Introduction and Need for Legislation

HB 158 will ensure the successful procurement of the Knik Arm Crossing and generate the best value to the State of Alaska. The passage of this legislation will facilitate the Knik Arm Crossing being open for traffic in 2015, thus expediting for the State of Alaska the benefits generated from the Crossing.

In 2003, the Alaska Legislature created the Knik Arm Bridge and Toll Authority "… to develop, stimulate, and advance the economic welfare of the state and further the development of public transportation systems in the vicinity of the Upper Cook Inlet with construction of a bridge to span Knik Arm and connect the Municipality of Anchorage and the Matanuska-Susitna Borough" (Alaska Statutes § 19.75 [AS § 19.75]). Since its creation KABATA has been working toward this goal by diligently pursuing the necessary environmental clearances and preparing the ground work to develop the Knik Arm Crossing once a Record of Decision was granted, including the development of a financial plan for the project.

After many years of hard work by both KABATA and ADOT&PF, the Federal Highway Administration signed the Record of Decision for the Knik Arm Crossing on December 15, 2010. Reaching this milestone provides the environmental clearance necessary for the Crossing to move forward and become a reality.

Project Benefits

The Knik Arm Crossing will serve generations of Alaskans by providing improved access to the regional transportation network. Some of the benefits of this interconnection include:

- More efficient movement of people, goods, and services between Anchorage, the Mat-Su Borough, and Alaska's interior.
- Providing jobs and supporting economic and population growth.
- Increasing the efficiency of freight movements to and from the Ports of Anchorage and MacKenzie and Ted Stevens Anchorage International Airport.
- Providing an alternative route for freight movement, thus reducing the number of trucks traveling through Anchorage and along the Glenn Highway.
- Helping the environment by reducing carbon emissions, reducing vehicle miles traveled, and improving sustainability.
- Improving access to and from economic activities in the interior of the State.
- Providing a vital second evacuation route for Anchorage and Kenai residents in case of an emergency.
- Helping fund future needed capacity improvements and other transportation and transit needs.

Finally, in addition to the positive impacts on employment during the construction of the Knik Arm Crossing, the Crossing is estimated to have a positive economic impact on the State of Alaska in excess of $18 billion dollars over the project's first 24 years.

Public Private Partnerships

KABATA plans to finance, deliver and operate the Knik Arm Crossing through a public-private partnership. Figure 1 graphically shows the major differences between how KABATA might develop the Crossing under a traditional procurement model and how the Crossing will be developed under a public private partnership.

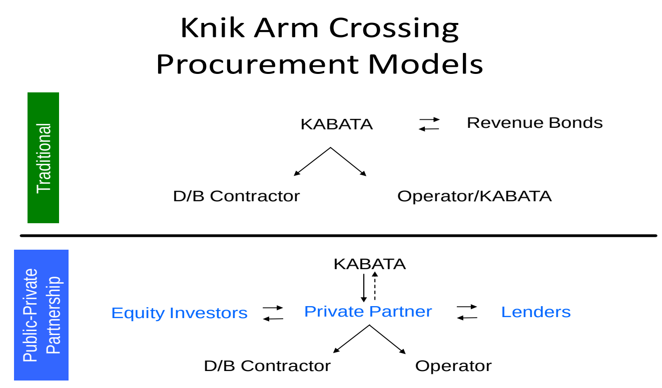

Figure 1

Under a traditional approach, KABATA would take significant design and construction risk for the Crossing. In addition, KABATA, either through a private operator or directly, would be responsible for operating and maintaining the Crossing. This includes operating the toll facilities and collecting tolls.

With a public-private partnership, KABATA will contract directly with a private partner. That private partner would be required to work with equity investors and lenders to raise the finances necessary to design and construct the Crossing to the standards required by KABATA, ADOT&PF and FHWA.

