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PPPs AND CONTINGENT LIABILITIES: A TEXAN CASE

Rafael M. Aldrete, Ph.D.

- Texas Transportation Institute
- Senior Research Scientist
- r-aldrete@tamu.edu

Texas Transportation Institute

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BACKGROUND AND OBJECTIVES

- Value Capture (VC) is an innovative financing method and a non-commercial form of PPP that leverages the real estate potential brought by infrastructure improvements

- Texas Legislation enacted in 2007 allows local governments to set up Transportation Reinvestment Zones (TRZ), a VC mechanism designed specifically to fund transportation infrastructure

- The implementation of the first TRZs has shown there is a need to improve the TRZ risk management framework

PPP, RISK SHARING AND VALUE FOR MONEY

- PPPs are effectively helping governments worldwide meet transportation funding needs and achieve value for money
- Optimal risk sharing is essential to achieving value for money
- However, it is because of the risk sharing principle that PPPs come with a fiscal cost
  - Governments using PPPs face significant risk and uncertainty related to the share of project risk they bear
  - Risk should be quantified to be effectively managed

RISK EXPOSURE IN PPP AND CONTINGENT LIABILITIES

- Uncertain nature of risk creates “contingent liabilities” via the potential for a sudden or larger than expected change of government obligations

Contingent Liabilities
▪ **A commitment to provide support only in the occurrence of an event determined ex-ante**
▪ **Upon the occurrence of the event the commitment becomes a direct liability**

VALUE CAPTURE, PPP AND TRANSPORT INFRASTRUCTURE

- Value Capture (VC) leverages the real estate potential brought by infrastructure improvements – a non-commercial PPP
- Through VC the public sector can recover all or a portion of increments in real property value attributed to "community efforts" rather than landowner actions
- VC uses public revenue streams to create a PPP within the zones directly affected by the investment, facilitating bond financing
  - Capturing value directly from properties (taxes)
  - Capturing value through JV with private sector

EXPERIENCE USING VC FOR ROADWAY FINANCING IN THE UNITED STATES IS SPARSE

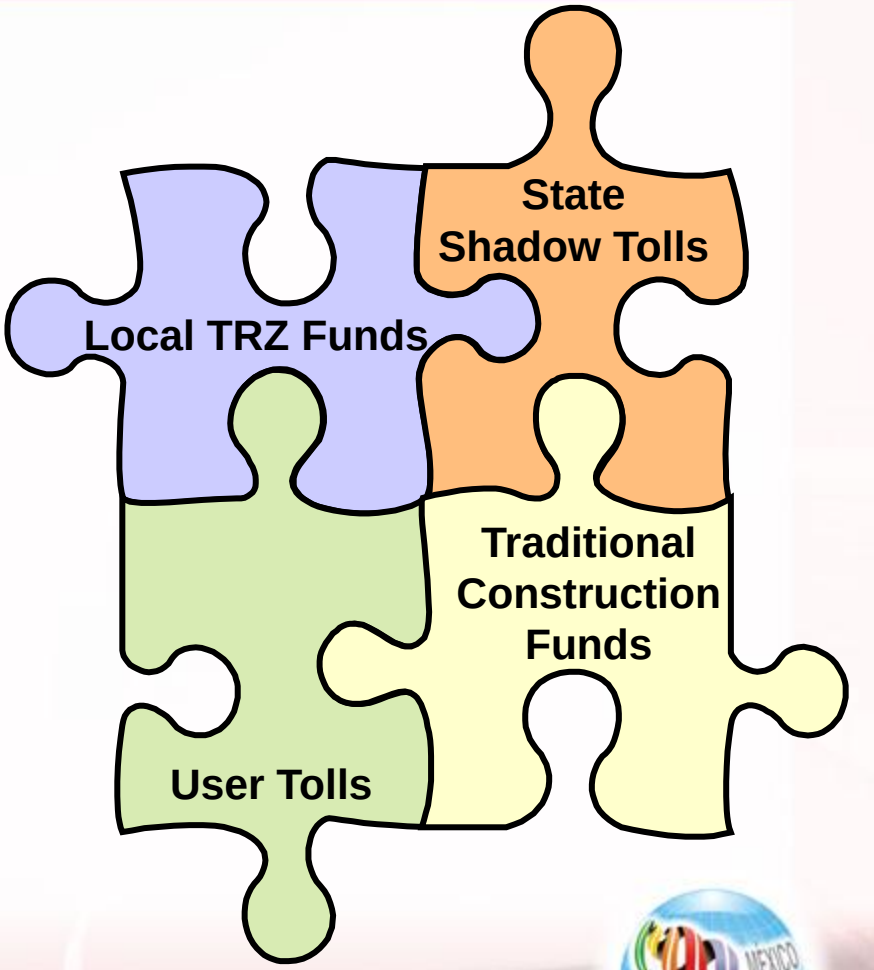
- VC is widely used to finance transit investments in the United States
- However, application to roadways is sparse:
  - Developer impact fees
  - Special Assessment Districts

