April 2, 2013

Knik Arm Crossing

Financing Briefing

This document responds to some of the pages in the presentation done by Citigroup Global Markets Inc. (Citi) to the Senate Finance Committee on April 2, 2013.
The annotations in the RED boxes in this document are by Bob French (bgkfrench@gmail.com, 907-240-1744) and Jamie Kenworthy (jamiek@alaska.com, 907-360-5661).
The original document by Citi is available on BASIS as "*SB 13 Citi Presentation KABATA Finance Committee 3-30-13 FINAL2.pdf*"

Public-Private Partnership Approach

KABATA's proposed P3 approach has been tested in numerous projects in the US and around the world.

- KABATA is using a public-private partnership, or P3, to build and operate the Crossing
  - Alaska legislature authorized and encouraged use of P3 for project d [1]
- Availability fee P3's for surface transportation have been used success

	Vehicle Tolls?	Smith Forecast?	Completed?
East End Bridge (over Ohio River near Louisville, KY)	Yes	Yes	No
Presidio Parkway (San Francisco)	No	No	No
I-595 (Fort Lauderdale)	No	No	No
Denver Eagle "Fastracks"	No	No	No
Port of Miami Tunnel	No	No	No

- P3s are accepted as a mainstream method to finance, deliver and operate major projects worldwide, including in the UK, US, Germany, France, Italy, Spain, Portugal, Australia, Canada, Chile and Brazil
  - Concept is so well proven that in Canada any project over $100M using federal funds must analyze use of P3 and justify why P3 should NOT be used
  - US road P3's have come in 23% to 42% lower than the owner's capital cost estimate[1]

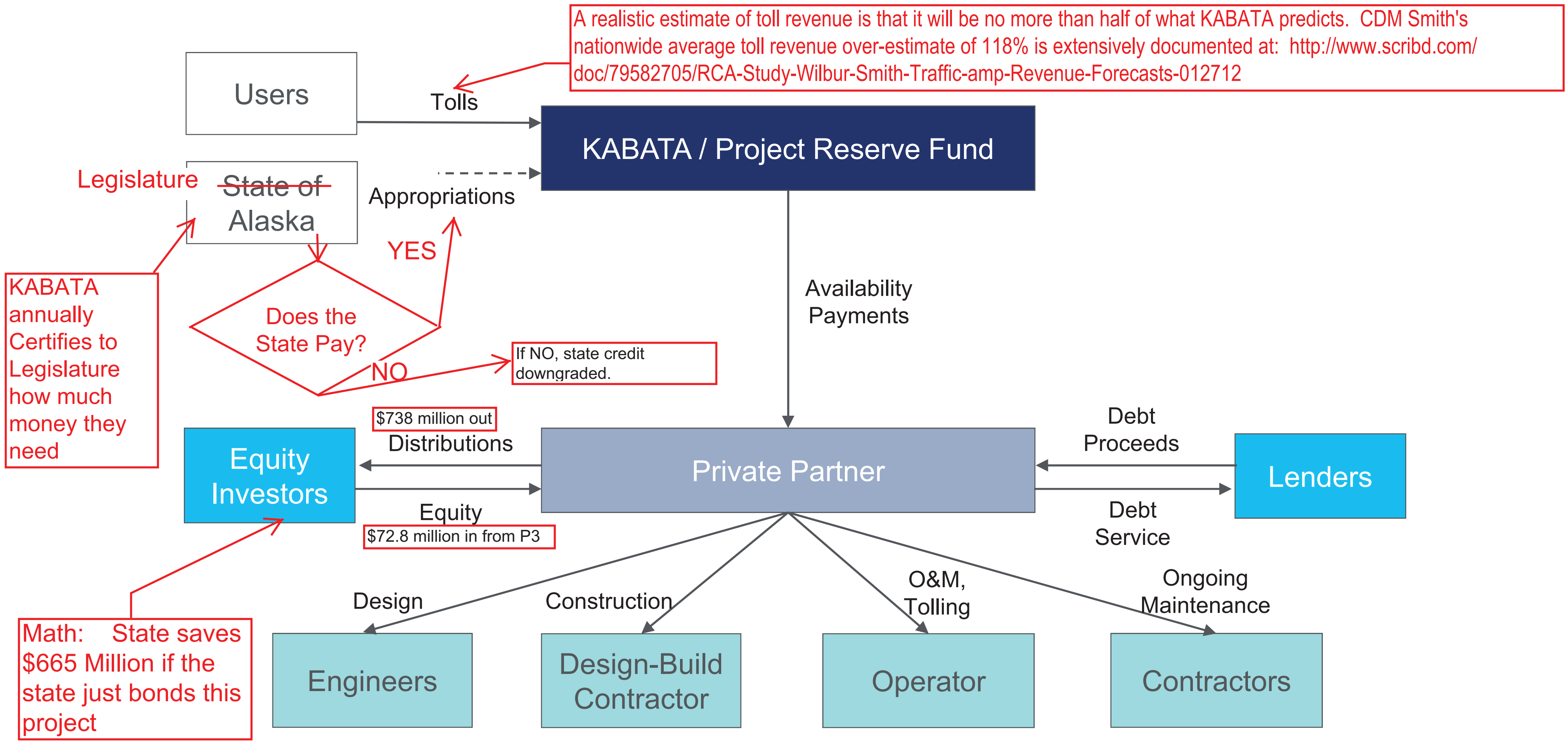
Other projects	Vehicle Tolls?	Smith Forecast?	Completed?	**Bankrupt?**
Pocahontas Pkwy (VA)	Yes	Yes	Yes	Yes
South Bay Expressway (CA)	Yes	Yes	Yes	Yes
Southern Connector (SC)	Yes	Yes	Yes	Yes
Knik Arm Bridge (AK)	Yes	Yes	No	???