The contract with the private partner will require the private partner to design, build, finance, operate, and maintain the Crossing for a set number of years. In return, KABATA would pay to the private partner pre-determined, fixed payments upon achieving certain milestones – especially project completion – and periodic payments during the operating period based on meeting performance requirements. Under this structure, KABATA and the State would retain the right to all of the toll revenues and use these revenues as the main source for the periodic payments. Figure 2 graphically shows these relationships.

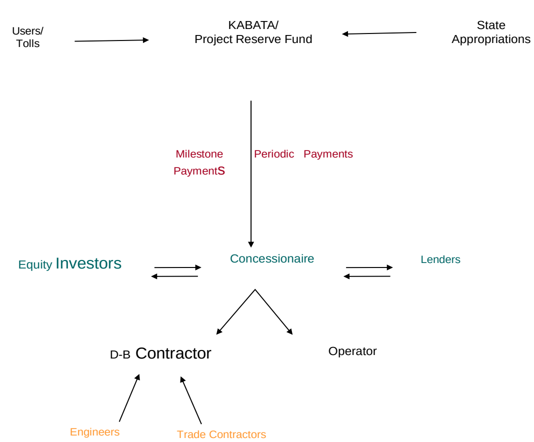

Figure 2

The private partner will use the payments it earns to service its debt, pay its operating and maintenance expenses, and provide a return to its equity investors. The State, through KABATA, would define its financial obligation to the private partner. There would be no recourse to KABATA or the State beyond these defined obligations. KABATA and the State will not have any direct liability for debt repayment and will not pledge any KABATA or

State revenues or assets to lenders to secure debt repayment.

Under the public-private partnership, the private partner will be responsible for constructing and maintaining the Crossing, operating the toll facilities, collecting tolls on behalf of KABATA, and providing customer service. These services will be performed pursuant to standards established by KABATA and the cost of these services will be included as part of the proposals. KABATA will monitor, audit and inspect the work and enforce contract requirements.

At all times under the public-private partnership the State, through KABATA, will own the project and the toll revenues.

Advantages of a public-private partnership

A public-private partnership will have distinct advantages over the conventional method of transportation project delivery. Among the advantages are:

- Maximizing up-front capital formation from non-governmental sources.
- Accelerating project delivery through the utilization of private capital and the integration of design and construction under one responsible party.
- Improving cost and schedule certainty early in the design phase.
- Improved risk management and more risk transfer to the private sector.
- Life cycle cost efficiency through private sector profit motivation throughout the contract term.
- Improving project quality, performance and maintenance via opportunity for design and construction innovations early in project development, strong performance standards, and long-term asset condition requirements.

Procurement Process

In late 2007 KABATA began procuring a private partner to design, build, finance, operate, and maintain the Knik Arm Crossing. This procurement was undertaken pursuant to ADOT&PF's innovative project delivery process. After KABATA issued a request for qualifications, two private sector consortia were determined to have the capacity to complete the project and were shortlisted.

KABATA then held several industry meetings with the shortlisted consortia and prepared draft procurement documents. KABATA brought into the process representatives from both ADOT&PF and FHWA to review and comment on the draft procurement documents. Due to delays in the environmental review process, in 2008 KABATA put the procurement on hold, pending the receipt of the Record of Decision. As noted above, the Record of Decision was signed on December 15, 2010.

Since the procurement was put on hold, the market place has changed. The global financial crisis has affected the financial market conditions and requirements for public-private partnerships. Transaction structures and sources of funds have changed in response to these new financial market conditions, with a strong market swing away from toll revenue concessions toward the form of "availability payment" concession depicted in Figure 2. In addition, participants in the concessionaires market have changed. As a result, changes to KABATA's enabling statutes are needed to address these new market conditions and allow KABATA to take advantage of the most advantageous transaction structure for the benefit of the State.

KABATA will conduct the procurement in close consultation with ADOT&PF and FHWA to ensure KABATA uses sound procurement practices and complies with all legal requirements. This will also help ensure that the State obtains best value.

