revenue risk).

Being a good candidate for a P3 procurement does not necessarily mean that entering into a public-private partnership contract is in the best interest of the public. There are many nuances in a P3 deal that ultimately determine whether it is a good deal for taxpayers. Unfortunately we have experienced both the good and the bad in Virginia.

Virginia Experience – The Bad

In this section I will outline Virginia's experience with the Downtown/Midtown Tunnels project. I want to stress that the bulk of the negative outcomes resulting from this project and its contract are the fault of the public sector, not our private partner. In most cases our private partner lived up to their end of the bargain and delivered an important transportation project ahead of schedule, though there have been times we have had to hold them accountable for shortcomings. The public sector on the other hand did not do its job well and failed to protect taxpayers.

The Hampton Roads region is located in southeast Virginia. It is a region separated by major bodies of water – namely the Chesapeake Bay and the many branches of the Elizabeth River. The region's economy is driven by water based industries such as the United States Navy, the Port of Virginia, ship building, and tourism.

There is significant congestion at the major water crossings in the region. The Downtown/Midtown Tunnels project delivered much needed expansion of capacity in the region – it doubled the size of the Midtown Tunnel, rehabilitated the Downtown Tunnel, and extended the MLK freeway for two miles completing a missing connection in the regional highway network.

The project was delivered through a public-private partnership. Under the terms of the deal, the private partner was responsible for designing, building, financing, operating and maintaining the facilities for 58 years. In return they have the right to collect a fixed toll on these facilities with rates specified in the contract.

The previous administration did not explore all of its available options to advance this project. They believed the Commonwealth did not have enough resources to construct large scale projects and that private financing was preferable to public financing. This notion is flawed as the toll revenues used to repay the private partner just as easily could have been used to repay public bonds used to build the project. This ideology put the private sector in the driver's seat and resulted in bad public policy outcomes for taxpayers. There are four areas where this procurement and the resulting deal caused poor public outcomes:

1. The toll rates are contractually fixed but were not publicly disclosed in advance of the deal being signed. The decision to not work with the public to determine a consensus toll rate resulted in a public outcry and significant impacts on the many low-income individuals that live in the two cities connected by the tunnels. This lack of transparency took away the opportunity of the elected officials and the public to discuss whether they would have preferred to pay more money up-front to reduce tolls or pay the proposed toll rates. Ultimately due to public outcry, almost $275 million in additional public funds were invested to 'buy-down' toll rates. Had $275 million been made available during the procurement much more significant toll reduction would have been possible or the state would have determined that publicly financing the project was more advantageous.
2. The tolls were imposed on the facilities in advance of any new capacity. In fact due to rehabilitation work, existing travel lanes were closed on the Downtown Tunnel. Many in the community felt that they were paying tolls for a worse commute. Drivers should not have to pay a toll in advance of capacity improvements.
3. The Commonwealth failed to ensure that there were meaningful performance standards related to toll violations in the contract. The idea was that the private sector would ensure efficient operations because that was in their best interest. However, when tolling started it was clear that the operator was not prepared to do the work. They charged cars the truck toll rate. They sent toll violation notices to the wrong customers. The Commonwealth had little recourse as the contract only required the use of 'good business practices'. Ultimately, Governor McAuliffe had to use the bully pulpit for the Commonwealth to see better practices from our private partner.

4. The most damning aspect of this deal is a provision that requires the Commonwealth to "compensate" our private partner if any of the other water crossings in the region are expanded and this results in reducing their toll collections. This was never publicly discussed and in fact many did not know it was included in the deal until months after it was signed. In a region where congestion is concentrated at water crossings, why would a state agree to pay a third party for the privilege to spend its own money to widen other water crossings? To complete this abdication of fiduciary responsibility, Virginia failed to evaluate the potential cost implications of this provision. After the deal was signed the private sector disclosed it valued the provision at $774 million. This provision significantly reduced the risk taken by the private sector.

The problems with this deal are a result of the public sector not looking out for the taxpayer. I do not blame the private sector for asking for the compensation event that requires Virginia to pay for any diverted traffic. They were looking out for their shareholders – that is their job.