(1) For East End Bridge, Presidio Parkway and I-595, the most recent three availability fee P3's.

It has been proven that private sector has made money packaging P3 contracts. It has not been proven that they represent the best value compared to state direct bonding. It is proven that CDM Smith (formerly Wilbur Smith) has a national track record of overestimating toll revenue by 118% or more than factor of 2. (Transportation Research Board of the National Academy of Sciences.)

Structure for Availability Fee P3 Deal

Private partner provides single point responsibility for design, construction, financing and long-term operation and maintenance, all for a pre-determined annual availability fee.



Proposed Legislation

Passage of SB13 (or HB23) is condition to the project proceeding under the "availability fee" P3 approach and obtaining a low cost TIFIA loan from the US Department of Transportation.

- Key elements of the proposed legislation:
  - Ability to establish a Project Reserve and subject it to a trust arrangement
  - Toll revenues collected by KABATA are deposited into the Project Reserve
  - KABATA's availability payment obligation and KABATA expenses are paid from the Project Reserve
  - The KABATA chair must annually certify to the Governor and Legislature the status of the Project Rserve and amounts needed, if any, to restore it to its minimum requirement
  - By the time the Crossing opens for traffic, the project reserve is expected to be funded by State appropriations totaling $150 million, with a "down payment" this year

Already in place in KABATA's statute

This sets up a new "Moral Obligation" of the state to KABATA, established by SB13-HB23

- Project Reserve minimum requirement is (1) 120% of the estimated average availability payment over next three years <u>plus</u> (2) 120% of prior year KABATA expenses <u>minus</u> (3) prior year toll revenues
  - Provides liquidity to KABATA to make the availability payments and fund KABATA administrative costs given the annual legislative schedule (appropriations can normally only be made during the 90 day session)

This new "Moral Obligation" reserve fund in SB13 is unlimited, and includes the payment of monetary obligations, liabilities, and indebtedness of the authority, including termination payment obligations, the authority's overhead and administrative costs and working capital; and maintenance, improvement, or operations. This represents a delegation of the legislature's traditional budget authority to a state agency.