Proposed Legislation

The requested legislation amends the existing statute and to enable a successful procurement. Action now on these legislative changes will facilitate the Knik Arm Crossing being open for traffic in 2015, accelerating when the State of Alaska will begin enjoying the economic benefits generated by the Crossing. The following explains the reasons for the requested changes and the appropriation.

- **Increase in Bonding Authority.** FHWA allocated $600 million of Private Activity Bonds to the Knik Arm Crossing. PABs allow tax-exempt bonds to be issued for projects which have a significant private interest, such as the Crossing. This allocation effectively lowers the cost of capital and provides better value for the State.

  Based on current analysis, it is anticipated that the entire $600 million PABs allocation may be utilized. These bonds have to be issued by a governmental entity, in this case KABATA. This request increases KABATA's ability to issue revenue bonds from $500 million to the $600 million expected to be needed. Issuance of PABs by KABATA, as a conduit issuer, will not create an obligation of the State, nor will it constitute a pledging of state revenues or assets. The private partner will be the borrower of the bonds, not the State or KABATA.

- **Property Tax Clarification.** This change will clarify ambiguities that the Knik Arm Crossing is exempt from state and local property taxes and assessments whether operated directly by the public authority or on its behalf by a private party through a public-private partnership. This change recognizes that the essential public nature, purpose and use of the Crossing remain unchanged regardless of whether it is operated by the State through KABATA, or by a private operator. Any private activity the private partner may undertake ancillary to operating the toll facility would remain subject to property tax. Under a traditional contracting approach, no private contractor or operator would be subject to property tax on the facility. This change would put the public-private partnership and the private partner on the same footing. It will reduce the availability payment and keep tolls more affordable.

- **KABATA's Contractual Monetary Obligations.** This requested change removes any ambiguity that may exist about the obligations of the State under a public-private partnership agreement between KABATA and a private partner. The requested change applies only to "monetary liabilities" which KABATA may incur pursuant to a public-private partnership. All other KABATA obligations – whether under other contracts, due to tortious conduct, or otherwise – remain separate from the State. Prior to approval and execution of a public-private agreement by KABATA's Board of Directors, the Attorney General, ADOT&PF and the Department of Revenue will review the agreement. KABATA's board approving the public-private agreement includes by statute the Commissioners of the Departments of Transportation and Revenue, three public members appointed by the Governor, one senator and one representative, providing a broad representation of the State's interest.

The obligation of the State under this change is a moral obligation not a legal obligation. Satisfaction of a contract liability is subject to a decision by the Legislature to appropriate money for this purpose.

This change is necessary and essential to attract low cost debt and equity to finance the Project. It will improve the market's confidence in KABATA's ability to pay, it will reduce the availability payment owed by KABATA and the State. In turn, this will help keep tolls affordable to the traveling public.

- **Project Reserve Fund.** The legislation includes provisions for establishing a project reserve fund. This reserve fund is not unique; it is patterned after similar reserve funds authorized for other Alaska governmental entities under existing statutes. E.g., AS 14.40.951 (Alaska Aerospace Corporation reserve fund); AS 14.42.240 (Alaska Student Loan Corporation capital reserve fund); AS 18.56.125 (Alaska Housing Financing Corporation capital reserve fund); AS 44.85.270 (Alaska Municipal Bond Bank Authority capital reserve fund); AS 44.88.105 (Alaska Industrial Development and Export Authority capital reserve fund).

  The purpose of the project reserve fund is to reduce KABATA's costs by reducing the developer's cost of financing the project. One of the funding sources for the project reserve fund will be appropriations by the Legislature. The project reserve fund also will be the place where toll revenues are deposited.

  The private partner's lenders and equity investors will rely solely on the payment stream from KABATA as the means for the private partner to service its debt and provide a return on equity. The financial markets will carefully examine whether that payment stream is reliable and creditworthy. Reliability is an important factor in whether the senior project debt that the private partner obtains will receive an investment grade credit rating. Such a rating is probably a "must have" for this project to be successful, and will lower the cost of debt and equity. The reserve fund is one of the key measures to establish this reliability and creditworthiness.