However, I do blame the public sector for agreeing to these requests. The failure to consider all options, ensure competition, and be transparent and accountable resulted in a bad deal for taxpayers.

Virginia Experience – The Need for Reform

In 2014, Governor McAuliffe entered office and wanted to ensure that the Commonwealth did not enter into any other deals like the Downtown/Midtown Tunnels P3 contract. I-66 outside the Beltway in Northern Virginia was the next major project to be considered in Virginia after the public outcry from the Downtown/Midtown Tunnels deal. This project would expand I-66 to 3 general purpose lanes and 2 express lanes in each direction over a 20+ mile corridor.

That year I received an analysis outlining whether or not this project should be procured as public-private partnership. The major underpinning of this decision was known as the 'Value for Money' analysis. It compared the cost of building and financing the project both publicly and privately, and attempted to monetize the value of transferring different risks to the private sector.

The value for money analysis found that a P3 was in the public interest as it would cost $186 million less than publicly financing the project after taking into account the value of transferred risks. Sounds like a P3 is the best solution, right?

As a certified public accountant I wanted to understand the basis for this determination. After reviewing the documents and several meetings it became clear that the basis for this determination was flawed. The analysis assumed that traffic projections and toll collections on I-66 would be negatively off by 25% - the average variance on toll road revenue projections over the previous ten years. If the project was publicly financed then taxpayers would be responsible for covering any debt service that tolls may be unable to cover while if the project was privately financed then taxpayers would be protected as private sector would be on the hook to cover debt service.

Our review found that if the traffic projections were off by less than 21%, then the analysis determined publicly financing the project was in the public interest. So for the estimated likelihood that traffic would be more than 21% off from projections, the Commonwealth was prepared to allow the private sector to finance the project with an assumed 13.5% return on investment.

It is not good business practice nor logical to apply the same risk profile to all projects. Each project is different and so is its risk profile. I-66 is the last link in a regional express lanes network. It is also in a region that has some of the worst congestion in the United States. It is not the same as express lanes in other parts of the country.

I was also told that the project would require a $900 million upfront public contribution and could not 'afford' to support any transit improvements. However, this was not the project the Commonwealth needed. I-66 after this expansion is unlikely to be widened again for a very long time but Northern Virginia is projected to continue growing at a rapid pace over the next 20 years. With a limited roadway footprint and continued growth, it is my responsibility to find ways to move more people in the space available. There are two ways to move more people – (i) encourage carpooling with express lanes to accomplish free passage for high-occupancy vehicles and (ii) increase transit service. Building a road without increased transit service meant not meeting our goals for moving forward with the project.

Based on this flawed analysis it was recommended that Virginia move forward with a P3 and not consider publicly financing the project. It was clear to me that the program needed to be reformed.

Virginia Experience – Implementing Reform

In early 2015, Governor McAuliffe directed me to re-evaluate our P3 procedures and develop a new path forward. I delayed the start of the I-66 P3 procurement for several months while this work took place.

These existing processes were leading to decisions that did not make sense or deliver the project the Commonwealth needed – so we decided to start over from scratch. We asked ourselves four key questions:

- What are the transportation objectives we want to accomplish with this project?
- How much does this cost?
- What are the revenues available to help us pay for this?
- What are the risks associated with this project?

We also worked in a bi-partisan fashion with our legislature to put in place new provisions in our P3 law to improve transparency and accountability. These changes were designed to help the public sector deliver the best deal for taxpayers. In some instances this meant reducing flexibility in negotiating business terms. In general, flexibility is a good thing for public-private partnership procurements, but too much can result in poor outcomes. It is flexibility in negotiating that allowed the compensation event for improving other water crossings to end up in the Downtown/Midtown Tunnels deal.

Virginia developed a new public-private partnership process to help deliver better outcomes for taxpayers. There are several key steps—

1. Establish major business terms of the deal based on what the Commonwealth wants to accomplish.
2. Develop a public option to finance the project based on these terms, including the amount of the upfront public contribution, if any.
3. Review the major business terms before the Virginia Transportation Public-Private Partnership Steering Committee to receive their concurrence with the public option and the major business terms. The Committee consists of representatives from the Office of the Secretary of Transportation, Office of the Secretary of Finance, the Commonwealth Transportation Board and legislative staff from the House of Delegates and Senate of Virginia.
4. If the Committee concurs, the private sector is then given the opportunity to beat the public option.
5. If the private sector submits a bid that meets the business terms and requires less upfront public funding than the public option the Commonwealth will enter into a P3 contract.

