REPORT CONCLUSIONS

In an effort to provide legislators with the knowledge necessary to make informed decisions on future KABATA-related legislation, an audit of the KAC Project was requested. The audit objectives were to:

1. Provide a historical summary of major KAC Project milestones;
2. Identify significant changes to the project scope;
3. Evaluate the adequacy of public participation;
4. Provide a detailed summary, by source, of KAC authorized, expended, and remaining funds, including the level of funding necessary to complete the project;
5. Ascertain the reasonableness of KAC toll and revenue projections and the KAC projected financial plan (financial plan);
6. Evaluate the KAC private-public-partnership (P3) agreement; and
7. Outline the balance of risks and rewards between public and private partner entities outlined in the P3 agreement.

The audit concludes that KAC toll and revenue projections are unreasonably optimistic, and the projected cash flows to the State are likely overstated as a result. These are important considerations for policymakers since the P3 compensation arrangement requires KABATA to make payments to the private partner regardless of the project's ability to generate toll revenues. The deficiencies in KABATA's methodology for generating toll and revenue projections are addressed in Recommendation No. 1.

KABATA's FY 03 through FY 12 expenses total $70.4 million and authorized funding totals $131 million. The project is expected to require an additional $1.4 billion from a variety of sources including bonds, loans, grants, and private equity. A discussion of key project planning and development milestones is provided as part of this report's Background Information section. Appendix A provides a list of significant KAC Project milestones.

The audit was unable to fully outline the balance of risks and rewards embodied in the final P3 agreement because the procurement process is not complete, and the P3 agreement has not been finalized. However, the general structure of the P3 agreement has been defined by KABATA's governing board and provides that the State will bear the risk of lower-than-expected toll revenues.

It is important to note that a final P3 agreement will also contain rewards and additional risks that are not addressed in this report due to the scope limitation already discussed. This report is not concluding whether or not this specific risk is justified when considering the P3 agreement's balance of risks and rewards for the agreement as a whole. The risk of lower-than-expected toll revenues is an important aspect of understanding the potential effect of deficiencies in projections and should be considered in that context.

Detailed report conclusions are presented below.

Approximately $1.4 billion in funding is needed to complete the KAC Project.

KABATA management, with assistance from a financial advisory firm, developed the KAC financial plan.[12] The total, necessary projected KAC funding is identified in the financial plan as approximately $1.6 billion. (See the schedule of proposed sources and uses in Exhibit 3 on page 19.) This estimate includes both phases of construction. Phase I is scheduled to begin immediately, and Phase II will be completed incrementally. Per Exhibit 5 on page 25, KABATA has secured $131 million of the $1.6 billion necessary for the project. The remaining unsecured funding sources of $1.4 billion are discussed in detail below.

Bonds ($846.9 Million – 52 Percent of Proposed Funding)

According to the KAC financial plan, the private partner will borrow $350.7 million of the total projected private bond funding of $516 million through a private activity bond (PAB) bond issuance for Phase I of the project. The remaining private and public bond financing in the plan ($496.2 million) for Phase II of the project will need to come from other sources. According to KABATA management, potential bond sources may be secured through KABATA (tax exempt municipal revenue bonds or TIFIA loans) or through the private partner (a syndicated bank credit facility, TIFIA loans, or taxable corporate bonds).

TIFIA Loan ($356.7 Million – 22 Percent of Proposed Funding)

In 2005, KABATA management pursued TIFIA funding on behalf of the future private partner by filing a loan request without success. Since 2005, eight separate applications have been unsuccessful. In July 2012, the United States Congress enacted[13] several changes to the TIFIA program. Changes increased funding levels, increased federal participation in eligible project costs from 33 percent to a 49 percent ceiling, and eliminated subjective selection criteria.

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[12]The financial plan referred to in this report is the December 2012 version KABATA for a credit rating.
[13]Public Law 112-141.

FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

Knik Arm Bridge and Toll Authority (KABATA) management should revise traffic and toll revenue projections to address deficiencies.

The audit of key assumptions and inputs used in KABATA's transportation modeling process identified several deficiencies regarding the validity of assumptions and inputs used as a basis for projecting toll revenues. Deficiencies are as follows.

- The household levels and growth rate KABATA projected for 2035 were overly optimistic when compared to the household growth rates and levels projected by University of Alaska's Institute of Social and Economic Research and the State's Department of Labor and Workforce Development. The discrepancy stems from KABATA's economic growth rate projections in the Point MacKenzie region, specifically in the Port MacKenzie (Port) area.

- KABATA's estimated traffic growth rate of five percent is significantly higher than the actual growth rate of 2.5 percent based on the Department of Transportation and Public Facilities' traffic counts. The differences are partially caused by the anticipated growth in population and employment in the Point MacKenzie area.

- A projected 50 percent KAC market share of traffic is unsupported.

- The estimate of a 12 percent split for commercial vehicle traffic for the KAC is high compared to actual traffic count data for the Glenn Highway which indicates a split of 4.9 to 6.6 percent. KABATA's 12 percent split is based on DOTPF's 2003 through 2006 traffic data. Since then, DOTPF has improved its traffic data collection methodology and now reports much lower traffic count splits that better reflect the actual count between personal and commercial vehicles.

- KABATA's projected 2035 Point MacKenzie area employment level of 14,337 is significantly higher than the level noted in the Matanuska-Susitna Borough plan of 4,515. A majority of KABATA's employment (13,828) is based on projected Port economic development which is inconsistent with the Port's master plan and regulations.

All of the above concerns have the effect of overstating traffic volume. Overstated traffic volume in KABATA's modeling process has the effect of overstating projected toll revenues.

The Federal Highway Administration's (FHWA) guidelines for P3s[20] state:

> *Inaccurate or overly optimistic traffic projections and underestimated project costs can lead to the development of pro forma financials that appear to justify the investment decision, but that do not reflect the project's actual ability to repay debt or to meet equity investor's return requirements.*

Under KABATA's planned P3 arrangement, lower than expected toll revenues would necessitate the need for additional funding as availability payments must be paid to the private partner regardless of how much the bridge is used.

In recognition of the risk that overstated toll revenues pose to the State, we recommend KABATA management revise the traffic and toll revenue projections to address noted concerns.

[20] The FHWA's Innovative Program Delivery, *Risk Assessment for Public-Private Partner ships: A Primer*, September 10, 2012.