The reserve fund will apply KABATA's sources of revenue –tolls and appropriations - for specific purposes. The most important is to use the funds to compensate the private partner for the design, construction, operations and maintenance of the facility for the term of the agreement.

By holding these sources of revenue in a reserve fund dedicated to this purpose, the private partner is assured of an interest in these funds and that they will not be diverted to other purposes. This greatly improves the market acceptance of KABATA's ability to pay. This increased acceptance will lower the cost of the private partner's equity and debt and thereby lower the amount proposers will bid for these payments.

Under the legislation KABATA is required to annually report to the legislature the status of the reserve fund. If the reserve fund drops below a minimum required amount, that will trigger a request from KABATA for further appropriation to meet the minimum required amount. The specifics on the minimum required amount will be developed during the procurement and spelled out under the documents that establish the reserve fund. If the reserve fund is authorized and funds are appropriated to it, KABATA's latest financial projections indicate that no further appropriation will be needed. These projections are believed to be realistic.

As the reserve fund builds up a surplus, the surplus could be used to fund needed capacity improvements and other federally-eligible transportation purposes and facilities. The specifics on what constitutes surplus funds will be developed and spelled out under the documents that establish the reserve fund.

Financial Benefit

Passage of HB 158 will facilitate the ability of KABATA to procure a public-private partnership which would greatly increase the benefit to the State. Passage of this legislation would allow KABATA the option to move forward with an availability payment structure, the public-private partnership which will generate the best value for the State.

Based on this structure, KABATA estimates the Knik Arm Crossing could generate for the State net revenue of approximately $10 billion over 60 years of operation, a portion of which will be reinvested in capacity improvements and Project extension, with

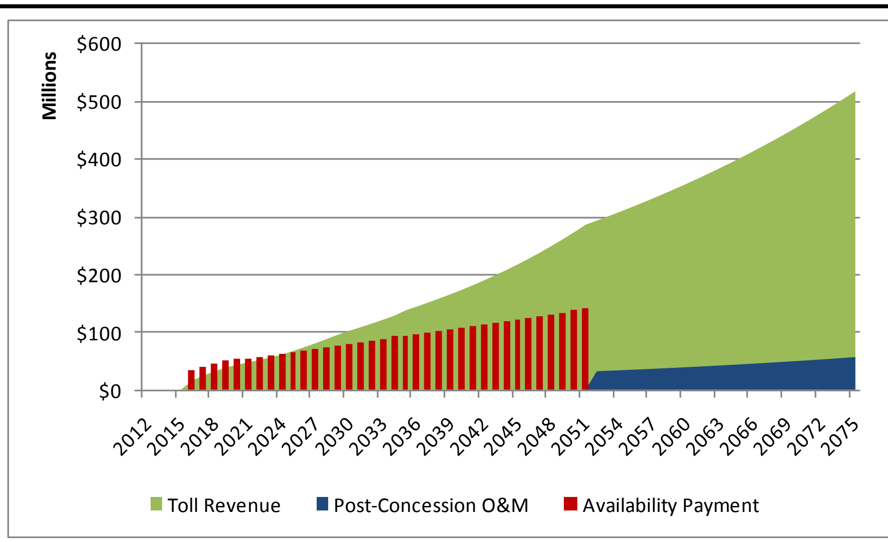

Figure 3

the remainder available to invest in any Title 23 eligible transportation projects in the State. This is shown graphically in Figure 3.

This $10 billion is in addition to the $18 billion in economic benefits which are estimated to be generated by the Crossing during its first 24 years of operations.

The proposed legislation establishes the framework for KABATA to procure, through ADOT&PF's innovative projects delivery process, a private partner to help the State realize these benefits.