How did these reforms help the public?

The private sector is better at negotiating these deals than the public sector. This is not an excuse for poor past performance by the public. Rather it is a statement of fact that needs to be recognized. The private partners negotiate these types of deals on a regular basis while those on the public side often have never negotiated such a deal. We recognized this and put in place steps to increase our leverage during negotiations.

Many actions taken by politicians can undercut the public sector's negotiating position. For example, under the previous administration in Virginia the Governor stated that he wanted the Route 460 project under construction before he left office and that it would be procured as a public-private partnership. These types of statements may make good politics but they are terrible for negotiating positions. Imagine being the public sector negotiators in this situation. Can you really drive a hard bargain if the people on the other side know you need to deliver a result before the Governor's term ends? Can you really say you are going to walk away from a bad P3 deal if the Governor has said the project will be procured as a P3?

It is much easier to walk away from a deal if you have other alternatives to deliver a project. That is why the McAuliffe Administration reforms ensure the public option is always on the table to deliver the project. Governor McAuliffe also stated publicly that he would rather have no project than a bad deal. This gave us the ability to drive a fair bargain knowing we could walk away from the negotiating table.

We made sure the deal delivered the project the Commonwealth needed by setting the major business terms at the outset. In this case that included $800 million, in net present value, of transit improvements over the term of the deal. We were not going to let the private sector tell us this was not affordable – this is a part of our project. Similarly there are no compensation events to pay for higher than expected carpooling usage. Carpooling will help move more people and should not be restricted.

Finally by having the public option available, we ensure competition throughout the process. Competition is critical. No analysis can quantify the factors that may drive a bidder. The only way to understand and evaluate these factors is through a competitive process.

Initially many in the private sector did not react well to these changes. Lobbyists for these companies told legislators that we were going to kill Virginia's P3 program. As you will see that is not how things turned out.

Virginia Experience – The Good

This reformed process was used for the I-66 outside the Beltway procurement. Under past practices it was originally determined that the project:

- Required a $900 million to $1 billion upfront public contribution;
- Could not support transit improvements in the corridor;
- Could not provide any excess revenue for future improvements to the corridor.

The public option developed under our reformed process determined that the project:

- Required an upfront public contribution of not more than $600 million;
- Could support $800 million in transit improvements throughout the term, in net present value;
- Could provide $350 million for future improvements to the corridor over the term, in net present value.

Two private consortiums competed against the public sector option. Both submitted bids that were a better deal for the taxpayers than the public option the Commonwealth could deliver for itself. The winning partner, Express Mobility Partners, submitted the following bid:

- No upfront public contribution;
- $800 million in transit improvements throughout the term, in net present value;
- $350 million for future improvements to the corridor over the term, in net present value; and,
- $500 million for additional improvements to be provided at financial close this summer.

Overall this represents a $2.5 billion swing from where things started under our old process. Under our reformed process I can stand before our legislature and citizens, and state with confidence that we delivered the best deal for the taxpayer.

You may be thinking this is too good to be true. Without competition we would have never realized this outcome. Why did the winning team offer a deal that was so much better than our public option? The truth is you never know what drives someone in a competitive environment. Did they want a strategic foothold in a new market? Did they want to keep a competitor from having a monopoly? Are there negative interest rates in their home currency? Do they have a higher appetite for risk?

Now in Virginia the private sector must meet or exceed the public sector terms to have the right to enter into a P3 contract. This means a P3 deal is only signed now when we know this is the best deal available for the taxpayers.

What is the Federal role in public-private partnerships?

Public-private partnerships at their most basic level are contractual arrangements between the public owner of an asset and the private sector. In the United States, the owners of assets are almost always states or local governments. This limits the federal role to providing programs to help address barriers to P3s and resources to help public asset owners understand these transactions better.