Experience with VC

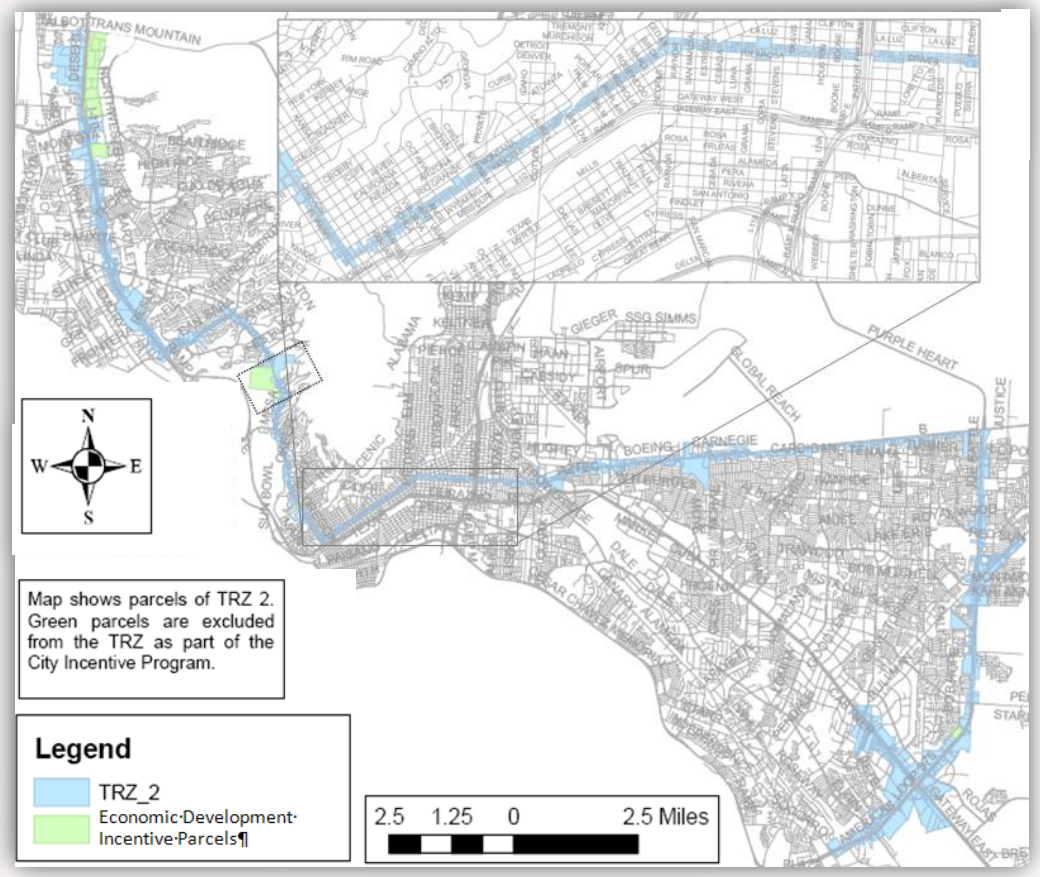
- Texas: Tax Increment Reinvestment Zones in various cities - transit
- Colorado and California: Developer impact and expansion fees - roadways
- Florida: Special Assessment District (SAD) - interchanges
- Minnesota and Arizona: SAD-roadways

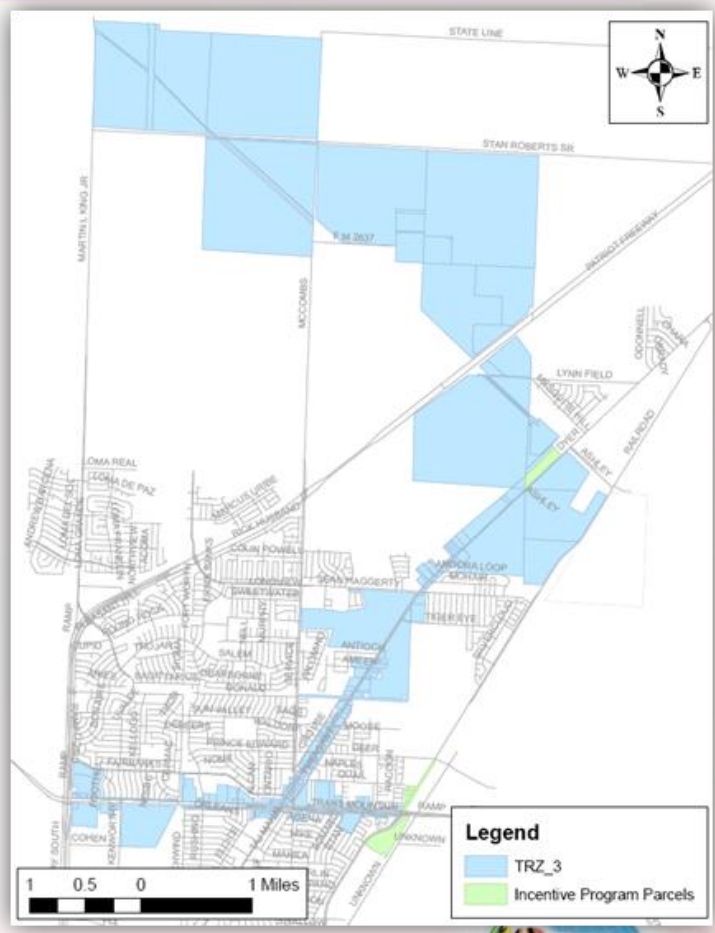
THE TEXAS TRANSPORTATION REINVESTMENT ZONE IS ONE OF THE FIRST ROADWAY-SPECIFIC APPLICATIONS OF VC IN THE U.S.

