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To: Angela Rodell, Commissioner of Revenue
Deven Mitchell, Director of Debt

Cc:

Subject: Financing Plan for Knik Arm Bridge

The State of Alaska (the “State”) has examined the possibility of constructing a bridge from the Municipality of Anchorage to the Matanuska-Susitna (“Mat-Su”) Borough for many years. The State proceeded with various legal, environmental and engineering studies to approve a 1.74 mile crossing across the Cook Inlet at Knik Arm (the “Project”). The State also created the Knik Arm Bridge and Toll Authority (the “Authority”) in 2003.

First Southwest Company (“FirstSouthwest”) has been retained by the Alaska Department of Revenue (“DOR”) to examine the financing assumptions advanced by the Authority and to propose an alternative financing model. FirstSouthwest has created a model (“FSC Plan”) based upon a design-build procurement process (“DB”) and a more traditional public financing option. Our proposed model will offer the State a lower cost of financing, provide budget certainty and enable the State to secure its financing sooner. Under the FSC Plan, the bonds issued to investors will be backed by direct appropriations of the State, therefore enjoying the benefit of the State’s sterling credit rating to achieve high AA credit ratings. State support for the debt service will be a finite, predictable amount based on the debt service for these bonds alone. The FSC plan calls for the State to have no ongoing obligation for the remaining funding of the Project, which will come from other sources.

First Southwest has used the following assumptions in developing our plan:

- Toll Revenues and Project Costs as forecasted in the CDM Smith Study dated August 31, 2011 (“CDM Study”)
- Interest rates at levels as of close of business October 21, 2013
- Funding of operations and maintenance and toll operations per the CDM Study

First Southwest proposes a financing plan with the following components:

1. Application to the United States Department of Transportation for the maximum loan under the Transportation Infrastructure Finance and Innovation Act (“TIFIA”). Based upon the CDM Study’s most recent costs projections and our revised financing model, we have assumed an amount of the TIFIA loan will be approximately \$276 million, sized at 33% of the eligible project costs.

The security for the TIFIA loan will be limited to the tolls collected from the operation of the Project (“Toll Revenues”). If the full amount of Toll Revenues predicted in the CDM Study materialize, the coverage on the TIFIA loan would be over two times debt service. Even if only 75% of the CDM Smith projections are collected, the TIFIA loan coverage will be 1.6 times debt service. We believe that the strength of the pledge of the toll revenues will enable USDOT to fund a TIFIA loan without additional State support.

We have assumed that Toll Revenues will be used to fund maintenance and operations of the Project, tolling operations and TIFA debt service and that the debt service on the TIFIA loan will be subordinated to the funding of operating and maintenance and tolling operations. Any Toll Revenues not needed to pay tolling operations, operations and maintenance and debt service on the TIFIA loan will be available for any other Title 23 transportation projects in the State and/or to reimburse the State for debt service on the State’s appropriation backed bonds described below.

2. Appropriations of \$300 million in available Federal and State transportation moneys. This amount includes approximately \$112 million already appropriated and used by KABATA to advance the Project. The balance of this appropriation would come from moneys that are currently assigned to State projects that are not ready to fund at this time. FirstSouthwest proposes that these moneys be reassigned and used to finance the Project. To ensure that projects that are currently designated with these expiring funds but aren’t shovel-ready at this time retain their viability, the State could use the Advance Construction financing technique. Advance Construction financing would be designed to holistically assist the funding of the State’s Department of Transportation capital program when projects are ready.

3. Issuance by the State of Alaska, through the State Bond Committee, of approximately \$262 million of 20 year subject-to-appropriation bonds (the “Bonds”). At current rates, the State would need to appropriate approximately \$19 million per year in debt service for the next 20 years. These appropriations could be reimbursed from toll revenues to the extent the collections exceed the cost of operating and maintaining the bridge and tolls and the TIFIA loan payments.

