

ALASKA STATE LEGISLATURE



SENATOR JOE THOMAS

March 11, 2011

Mr. Andrew Niemiec, executive director
Knik Arm Bridge and Toll Authority
550 West 7th Ave., Suite 1850
Anchorage, AK 99501

Dear Mr. Niemiec,

Thank you for meeting with me to discuss SB 79 and SB 80 and the Knik Arm Bridge project.

I understand the value of investment in our infrastructure and the importance of projects that create jobs and opportunity for economic development. I have been a consistent supporter of such projects. I also believe it is my responsibility as a legislator to ensure that we clearly understand the financial terms and implications of this legislation, especially because it makes a 35-50 year commitment to appropriate state funds if toll revenue is insufficient.

Due to the complexity and significance of the issues, I felt it would be most efficient to submit my questions to you in writing, so you can prepare a response that can be shared with other Senate Finance Committee members. These detailed questions should not be interpreted as opposition to the Knik Arm Bridge or to state financial involvement. I may, in fact, support the project if these concerns are adequately addressed.

Questions about the KABATA project and SB 79/80

1. SB 80 (page 5, lines 17-31) says the reserve fund, into which the state may deposit \$150 million through SB 79 and into which all toll revenue will be deposited, can be used for a wide variety of expenses besides the annual availability payment. Uses include the authority's overhead and administrative costs, any indebtedness of the authority, termination payment obligations, improvement or expansion of the bridge, and construction and operation of projects of the authority or other public entities.
 - Why does KABATA need this broad spending authority if the purpose of the fund is to ensure the annual payment in order to attract lower cost financing?
 - What situations would trigger an obligation to make termination payments, and how large would those payments be?
 - If KABATA is not successful in entering into a contract with a private partner to build and operate the bridge, will the state have to refund money KABATA

received from the federal government, what would be the refund amount, and could the reserve fund be used for that purpose?

- Does the existing statute or SB 80 authorize KABATA to be involved in projects other than the Knik Arm Bridge?
- What other public entities and projects might be funded with the reserve?
- Would the state have to guarantee payment of monetary obligations KABATA may incur in connection with these new projects, in accordance with page 2, lines 17-20 of SB 80?
- What is the legislature's role in approving projects the authority may wish to undertake with excess reserves or earnings?

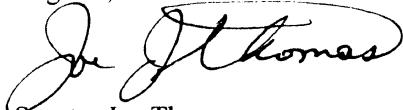
1. SB 80 (page 6, line 6) says income and interest earned by the fund can be transferred to other accounts and used for other purposes. Page 5, line 8 (current law) says, "The interest earned on or profit derived from these funds and reserves shall be the property of the authority." The state's \$150 million deposit into the reserve fund should generate \$5-10 million each year. In addition, up to \$8 billion in toll revenue is anticipated by the authority and will earn significant interest.
 - Why are earnings not retained in the reserve fund, or deposited in the state General Fund if they exceed the amount needed to meet the reserve fund requirement?
2. SB 80 (page 6, line 4) prohibits using the fund for the design, construction, or operation of projects, if that would reduce the fund to less than the reserve fund requirement. The term "reserve fund requirement" is defined on lines 20-23 as an amount determined by the authority, but there are no guidelines for setting that amount.
 - Please explain what criteria the authority will use to determine if the reserve fund is sufficient.
 - Why does the bill not establish \$150 million as the floor for use of the reserve fund for other purposes, or return excess reserves to the General Fund?
3. The authority anticipates that over \$8 billion in excess toll revenue will be received by the reserve fund over sixty years, and that those funds will be available for transportation projects statewide.
 - Can the authority board of directors lower the toll to reduce or eliminate this excess revenue?
 - Would excess revenue return to the General Fund for appropriation by the legislature, and through what mechanism?
4. Would the existing "pledge of the state" in AS 19.75.251 limit future legislatures' ability to reappropriate fund earnings or excess reserves from the authority to other state programs?
5. A financial document supporting the March 1, 2011 TIFIA Letter of Interest contains a column entitled "State Replenish" with a footnote stating, "If ending balance falls below \$50 million, the State will replenish the account back to \$50 million." (page 7 Private Model – Availability Payment Structure – Current Market – State Reserve Fund)
 - What are the implications for the state if KABATA receives TIFIA credit based on that document?
6. KABATA has significant remaining federal funds.
 - What is the amount of remaining KABATA funds?
 - Can that money be used to cover future administrative costs, which the TIFIA LOI documents estimate will be \$3 million/year adjusted for inflation, rather than using toll revenue backed by the state to pay administrative costs?