Over the last ten years, Virginia has attracted $2.5 billion in private equity. This amount is more than 25% of the federal highway apportionment received by Virginia during the same period. I raise this issue not to say that private equity can replace public funds. It cannot. In fact without some form of public funding or publicly subsidized financing most public-private partnerships in the United States would not have happened. Rather I raise this issue to note that today there are not significant financial barriers to attracting private capital to invest in transportation projects.

The existing federal financing programs are very helpful for public-private partnerships. All of the P3 deals in Virginia have involved TIFIA loans from the U.S. Department of Transportation and most have involved private activity bonds. These tools can help states negotiate better deals for the taxpayer and do not create distortions in negotiations that only benefit a project if it is financed in a particular manner. TIFIA loans are available whether a project is publicly or privately financed. Private activity bonds can help level the playing field between public and private debt used for public infrastructure.

As Congress considers potential infrastructure packages in the coming months, I would strongly urge members to be careful not to create unintended consequences through new incentives for public-private partnerships. I have concerns with several of the proposals I have heard being floated for consideration. Many of these concepts would provide an incentive that is only available if a project is financed privately. This creates distortions in procurements that will undercut the public's negotiating position.

Many of these incentive concepts are particularly troubling because a significant portion of the federal incentive will end up being 'consumed in the transaction'. That is to say the public will not realize benefits for a significant portion of this federal spending. At the same time, Congress will need to find $1 for each $1 in incentive provided. When the federal Highway Trust Fund is taking in less than $40 billion but spending closer to $55 billion a year, I would hope that limited federal outlays would not be used for programs where the public does not realize at least a dollar for dollar benefit from money spent.

One of the ideas being floated is to provide a tax credit equal to 82% of the private equity invested in infrastructure to the private investor. The idea is that this will help attract private equity and may help lower the cost of equity in the transaction. However, this concept is flawed. In public-private partnerships the private consortiums create special purpose vehicles for each project. Due to depreciation, financing costs and project 'ramp-up' periods these entities usually do not have any taxable income for a number of years after they are created. This means that the private partners would need to sell tax credits to other parties. Each sale would be at a discount because no one will pay a dollar to have the same dollar then deducted from their tax liability. This would create a situation where the federal government would bear 100% of the cost of the tax credit but only realize a discounted benefit – likely in the 60-70% range.

Another idea that has been discussed is 'asset recycling'. This encourages states and localities, the asset owners, to seek private investment in their transportation projects by awarding a bonus payment of 15-20% of the value of a project to the public asset owner if it is privately financed. As an example, consider a situation where a state has a $2 billion project that could be publicly financed with only $200M in upfront public funding. The state offers the private sector the opportunity to beat the public option to determine if the private sector can offer a better deal for their taxpayers. If an asset recycling program is created in the United States, then in this example the private parties know that there is a $300 million 'bonus' payment that can only be realized by the state if they privately finance the project. The private sector could offer to build the project for $400 million in upfront public funding, knowing that because of the $300 million 'bonus' payment from the federal government the state would still be better off by $100 million compared to publicly financing the project. This would be true only due to this distortion from the federal program in the procurement even when the state pays $400 million upfront instead of

$200 million. While the taxpayer from the state perspective and the private sector may be better off in this example, the United States taxpayer paid an extra $200 million that did not result in public benefits.

Concluding Thoughts

In closing, there are significant transportation needs that this country must work to address. As state, local and federal governments work together to improve transportation we should not assume there is a single solution to these issues nor should we close doors on options available to assist in this effort. Financing alone cannot solve this problem, nor can funding. Similarly states cannot do this alone – we must have a strong and reliable federal partner.

Public-private partnerships offer real promise to help address certain transportation needs across the United States. However, they are not for all places or all projects. We must avoid the simplistic and easy assumption that if a project has a revenue source and risks that can be transferred, that a P3 procurement will always be in the best interest of the public.

Virginia's experience has shown that whether a public-private partnership deal is in the best interest of the public is not a black and white answer. Evaluating a decades long-deal involving hundreds of millions of dollars, if not billions, is a nuanced endeavor. States will need knowledgeable and experienced people at the table when these deals are being negotiated. The reformed P3 process implemented by the McAuliffe administration can serve as a model for other states in the country.