This formula using Citi numbers, starts the project with over $100 million needed for the reserve fund and because tolls are likely to be half of what is expected, it just gets worse. See "Real cost" paper.

"Real Cost" paper is listed in the BASIS Documents as "SB 13 KABATA 2013 REAL COST - Kenworthy & French.pdf" and "HB 23 KABATA 2013 COST Analysis Kentworthy.pdf"

Purpose of State Financial Backstop

The private partner is investing nearly $800 million of its funds to build the Crossing and needs assurance that KABATA and the State can pay if the private partner meets its obligations.

Actually, the private partner is "investing" only $72.8 million, but are bonding $800 million, with the “Moral Obligation” guarantee that the "Availability Payments" will be made to cover the partners payments on those bonds, regardless of how much toll revenue is received.

Request	Key Purpose
1. Funding shortfalls if availability payments and other expenses exceed toll revenues	• Provides funding for early year projected revenue shortfalls during traffic ramp up on bridge • Under base case projections there are minimal future need for State support
2. Funding “pinhole” risks	• Provides funding for “pinhole” risks assumed by KABATA • Pinhole risks proposed to be backstopped by the State include: (1) termination costs, should the concession be terminated prior to its maturity for KABATA fault or convenience ; and (2) compensation for specific conditions/events outside private partner control

If terminated, the P3 contractor is likely to sue for construction costs, construction profits, and financing profits that were include as costs in calculating 35 years of "availability payments".

The "KABATA Retained Risks" outlined on page 6 of Citi's presentation are factors that typically cause the most costly change orders in construction work. The "Cherry Hill Landfill" that will be dug into at the east side of the Port of Anchorage is both a "Superfund" hazardous waste site, and one with unstable soil conditions. The Corps of Engineer permit is still under review after 16 months, and the right of way acquisitions with Joint Base Elmendorf Richardson and the Alaska Railroad are likely to be time consuming.

Assumptions Provided by Team of Experts

The financial projections are based on a set of assumptions carefully prepared by a team of experts in their respective fields.

- As KABATA's financial advisor, Citigroup has prepared financial projections to show how the project will perform under a set of assumptions developed by national experts in their respective fields:

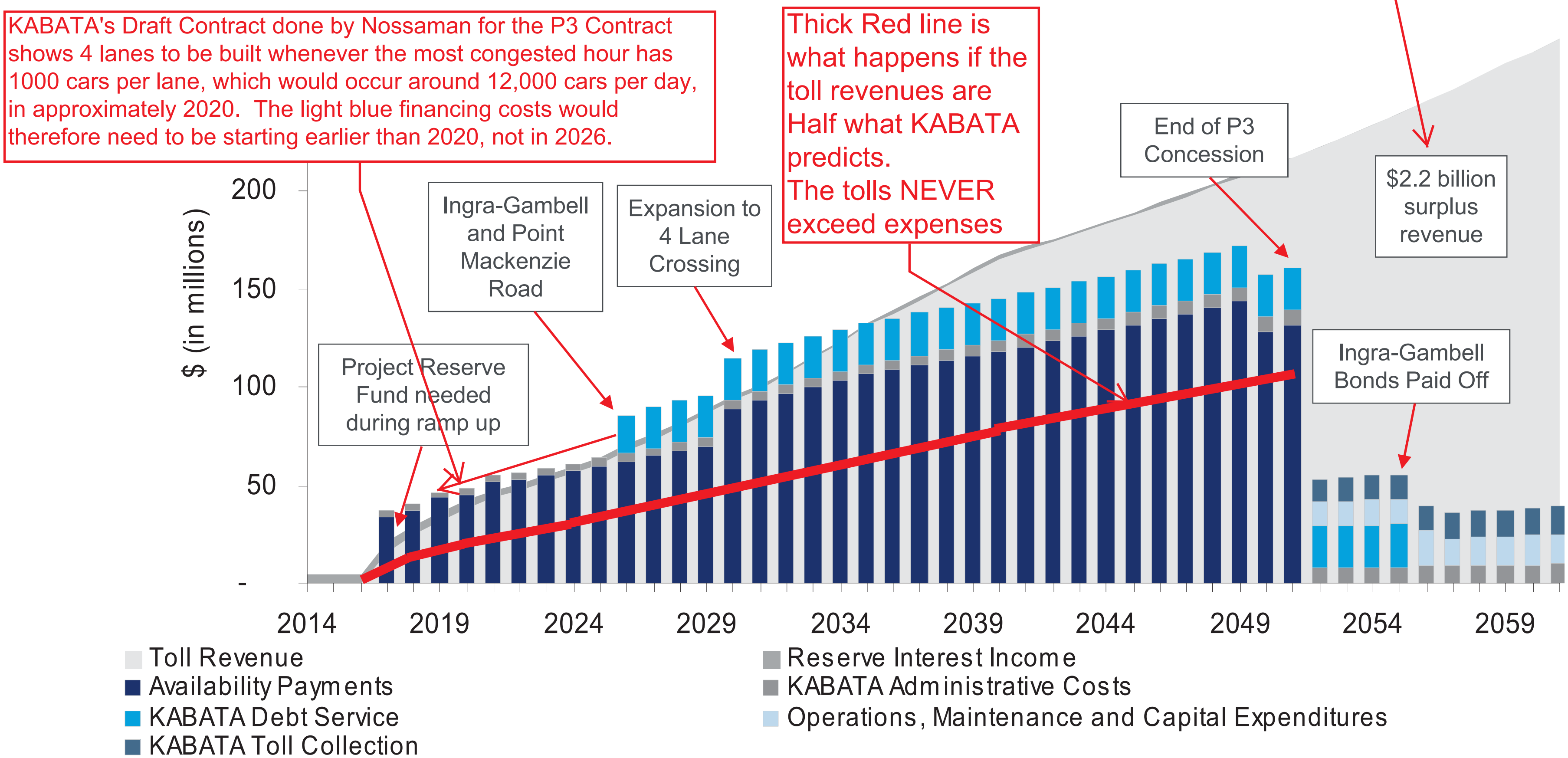
Assumption	Firm	Credentials
Construction Cost	HDR[1]	Fifth-ranked engineering firm for highway design in the US
Traffic and Revenue	CDM Smith	Foremost Traffic and Revenue consultant with more studies supporting financings than any other firm
Operations and Maintenance	HDR/PND	Fifth-ranked engineering firm for highway design in the US and one of the top Alaskan road and bridge engineers
Toll Collection	CDM Smith	Leading toll system advisor to toll and transportation agencies
Renewal Capital Expenditures	CDM Smith[2]	Substantial experience in inspecting bridges and developing capital maintenance programs for transportation agencies in the US.
Debt and Equity	Citigroup	One of the world's largest banks and the #1 underwriter of US toll road bonds

State Checkbook shows the FY12 cost of these experts:
$1.4 million went to Nossaman LLC, a LA Law firm who also pays Citi, and CDM Smith. (Audit should clarify)
The Aug. 2012 Finance Plan produced by Citi can only get to a bond cover ratio of 1.33 to achieve investment rating by including $500 million of a non-existent TIFIA loan and using a fiscal fiction of including revenue from what will only fit on 4 lanes, while only showing the cost of building 2 lanes of road and bridge.

(1) HDR was assisted by PND, Armeni, William Ott and DCS for bridge design and Hydro-Ram and IHC Merwede for piling
(2) CDM Smith was assisted by PND

The similar graph in KABATA's Nov. 30, 2011 presentation to the legislature in Wasilla, showed a $9.1 billion surplus over a 60 year period.

KABATA Projected Obligations and Toll Revenues



KABATA's traffic estimates are double those done for the H2H project. The traffic estimates done for the Wasilla Bypass project are 2/3rds of KABATA's number, but without tolls. Adding the effect of tolls in the estimates for the H2H project dropped traffic by half.