7. The March 1, 2011 TIFIA Letter of Interest includes a document entitled "Annual Employment Impact of Knik Arm Toll Bridge." This document anticipates 2,400 direct bridge construction jobs and 4,000-8,000 direct jobs after construction in fields such as "residential," "retail" and "office."
 - How many full-time and part-time jobs are anticipated in the actual operation and maintenance of the bridge and toll facilities, who will employ those workers, and what percentage are expected to be Alaska residents?
 - Has the authority taken into account the strong financial incentive for the private partner to keep labor costs to a minimum in the on-going operation of the bridge, which could encourage the use of out-of-state workers, perhaps in a week on/week off rotation?
 - Which provisions in the RFP will encourage use of Alaska subcontractors and Alaska workers in construction, maintenance, and operation of the bridge?
8. The March 1, 2011 TIFIA Letter of Interest includes a "pro forma financial plan" with 35 annual availability payments beginning at \$36 million in 2016 and ending at \$141 million in 2051. However, the KABATA board has the authority to enter into a contract with substantially different terms.
 - What would be the consequences of amending SB 80 to require legislative approval of the final contract, or to establish a maximum length and amount of the availability payments?

I understand the value of expanding the state's transportation network and opening new land to development, so I do not need an explanation of the benefits of the bridge. I would, however, very much appreciate a written response to the questions contained in this letter before SB 79 and SB 80 are considered by the Senate Finance Committee on which I serve.

Thank you for your assistance.

Regards,



Senator Joe Thomas

Cc: Knik Arm Bridge and Toll Authority Chairman Michael Foster and Members
Knik Arm Bridge and Toll Authority Executive Director Andrew Niemiec
Senate Finance Committee Co-chairmen Senator Lyman
Senate Finance Committee Co-chairmen Senator Bert Stedman

STATE OF ALASKA

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March 16, 2011

The Honorable Joe Thomas
Alaska State Legislature
State Capitol
Juneau, Alaska 99801

Re: SB 79 and 80

Dear Senator Thomas:

We appreciate your thoughtful questions and evident interest in the Knik Arm Bridge project. We take this opportunity to provide specific answers to your questions.

1. Your first item 1 includes the following questions.

- *Why does KABATA need this broad spending authority if the purpose of the fund is to ensure the annual payment in order to attract lower cost financing?*

KABATA does not seek to, and SB 80 will not, expand KABATA's existing spending authority. AS 19.75.111(a)(1) limits KABATA's jurisdiction to "the Knik Arm Bridge and its appurtenant facilities." In the Record of Decision, the FHWA defined the Project to include the bridge and approximately 18 miles of connecting roadway. Future phases will include capacity improvements and a second connection in Anchorage to Ingra and Gambell Streets. We refer to these future appurtenant facilities collectively as "other KABATA project responsibilities."

The purpose of establishing in SB 80 a broad set of uses of the project reserve fund is to make it abundantly clear to the private party and its lenders that their beneficial interest in the project reserve fund cannot prevent use of surplus funds for other purposes of benefit to the State. It is not to expand KABATA's statutory authority.

To attract lower cost financing, the trust agreement governing the project reserve fund must set forth sources and uses of funds. The sources of funds in the project reserve will be the \$150 million appropriation, toll revenue, and earnings

on deposited funds. The funds in the project reserve will be used according to an established order of priority for use. We anticipate that KABATA's normal overhead and administrative costs and the availability payments will receive top priority. Reserves also need to be built for project contingencies. The trust agreement will also establish the conditions under which KABATA may use surplus funds – i.e. funds not needed for these higher priority uses – for its other KABATA project responsibilities, for release of the \$150 million (plus interest) back to the General Fund and for other eligible transportation purposes as decided by the State Legislature. During the procurement KABATA will develop the precise terms and conditions of the trust agreement for the project reserve fund, taking into consideration input from the proposers, their lenders and the ratings agencies.