According to FHWA, there are only 42 surface transportation projects across the country that have involved private financing. Of these almost 60% have taken in place in just five states – Virginia, Texas, Florida, California and Colorado. Overall 35 states have never entered into a single transaction involving private financing. Many states would be unable to take advantage of private financing today even if they had a project that was a good candidate for a public-private partnership because they lack the knowledge and experience to do so.

I would encourage members of Congress to ask those who propose a program or incentive for public-private partnerships: (i) how it will help deliver the best deal for taxpayers and (ii) whether it will create distortions that undercut the public's negotiating position.

In Virginia we have found that there are plenty of opportunities for innovative finance and public-private partnerships. Many in the private sector will spend lots of time trying to convince policymakers that there are barriers that need to be addressed. Please remember that these are the same people who told Governor McAuliffe and me that the reforms we implemented in Virginia would kill our public-private partnership program. Eighteen months later we announced that the $3.3 billion I-66 outside the Beltway project was being delivered with no upfront public contribution and that we would receive a concession payment of at least $500 million at financial close.

We must remember our fiduciary responsibility to our citizens as well as those of the private sector when considering policy changes on this topic.

Thank you for the opportunity to provide input on this matter.

COMMONWEALTH of VIRGINIA

TESTIMONY

OF

The Honorable Aubrey L. Layne, Jr.

Secretary of Transportation

Commonwealth of Virginia

Regarding

New Routes for Funding and Financing Highways and Transit

Before

The United States Senate Finance Committee

On

May 6, 2014

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Introduction

Chairman Wyden, Ranking Member Hatch, Senator Warner and other members of the Senate Finance Committee, thank you for the opportunity to provide input on the importance of sustaining and increasing federal investments in surface transportation infrastructure. My name is Aubrey L. Layne, Jr., and I serve as the Secretary of Transportation for the Commonwealth of Virginia. My testimony today addresses the implication of the pending insolvency of the Highway Trust Fund and the lack of a fully-funded, long-term surface transportation bill on the Commonwealth of Virginia.

Over the last 18 months, there have been numerous witnesses before Congressional committees and reports from the Congressional Budget Office and the United States Department of Transportation that detail the dire state of the federal Highway Trust Fund. For those reasons, I will not discuss in detail the financial status of the Trust Fund, except to say that a significant infusion of revenue is necessary to avert negative balances in the near future.

Prior to being appointed by Governor McAuliffe as Virginia's Secretary of Transportation, I served former Governors Kaine and McDonnell as a member of the Commonwealth Transportation Board for five years. I also served on the Chesapeake Bay Bridge Tunnel Commission for five years, most recently as Chairman of the Board. In these positions I was involved in several major public-private partnership projects. I have had a successful professional 30-year business career serving, as President of a large retail company, and President and Principal Broker for one of the largest privately owned multifamily real estate companies in the Mid-Atlantic region where I was responsible for all operations and financing activities. I began my professional career as an auditor and certified public accountant for KPMG after graduating from the University of Richmond with a degree in accounting. I also hold a master's degree in business administration from Old Dominion University.

As Secretary of Transportation, I oversee the Commonwealth's seven transportation agencies – the Virginia Department of Transportation, the Department of Rail and Public Transportation, the Virginia Port Authority, the Department of Motor Vehicles, the Virginia Department of Aviation, the Virginia Commercial Spaceflight Authority and the Motor Vehicle Dealer Board. Collectively, these agencies employ more than 9,700 staff and have a combined annual budget in excess of $5.7 billion.

I am also the chairman of the Commonwealth Transportation Board. This Board administers, distributes, and allocates funds in the Commonwealth's Transportation Trust Fund, which provides funding for surface transportation capital improvements and maintenance activities.

Guiding Principles

Before I outline Virginia's transportation program and the importance of the federal-aid program to the Commonwealth, there are a few key points I would like to highlight.

- The federal government has and should continue to have a strong role in surface transportation. Transportation infrastructure is critical for the movement of commerce – both people and goods. Investments made today by transportation agencies will improve the ability of people to participate in the economy.
- While states like Virginia are stepping up and raising revenues, states can only do but so much. States, MPOs and transit agencies need a strong and reliable federal partner to help address pressing transportation needs like state of good repair and congestion mitigation.
- The solutions to resolve the federal surface transportation needs must be long-term and address all modes of surface transportation – highways, transit and rail. There needs to be discussion about growth in the program – patching the hole is only a short-term solution.