4. We would recommend the creation of a Local Improvement District in the Mat-Su Borough to capture the anticipated growth in property values as a result of the completion of the Project. The Borough could leverage the growth in property values to provide for costs of improved Borough infrastructure as a result of the Project.

By comparison, the Authority has proposed a plan that calls for the selection of a private consortium to enter into a series of agreements to design, build, finance and operate the Project. This arrangement, known as a public-private partnership or P3, has been used to develop certain transportation developments across the country. Under the P3 proposed for the Project, the State would be obligated to make an annual availability payment. This availability payment would be used to pay all debt payments (TIFIA and PABs), equity return, operation and maintenance and toll collection. The availability payment is expected to start in 2017 at \$34 million and increase to \$131 million in 2051, the final year of the partnership.

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There are several noteworthy challenges with the Authority's model. The structure of the availability payment requires that the State be obligated to cover projected and potential toll revenue shortfalls. Despite the State being obligated to make up deficient toll revenue, it is expected that debt issued under the Authority's plan will result in low investment grade credit ratings in the BB to BBB range. Additionally, the State Legislative Budget and Audit Committee's report dated March 7, 2013 identified concerns about the feasibility of achieving the projected toll revenues in CDM Study. The uncertainty associated with these factors makes it likely that State funds will be needed to fund shortfalls, that those shortfalls may be greater than expected, and that the P3 debt structure will have higher project and interest costs. By comparison, the FSC Plan calls for fixed payments from the State of approximately \$19 million for 20 years.

	Authority Plan (Amounts in Millions)	FSC Plan (Amounts in Millions)
Project Costs		
Construction	\$706	\$706
Reserves	\$185	\$20
Other Costs	\$190	\$112
Total	\$1,081	\$838
State Funds Contribution		
	\$295	\$300
TIFIA Bonds		
Amount	\$357	\$276
Security	Tolls plus State Support	Tolls
Maturity	30 years	20 years
Interest Rate*	3.61%	3.41%
Equity		
Amount	\$79	None
Rate of Return	12%	0%
Other Debt		
Amount	\$351	\$262
Type	Private Activity Bonds	Appropriation
Issued By	Private Consortium	State Bond Committee
Rating	BBB	AA+
Final Maturity	2051	2034
Interest Rate*	6.20%	3.36%

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* Estimated as of 10/23/13

We believe the FSC Plan has several advantages for the State. The direct State funding for a portion of the Project will enable a lower cost of financing and known debt service obligations in comparison to the unknown obligations under the Authority's P3 structure. State funding will also provide for quicker financing of the project since funding can be provided expediently. Finally, the State will be able to retain any toll revenues in excess of the expenses of operations and maintenance, toll collections, and debt service on the TIFIA loan from the Project, allowing those revenues to be reinvested in other State transportation projects.

The Authority's P3 proposal places an uncertain burden on the State, as the amount and the duration of the State's commitment is not fixed. Under the FSC Plan, the federal government would assume the risk of toll collections meeting the CDM Study expectations. The State would also control the distribution of excess toll revenues under the FSC plan, as opposed to having the tolls be used to repay the debt of the project. Other risks can be delegated or accepted, as the State desires.

State of Alaska Department of Revenue Comparison of Plans Risks		
	<u>KABATA</u>	<u>FSC Plan</u>
Toll Revenue Fails to meet Projections	State	TIFIA
Design	Developer	Developer
Cost Overrun	Developer/State	Developer/State
Operations	Developer	State
Environmental	State	State
Term of State Payments	2051	2034
Annual State Payment	Uncertain	\$19 million
Initial Contribution	\$295 million	\$300 million
Maximum State Payment (including Initial Contribution)	\$3,238 million	\$689 million
Toll Revenue after Debt Service (100% CDM Study)	\$2,221 million	\$3,105 million
Toll Revenue after Debt Service (75% CDM Study)	\$1,666 million	\$2,329 million

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