- *What situations would trigger an obligation to make termination payments, and how large would those payments be?*

Concession agreements involving private financial investment always include termination payments if the concession is terminated before the end of the concession term. It is impossible to raise private debt and equity financing without termination payment provisions.

The amount of termination payments generally falls into three categories. The first category includes termination for convenience by the State or termination due to material uncured public party default. For this category, the payment is intended to compensate the private party for its lost business enterprise (similar to the constitutional requirement for just compensation upon condemnation of private property). It includes an amount sufficient to repay outstanding project debt, outstanding equity investment and the contractual rate of return on the equity investment.

The second category is termination due to uncured, material private party default. The termination payment typically results in loss of the private equity and coverage for less than all (e.g. 80 – 85%) of the outstanding project debt.

The third category is termination for stated reasons beyond either party's control. These can include continuation of excusable delays (e.g. due to earthquake) for an extended period of time, or a final court judgment halting the project or invalidating the public-private agreement. The termination compensation is basically calculated to return the private party to the position it was in before entering into the contract – i.e. the amount of its outstanding project debt, return of expended equity plus a rate of return on expended equity up to the date of termination (sometimes less than the rate stated in the proposal).

Although KABATA will need to take all termination possibilities into account in negotiating the public-private agreement, it is unlikely that any will occur. While the foregoing termination payments can be large, KABATA and the State will have received the value of the developed project in return. In addition, KABATA

would have the authority and capacity to issue toll revenue bonds to raise all or a portion of the money needed to make the termination payment.

It is rare that any termination compensation is provided if termination is due to the bankruptcy of the private party, and the public-private agreement will be structured to preclude or minimize the possibility.

- *If KABATA is not successful in entering into a contract with a private partner to build and operate the bridge, will the state have to refund money KABATA received from the federal government, what would be the refund amount, and could the reserve funds be used for that purpose?*

Title 23 requires that the ADOT&PF pay back any Preliminary Engineering to FHWA if the project has not advanced to the Real Estate or Construction phase within 10 years from the date the project was authorized. Likewise, real estate funds must be paid back to FHWA if the Construction phase of work has not commenced within 20 years of the date the funding for real estate acquisition was made available. The funding for real estate acquisition has not yet been made available, but is imminent.

The refund amount would depend upon the amount of federal funds expended at the time. To date, \$57,043,987 of federal Title 23 highway funds have been obligated to the project and approximately \$46 million have been expended (excluding State matching funds).

In the unlikely event that FHWA requested that funds be repaid, they would not be paid from the project reserve fund. This is because under SB 80 the \$150 million appropriation will not have been released to the project reserve fund. The appropriation is to be held by the Department of Revenue at least until a public-private partnership agreement is signed. Under the circumstances described, no signing will have occurred.

- *Does the existing statute or SB 80 authorize KABATA to be involved in projects other than the Knik Arm Bridge?*

The existing statute limits KABATA's jurisdiction to "the Knik Arm Bridge and its appurtenant facilities." AS 19.75.111(a)(1). SB 80 does not change the scope of jurisdiction. For further discussion, see the response to the 1st question under this item 1.

- *What other public entities and projects might be funded with the reserve?*

Federal law and regulations limit the permissible uses of surplus toll revenues from transportation projects funded in whole or in part with federal-aid highway funds to "any purpose for which Federal funds may be obligated by a State under this title [23]," including roads, bridges, trails, transit, ferries, etc. 23 U.S.C. §129(a)(3). The Knik Arm Crossing and the toll revenues from it are subject to

these laws and regulations. Therefore, surplus funds in the reserve could be used to fund or finance other KABATA project responsibilities (described above) and other federally eligible transportation purposes as determined by the State Legislature.

We believe, however, that surplus funds used to repay the \$150 million appropriation, as well as a reasonable interest rate on the appropriation, could be returned to the General Fund free of these federal restrictions on use. KABATA will work with the Department of Revenue and the FHWA on arrangements that will facilitate this result.