Key Assumptions

Traffic & Revenue	• Traffic and toll revenue assumptions from CDM Smith study dated August 2011 and as updated August 2012
Tolls	• $5 per trip (2017) initially for passenger vehicles and escalating at CPI – higher for commercial vehicles Rising 2.5% per year per KABATA
Expenses	• Availability payment under the base case financial analysis with equity, private activity tax exempt bonds and 33% TIFIA • Assumes the bridge is expanded to four lanes and Ingra-Gambell connector is built as traffic warrants • KABATA annual administrative expenses of $3.0 million at opening and escalating at inflation (2.5%)
Term of Analysis	• 45 years from Crossing opening, which is 10 years beyond the 35 year concession term (bridge life estimated at 75-100 years)

KABATA has been turned down 5 times for TIFIA, which increases both the Finance Costs and Availability payments, thus the deficits increase, triggering more and larger calls for the Reserve Fund to be replenished.

Sensitivity Results

Sensitivity and Monte Carlo analysis are highly sophisticated modeling tools, but are only as good as the base assumptions. Without TIFIA and with tolls likely to be half, plus the 4 lanes revenue, 2 lanes cost problem, Garbage in plus sophisticated modeling tools still equals Garbage out.

Under the base case, over 45 years, ongoing appropriations of $37 million are required, while the Knik Arm Crossing generates $2.3 billion of revenues to fund transportation in the State.

	Severe Downside[1]	Downside[1]	Base Case (Most Likely)[2]	Upside[1]	Aggressive Upside[1]
Initial Project Reserve Funding Gross/ (Present Value)[3, 4]	$150 million ($150 million)	$150 million ($150 million)	$150 million ($150 million)	$150 million ($150 million)	$150 million ($150 million)
Expected Future State Liability Gross/ (Present Value)[3, 4]	$627 million ($208 million)	$135 million ($56 million)	$37 million ($16 million)	$0 ($0)	$0 ($0)
Expected Total State Liability Gross/(Present Value)[3, 4]	$777 million ($358 million)	$285 million ($206 million)	$187 million ($166 million)	$150 million ($150 million)	$150 million ($150 million)
Expected State Financial Return Gross/(Present Value)[3, 4]	$910 million ($139 million)	$1,725 million ($265 million)	$2,513 million ($424 million)	$3,364 million ($628 million)	$4,561 million ($934 million)
Net State Revenues Gross/(Present Value)[3, 4]	$133 million (-$219 million)	$1,440 million ($59 million)	$2,326 million ($258 million)	$3,214 million ($478 million)	$4,411 million ($784 million)

(1) The severe downside, downside, upside and aggressive upside cases represent 95%, 75%, 25% and 5% probabilities that traffic and toll revenues will be greater, respectively. For instance, under the severe downside, 95% probability case, there is only a 5% probability that toll revenues will be below the projection.

(2) Equal probability that the traffic and toll revenues could be higher or lower than projection.

(3) Present value assumes 4.4% discount rate (State's 30 year borrowing cost).

(4) Includes Crossing and expansion to 4 lanes and Ingra-Gambell Viaduct when traffic warrants.

This means that even Citi believes that there is only a 25% chance that $150 million is the most that the state will have to pay.

Should the state take on an "Unlimited" liability on a chance of this future payback? We could get the same return just investing $424 million at 4.4% which is below the Permanent Fund target rate for real return of 5%.

Since PND 2009 estimate, Bridge now a 1000' longer, East approach moved into bluff per Muni-Port Settlement, and further drilling not done to determine depth of unstable Bootlegger Cove Clay as was recommended by KABATA geotech consultant. With these design changes, most of customary 10% contingency likely to be already depleted before construction even starts.

Faulty

~~Conservative~~ Assumptions Used in the Financial Analysis

Citigroup's analysis uses conservative, reasonable assumptions.