Virginia's 2013 Revenue Package

Virginia has struggled with solving its transportation funding situation for a number of years. There have been a number of proposals advanced in fits and starts that were intended to address the problem for the long-term but ultimately fell short. These include the Virginia Transportation Act of 2000, the 2002 regional sales tax referendums, House Bill 3202 in 2007 and other packages that were not enacted.

As you may know, last year a major revenue package that will provide long-term benefits was enacted. It was the first of its kind in 27 years. This package was passed by a Republican-led General Assembly and Republican Governor who worked across the aisle with Democrats. The final bill contains a number of provisions and represents a compromise by all sides. While no one was happy with all of the provisions in the bill in its final form, it passed both chambers of the legislature with close to a two-thirds majority.

The bill modifies a number of statewide taxes. First, the bill eliminated the 17.5 cents per gallon tax on gas and diesel and replaced it with a sales tax, 3.5% on gas and 6% on diesel. This ultimately represented a cut in the gas tax. To ensure that a certain amount of revenues would be generated from the sales tax on fuel, a "legislative floor" for the wholesale price of gas and diesel was established for the basis of determining the sales tax on gas and diesel. This provision has turned out to by very important, as the current wholesale price of gas is approximately 60 cents less than "legislative floor" price.

The package also raised two existing sales taxes to support transportation. The statewide retail sales tax was raised by 0.3%, with 0.125% being dedicated transportation improvements and 0.175% to support the maintenance and operations of the highway network. In addition, it raises the motor vehicle sales tax by 1.15% over a period of three years. These two sources represent the bulk of the new statewide revenues generated by this package.

A portion of the existing retail sales tax is transferred from the General Fund to the dedicated transportation fund over a 4-year period. The amount to be transferred was to be up to 0.175% sales tax, however the 0.075% was contingent upon the Congress passing the Marketplace Fairness Act. At this time only 0.1% has been transferred.

The bill also establishes a structure by which if Congress enacts the Marketplace Fairness Act a majority of the sales taxes collected from online retailers would be dedicated to transportation purposes. Of the total 5.3% state sales tax, 3.05% would be used for transportation. This is significantly more than the existing retail sales tax. In the event that Congress does not enact this legislation, then the sales tax on gas will increase to 5.1% on January 1, 2015.

Lastly, the bill recognizes the importance and more complex needs of Virginia's two largest metropolitan areas – Northern Virginia and Hampton Roads. It imposes additional taxes in these regions that will be controlled and allocated by regional authorities. In Northern Virginia the bill increases the retail sales tax by 0.7%, imposes a grantor tax of $0.15 per $100 of assessed value on real estate transfers, and imposes a 2% transient occupancy tax on hotel rooms. In Hampton Roads, the bill imposes a 0.7% retail sales tax and a 2.1% sales tax on gas. While not discussed as much, the new taxes in the regions will generate more revenue for transportation improvements than the statewide tax increases.

Virginia's Transportation Program

Virginia has a multimodal Transportation Trust Fund and related accounts that help fund projects to improve all modes of transportation. In fiscal year 2015, these accounts will provide approximately $1.2 billion for projects in the Commonwealth. The 2015 Transportation Trust Fund revenues are planned to be used as follows:

- 69% is dedicated for highway construction and capital repair;
- 19.6% is dedicated for transit capital and operating support;
- 6.4% is dedicated for passenger rail capital and operating support, as well as freight rail improvements; and
- 4.9% is dedicated for port and aviation improvements.

In addition to state revenues, the Commonwealth of Virginia aggressively pursues other potential funding and financing options to help improve our transportation system. The following sources and tools have been used over the last four years:

- TIFIA loans;
- Private Activity Bonds;
- Private equity;
- Contributions from local governments;
- Contributions from developers;
- State bonds;
- GARVEE bonds;
- Toll revenues; and,
- Loans and lines of credit from the Virginia Transportation Infrastructure Bank.