- *Would the state have to guarantee payment of monetary obligations KABATA may incur in connection with these new projects, in accordance with page 2, lines 17-20 of SB 80?*

No. SB 80 creates no State guarantee of any monetary obligations of KABATA. To do so would be unconstitutional. Rather, SB 80 would mean that although a monetary obligation of KABATA under a public-private partnership agreement – including one for a future, new project – would be treated as a contractual obligation of the state, it could only be satisfied from State funds to the extent a future State Legislature chooses to appropriate funds needed to pay the obligation.

KABATA has no plans to enter into such a future public-private partnership agreement for meeting other KABATA project responsibilities and its statutory authority under AS 19.75 is limited to the Knik Arm Bridge and appurtenant facilities, constraining its ability to contract for other projects. When the time comes, KABATA's board would evaluate whether it is in the public interest to use such an agreement or some other method of contracting for meeting other KABATA project responsibilities.

- *What is the legislature's role in approving projects the authority may wish to undertake with excess reserves or earnings?*

The central reason KABATA is requesting that SB 80 authorize the use for other transportation purposes of reserve funds in excess of those needed to meet project financial obligations is to assure that KABATA's Board and the State Legislature have maximum freedom to decide when, where and how to use the excess funds. We do not want the private party or its lenders to restrict such uses.

Those future uses will be subject to commitments in the Record of Decision for the Knik Arm Crossing. Because AS 19.75 assigns to KABATA the other KABATA project responsibilities and the Record of Decisions and EIS for the Knik Arm Crossing call for these future capacity improvements, it can be expected that the KABATA Board will allocate such future surplus revenues first toward meeting these responsibilities.

The State Legislature will control use of excess revenues for Title 23 eligible transportation projects beyond the other KABATA project responsibilities, as explained at the 1st and 4th questions above.

1. Your second item 1 sets forth the following question.

- *Why are earnings not retained in the reserve fund, or deposited in the state General Fund if they exceed the amount needed to meet the reserve fund requirement.*

Interest earnings will be retained in the project reserve fund and will be subject to the same uses and priority of uses as all other funds in the reserve.

KABATA sized the \$150 million appropriation request based on the assumption that earnings would be retained. The financial projections indicate that interest earnings on the \$150 million appropriation will be needed in order to keep the project reserve fund at a level that will not require a request for an additional appropriation. Thus, retention of the earnings in the reserve fund until there are surplus funds will enhance the ability to attract low cost, highly rated financing for the project.

Once the reserve fund builds back up to the level that there are excess funds not needed for the project, then interest earnings, like all other surplus funds, will be freed up for other KABATA project responsibilities, repayment to the General Fund of the \$150 million appropriation and interest thereon, and other eligible transportation purposes, as described in the 5th and 7th questions under the first item 1 above.

2. Your item 2 includes the following questions.

- *Please explain what criteria the authority will use to determine if the reserve fund is sufficient.*

KABATA's primary criterion will be to set the minimum reserve requirement at the lowest level consistent with obtaining the best financing terms for the project. KABATA's Board and staff will be working with our financial and legal advisors and will consider input from proposers, their lenders and rating agencies to determine this number.

For KABATA's financial plan, we have assumed a \$50 million minimum reserve requirement. The financial plan is a pro forma model from the private perspective on the transaction. The minimum reserve requirement in the plan is a hypothetical floor for modeling purposes only, and is only indicative of the final structure for the project reserve fund.

We point out that the minimum reserve requirement is different from the maximum reserve requirement. The latter is the floor above which available funds would be treated as surplus funds that could be used for other KABATA

project responsibilities, for repaying to the General Fund the \$150 million reserve appropriation, plus interest, and for other eligible transportation projects chosen by the State Legislature. For KABATA's financial planning purposes, we have assumed a \$150 million maximum reserve requirement once the project achieves annual toll revenues at least equal to annual availability payments.

The minimum and maximum requirements will be refined as the project nears the close of financing.