- Interest rate assumptions significantly above current market
  - 1.5% higher for tax-exempt PABs
  - 1.1% higher for TIFIA loan
  - Using current market interest rates eliminates any State reserve replenishment in other than the 95% probability, severe downside scenario
    - Reduction in the reserve replenishment in 95% probability scenario from $627 million to $113 million

Bad Math. Citi's last financial plan 8/12 showed half the construction funds from $500 M TIFIA loan at about 3.2% making overall interest cost 5.8%. Citi's interest rate is high because with deficits the first 8 years, the amount that needs to be financed grows (negative amortization). Without TIFIA, using Citi numbers, interest cost will be over 8% versus state long term direct bonding (no P3) of less than 4%.

- Construction cost includes a $84 million contingency

Citi's last August, 2012 Phase 1 Financial Plan included the revenue from 4 lanes from 2026-2051 but only the cost of a 2 Lane Bridge. That's an impossible, not conservative, assumption.

- Assumes crossing expansion as traffic warrants, even if state is paying under "moral obligation" pledge
  - If KABATA did not move forward with the expansions, under the severe downside case, State reserve replenishment drops from $627 million to $113 million, but the Crossing would become congested
- Upside and downside traffic and revenue projections modeled
- 33% TIFIA and no rural eligibility
  - Recent Federal Highways reauthorization allows up to 49% TIFIA and lower interest rate for rural projects
    - Portion of the Crossing in the Mat Su likely considered rural

Assumes receipt of $300 million low cost TIFIA loan that KABATA has been turned down for 5 times (2007, 2009, 2011 twice and 2012). This is highly competitive program with next TIFIA round expected to have 5-10 times more requests than funds available. Sen. Coburn (R-OK) listed KABATA as #6 most wasteful project. Pres. Obama said "no more Bridges to Nowhere"

- Does not consider the benefits of the Crossing to the public or the resulting economic development
- At the end of analysis State owns a $1 billion+ asset unencumbered

Should state not pay a cumulative $2.6 Billion minimum (See Real Cost Paper) we will likely suffer downgrading of the State's credit rating. Over $665 million in financing profits to contractor (Net cash flow minus equity, in Citi's Aug. 2012 financial plan). If the state defaults on replenishing the unlimited reserve fund, the P3 contractor is likely to sue for construction costs, construction profits, and financing profits that were include as costs in calculating 35 years of "availability payments". The final amount for those "availability payments" will only be known to the legislature after KABATA and the State signs the Contract. That contract is only possible if the legislature signs the "blank check" reserve fund that would be created if SB13-HB23 are passed.

Citi indicates that the economic risks and merits in this presentation should be independently verified. The LB&A Audit will help, RFP 2013-0400-1683 from the Dept. of Revenue would have been a separate independent review, but that RFP was unfortunately canceled.

Citi believes that sustainability is good business practice. We work closely with our clients, peer financial institutions, NGOs and other partners to finance solutions to climate change, develop industry standards, reduce our own environmental footprint, and engage with stakeholders to advance shared learning and solutions. Highlights of Citi's unique role in promoting sustainability include: (a) releasing in 2007 a Climate Change Position Statement, the first US financial institution to do so; (b) targeting $50 billion over 10 years to address global climate change: includes significant increases in investment and financing of renewable energy, clean technology, and other carbon-emission reduction activities; (c) committing to an absolute reduction in GHG emissions of all Citi owned and leased properties around the world by 10% by 2011; (d) purchasing more than 234,000 MWh of carbon neutral power for our operations over the last three years; (e) establishing in 2008 the Carbon Principles; a framework for banks and their U.S. power clients to evaluate and address carbon risks in the financing of electric power projects; (f) producing equity research related to climate issues that helps to inform investors on risks and opportunities associated with the issue; and (g) engaging with a broad range of stakeholders on the issue of climate change to help advance understanding and solutions.

Citi works with its clients in greenhouse gas intensive industries to evaluate emerging risks from climate change and, where appropriate, to mitigate those risks.

efficiency, renewable energy and mitigation