The surface transportation funds, other revenues and financing tools are combined with the $1.1 billion in federal funds to develop the Commonwealth's Six-Year Improvement Program. This Program is updated every June and the current draft of the Fiscal Year 2015 to 2020 Program is $13.1 billion.

The Program outlines the planned investments of a six-year period. It includes all capital projects receiving funds. Examples include the following:

- $12.7M project to restore and rehabilitate 11 miles of pavement on I-81 in Shenandoah County;
- $31.6M freight rail improvement along the Crescent Corridor to add a double track between Nokesville and Calverton in cooperation with Norfolk-Southern;
- $2B public-private partnership to add capacity to the Midtown Tunnel, extend the MLK expressway and rehabilitate the Downtown Tunnel in Hampton Roads;

- $25M for the first year of WMATA’s momentum program to improve the ability of the system to move more people through its core;
- $1.2M replacement of the Route 601 bridge over Little Walker Creek in Bland County; and,
- $95.8M project to extend passenger rail service to the City of Roanoke from the City of Lynchburg, connecting it with the Washington, DC and the entire Northeast Corridor.

Importance of the Federal Program

Even with all of the efforts and options undertaken by the Commonwealth, our program would not be what it is without our strongest partner – the federal government. Of the $2.1 billion in revenues available in fiscal year 2015 for transportation capital improvements, more than half comes from the federal government.

As you know, the federal Highway Trust Fund is facing an impending insolvency. Recent reports indicated that the Highway Account may face negative balances as soon as August and the Transit Account shortly thereafter. I want to be clear; if nothing is done to address this situation, the consequences will be dire.

In Virginia we expect the consequences of not shoring up the Trust Fund for fiscal year 2015 alone to be the following:

- 149 bridge replacements will not happen;
- 44 smaller transit systems, mostly in rural Virginia, will not have the funds to continue running;
- Over 350 other projects will ground to a halt; and
- 175 transit vehicles will not be replaced.

This outcome will impact more than 43,000 jobs across Virginia and the country. And these effects would grow over time.

In addition to these direct impacts, many states including Virginia have taken advantage of the tools provided by Congress to help advance large-scale projects through bonding backed by federal revenues. These bonds known as GARVEE are sold by a state and are to be paid back through future federal apportionments. If those apportionments are not provided then states are faced with the tough choice of canceling other projects to re-direct state revenues to pay debt service or defaulting on the bonds. States entered into these arrangements based on an understanding that future federal funds would be available.

Congress must act to shore up the federal Trust Fund. The solutions should address all modes of surface transportation, increase revenues and be long-term. The options on how this can be accomplished have been discussed at length so I will not outline them here.

The Commonwealth of Virginia will support pragmatic solutions to address this problem. The specific option of how to best address the problem should be selected by members of this Committee and other members of Congress.

I would like to note that the Trust Fund is not the only pending issue we face with regards to federal support for surface transportation. There are several key programs that are not currently included in the Trust Fund and must go through the annual appropriations process instead.

- The TIGER grant program has helped several key projects in the Commonwealth. It supported a TIFIA loan to advance the $1 billion I-95 Express Lanes project, provided $12 million to extend the life by 50 years of two structurally deficient bridges on I-64 in rural Alleghany County, and provided funds to build the first bus-rapid transit system in Virginia.

- Virginia partners with Amtrak to provide intercity passenger rail service to 23 communities across the Commonwealth. The lack of a federal partner for capital improvements hinders the ability of Virginia to expand service and meet the needs of our communities, many of which are losing air service and need connections to other parts of the Country.

- The New Starts grant program helps communities expand transit and leverages federal resources. The Dulles Rail project – arguably the most important project in Virginia and one of the largest construction projects in the country at more than $5 billion – would not be under construction without this program. Nor would my home region of Hampton Roads have its first rapid transit line – the Tide. The New Starts program provided $75 million to bring this project to fruition.

Unfortunately these programs are at risk each year and states do not know whether they will be funded in a given year. The certainty that is often discussed for the highway and transit formulas is just as important for these programs, though I find these programs are often left out of the discussion. Dedicated funding for these programs would help provide much needed certainty.