- *Why does the bill not establish \$150 million as the floor for use of the reserve fund for other purposes, or return excess reserves to the General Fund?*

Like the minimum reserve requirement, KABATA's objective is to set the maximum reserve requirement, as described in the immediately preceding paragraph, as low as possible consistent with obtaining the best financing for the project. KABATA believes it is unwise to set a fixed amount as the floor in the bill because it will not be tested and verified by actual financial market conditions. The \$150 million floor in the pro forma financing plan is a hypothetical threshold for modeling purposes only, and is only indicative of the final structure for the project reserve. If setting a floor higher than \$150 million were to prove beneficial in reducing the overall cost of debt and equity financing for the project, the flexibility to do so would be advantageous to the State. Likewise, if setting a floor lower than \$150 million can achieve optimal financing for the project, the flexibility to do so would be to the State's advantage.

2. Your item 3 includes the following questions.

- *Can the authority board of directors lower the toll to reduce or eliminate this excess revenue?*

Yes, as provided by AS 19.75.111(a)(10). The board has the exclusive authority to set and collect tolls, as provided by AS 19.75.111(b)(6).

KABATA expects that the public-private agreement and related financing agreements will require KABATA to follow toll rate and toll revenue covenants in order to meet coverage ratios for the availability payments.

- *Would excess revenue return to the General Fund for appropriation by the legislature, and through what mechanism?*

For potential uses of excess revenue, please refer to the answers to the 5th and 7th questions under your first item 1 above.

The mechanism for return of excess revenue (i.e. fund balances in excess of the maximum reserve fund requirement) presumably would be through the normal legislative process. Under SB 80 KABATA would make annual reports to the State Legislature and Governor on the status of the project reserve fund, giving the State Legislature the information it will need to decide on legislation to use

and apply the excess reserve funds to projects of their choosing. Consistent with SB 80, the reserve fund terms and conditions will explicitly authorize use of surplus funds for non-project purposes without need for consent of the private party or its lenders.

4. Your item 4 sets forth the following question.

- *Would the existing “pledge of the state” in AS 19.75.251 limit future legislatures’ ability to reappropriate fund earnings or excess reserves from the authority to other state programs?*

No. The very purpose of authorizing use of surplus funds in the project reserve for non-project purposes is to assure that the State Legislature has maximum flexibility, consistent with federal regulations and the commitments in the Record of Decision and EIS, to decide on use of the surplus funds free from interference by the private party or its lenders.

5. Your item 5 sets forth the following question.

- *What are the implications for the state if KABATA receives TIFIA credit based on that document [the TIFIA Letter of Interest]?*

The TIFIA letter of interest is only an expression of interest and is not a binding commitment. KABATA submitted it to the TIFIA program for the benefit of the project and the eventual private party. KABATA would not be the borrower. The private party, if it chooses to use TIFIA, will be the borrower and negotiate its own terms and conditions with the FHWA, which administers the TIFIA program. KABATA will not be bound by the credit agreement between the private party and the FHWA.

Regardless of whether the private party uses TIFIA financing, as provided in SB 80, KABATA would request an appropriation if the reserve balance falls below the minimum reserve requirement. The amount of the appropriation would be the amount necessary to restore the fund balance to the minimum reserve requirement. For a further explanation of how the minimum reserve requirement will be set, see discussion at the 1st question under your item 2 above.

6. Your item 6 includes the following questions.

- *What is the amount of remaining KABATA funds?*

The remaining federal Title 23 highway funds previously appropriated but not obligated to the Project are \$55,528,355. The State matches just over 9% of eligible costs, for total Title 23 funding of \$61,040,294. The \$55.5 million figure is included in the sources in the pro forma financing plan within the \$112.6 million figure designated *Federal* under Public Funds.

- *Can the money [i.e. KABATA's remaining federal funds] be used to cover future administrative costs, which the TIFIA LOI documents estimate will be \$3 million/year adjusted for inflation, rather than using toll revenue backed by the state to pay administrative costs?*

KABATA's remaining federal funds can be used to cover KABATA administrative costs during construction only. Federal Title 23 funds cannot be used for operations and maintenance post construction.

7. Your item 7 includes the following questions.

- *How many full-time and part-time jobs are anticipated in the actual operation and maintenance of the bridge and toll facilities, who will employ those workers, and what percentage are expected to be Alaska residents?*

It is estimated that the actual operations and maintenance of the bridge and toll facilities will require between 35 and 75 persons depending on the traffic volume and number of transactions/accounts under management. These workers will be employed by the private partner and/or their subcontractor(s).