I understand there has been and continues to be a debate regarding the role of the federal government in transportation investments. As you consider these questions, I ask that the members of this Committee remember that transportation is not an end unto itself. We make investments to accomplish outcomes. A focus on whether an investment is on a particular road system or mode is not appropriate. People and goods move on all modes of transportation – not a particular road system or mode.

The focus should be on how an investment using federal funds achieves the desired outcomes. From my perspective the desired outcomes of transportation investments should be to support economic growth by more efficiently moving people and goods, and improving the ability of people to participate in the economy. At the end of the day, transportation is the backbone of our economy and investments should be considered through that aperture.

Demonstrating Public Benefit

Money alone is not the answer. There are many needs and the needs will always exceed resources. To be prudent stewards of the taxpayer funds, transportation agencies have a responsibility to ensure they can demonstrate benefit and results to the public from their investments.

The last federal reauthorization proposal, Moving Ahead for Progress in the 21st Century, started the transition towards a performance-based system. It requires states to establish targets for future performance in several areas and track performance made towards those targets.

We applaud these efforts and will take further steps in Virginia. This past legislative session, at the direction of Governor McAuliffe, I worked with the Speaker of the Virginia House of Delegates, William Howell, and other members of the House and Senate to develop legislation that will implement significant reforms for the programming of transportation funds.

The proposal signed by Governor McAuliffe requires the Commonwealth Transportation Board to develop a statewide prioritization process for capacity expansion projects. The process will establish criteria for congestion mitigation, economic development, accessibility, safety and environmental quality that will be used to rate projects. The Board will use this process to select projects for funding in our Six-Year Improvement Program.

We believe a commitment to transparency and performance is paramount. Our statewide prioritization process when up and running will help citizens of the

Commonwealth understand the benefits they will receive from transportation investments.

Financing Tools and Public Private Partnerships

As a former businessman, I understand the importance and benefits of having financing and other project delivery tools at your disposal. In Virginia we have used a wide range of financing tools and partnered with the private sector to delivery large scale transportation projects.

Federal tools like TIFIA and private activity bonds are helpful to bring large, complex projects to completion. Since 2005, Virginia has received the benefit of more than $1.4 billion in TIFIA. In 2011 an Office of Transportation Public-Private Partnerships was established to allow the Commonwealth to better partner with the private sector on projects. For this reason, I support proposals like Senator Warner's BRIDGE Act. These additional tools would help us advance projects moving forward.

However, I want to address a misconception that I have heard expressed by some. Financing and public-private partnerships are not silver bullets and cannot address many of the pressing transportation needs faced today. In fact without sustainable funding, states cannot take advantage of financing tools and would be unable to partner with the private sector.

The major benefit of public-private partnerships is the transfer of risk from the public to private partners and the private sector must be rewarded for taking on that risk. While this is possible for large-scale projects like the 495 Express Lanes in Northern Virginia, it will not work to reconstruct aging pavements on Interstate highways.

It is also important to remember that there are two "P"s before partnership in P3s – public and private. Without public sector funding the risk is too high to attract private investment. An often cited example of a successful P3 deal is the already mentioned 495 Express Lanes. However, in the initial deal only $348M of the $1.9 billion price tag did not involve some form of public support. The funding for deal is as follows:

- $495 million in federal highway trust fund and state funds;
- $589 million in TIFIA loans, publicly subsidized loans with favorable terms;
- $589 million in private activity bonds, publicly subsidized bonds through tax breaks provided to bond holders; and,
- $348 million in private equity.

Without public funding this project could not have been advanced. At the same time without the federal financial tools this project would not have been constructed

Conclusion

In closing, the problems that are faced are significant and the consequences too great to ignore. Many states like Virginia are doing their part to address this problem but we need a strong, reliable partner in the federal government.

The solutions to this problem have been identified. At this point it is a matter of Congress' willingness to take the necessary steps to implement them. Failure to do so will hinder the economic growth of this country.

The Commonwealth of Virginia and its partners – metropolitan planning organizations, transit agencies and local governments – stand ready to partner with the federal government and deliver a transportation system that will promote economic competitiveness.

I hope that over the coming months Congress will do its part and solve this problem in a cooperative, bi-partisan fashion.

Thank you again for the opportunity to address this Committee on an issue of vital importance to our nation's economy.