While there may be several supervisory management personnel from outside of Alaska representing the private partner, KABATA believes that all other employees, representing the vast majority (e.g. 95%) of project personnel, will be Alaska residents. KABATA will encourage Alaska hire to the extent allowed by law.

- *Has the authority taken into account the strong financial incentive for the private partner to keep labor costs to a minimum in the on-going operation of the bridge, which could encourage the use of out-of-state workers, perhaps in a week on/week off rotation?*

Yes. It is very unlikely that rotational work by out-of-state workers would be cost-effective for the private party. The nature and scope of the work requires on-site personnel for bridge operations and for managing customer care for tolling operations. In addition, the travel costs for shuttling a work force in and out of the State would be prohibitive. Strong local hiring is the consistent result for other P3 projects in the United States.

- *Which provisions in the RFP will encourage use of Alaska subcontractors and Alaska workers in construction, maintenance, and operation of the bridge?*

The RFP will encourage Alaska hire to the extent allowed by law.

The overwhelming experience with other P3 projects in the United States is that proposers form consortia with substantial participation by local firms. Proposers obtain real advantages by doing so, including local knowledge, local connections, economies of scale and goodwill. As a practical matter, most of the approximately 5,000 FTE's needed to construct the bridge over 3-5 years will be

Alaska hire, including jobs in excavating, gravel trucking and placement, grading and paving, placing armor rock, etc.

8. Your item 8 sets forth the following question.

- *What would be the consequences of amending SB 80 to require legislative approval of the final contract, or to establish a maximum length and amount of the availability payments?*

KABATA wants to leave you with no doubt that a requirement for legislative approval of the final contract would so chill private sector interest in proposing that it would most likely lead to an unsuccessful procurement. The experience of other states like Pennsylvania, Florida and California is informative. In Pennsylvania, the legislature refused, for political reasons, to approve a P3 proposal for the Pennsylvania Turnpike after a successful P3 procurement was completed, sending shock waves through the industry. In Florida and California, this type of legislative provision completely stifled P3 procurements. Only after these states removed this requirement did the private sector take the P3 programs seriously and were these states able to successfully conduct P3 procurements (for the Port of Miami Tunnel project, the I-595 managed lanes project in Ft. Lauderdale, and the Presidio Parkway project in San Francisco).

Prospective private partners will spend in excess of \$5 million in preparing proposals. They must prepare conceptual designs in order to assemble a competent, fully priced competitive proposal. They will have a substantially negotiated design-build contract, firm financing commitments, arrangements for operations and maintenance, etc. that all must be considered in preparing a proposal. Even if a stipend is paid, it will not fully compensate them for proposal and opportunity costs of committing scarce resources to a complex proposal process. Subjecting the proposal process to a political decision after substantial investment of money and time will not draw private sector interest. The private sector will not take this kind of political risk.

In short, the requirement for legislative approval of the P3 agreement would deal a major setback to the project.

Regarding a legislatively-mandated maximum length and/or maximum availability payment, while there is some precedent for this in other states, we believe the existing governance structure for KABATA under chapter 19.75 makes this unnecessary. The KABATA Board is composed of the commissioners of the ADOT&PF and the Department of Revenue, and three members from the general public appointed by the Governor and two State Legislators. The state's interests are well represented and well protected. The KABATA Board is under a fiduciary duty to obtain terms that it determines are advantageous to the state. They will make decisions within a disciplined framework, with consultation with and involvement of the ADOT&PF, the Department of Revenue, the Alaska

Department of Law and highly qualified financial, technical and legal consultants for KABATA.

If your office remains interested in a statutory limit for the term and/or the availability payment, we would like the opportunity to discuss it in more detail with you. The structure of those limitations must recognize market realities and the complex nature of these arrangements. Our interest is in obtaining the best results for the state.

Sincerely,



Andrew J. Niemiec
Executive Director

cc: Knik Arm Bridge and Toll Authority Chairman Michael Foster and Board Members
Senate Finance Committee Co-chairman Senator Lyman
Senate Finance Committee Co-chairman Senator Bert Stedman