- Legislation passed in 2007 provides for the creation of TRZs as a supplementary source of transportation project financing
- Allows local governments to coordinate and leverage multiple sources of funding
- Local entities sell bonds secured by incremental tax revenues and other sources to secure project financing

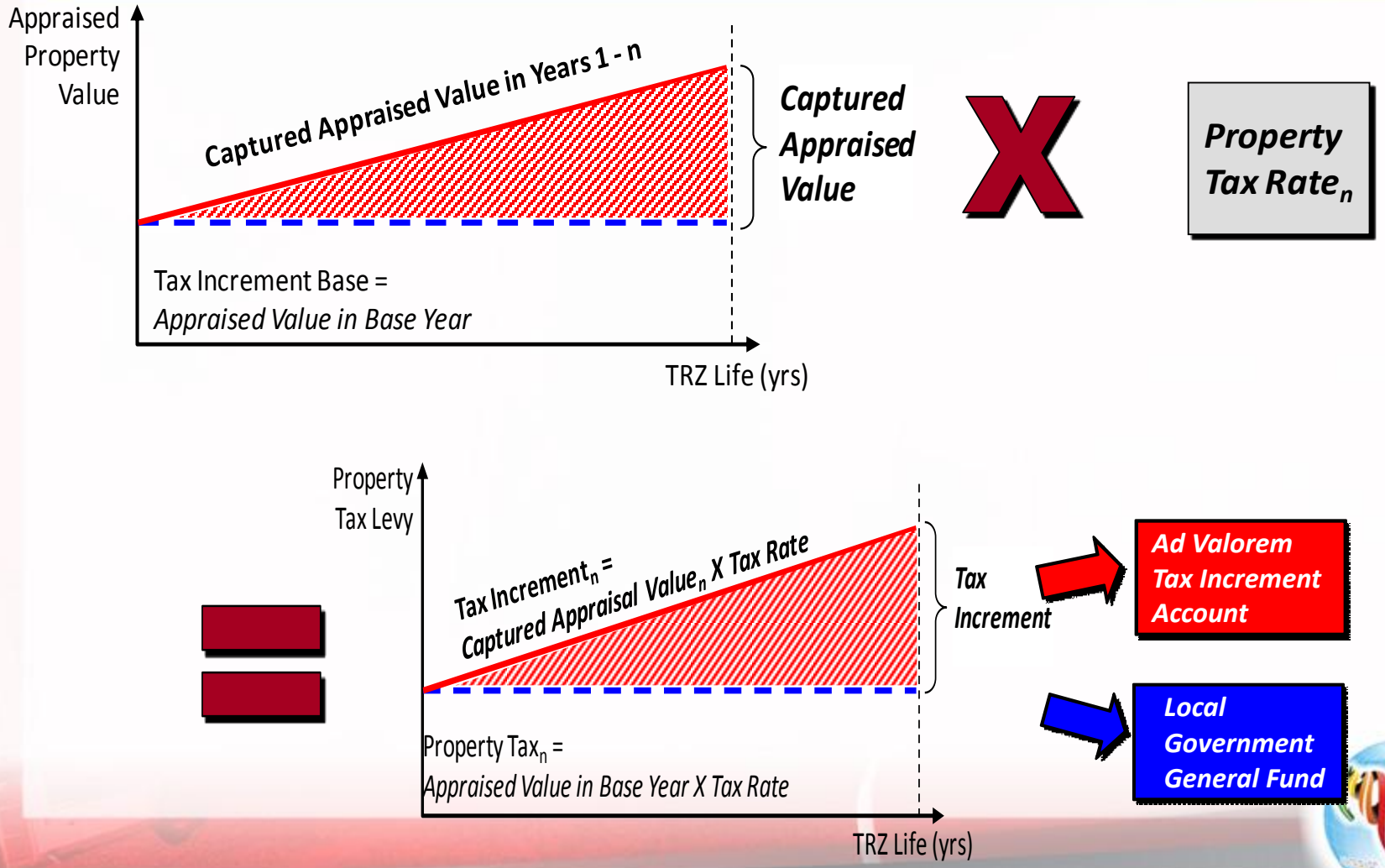


TRZ CORRIDOR GEOGRAPHICAL LIMITS– TRZ #2 AND TRZ #3 IN EL PASO, TEXAS

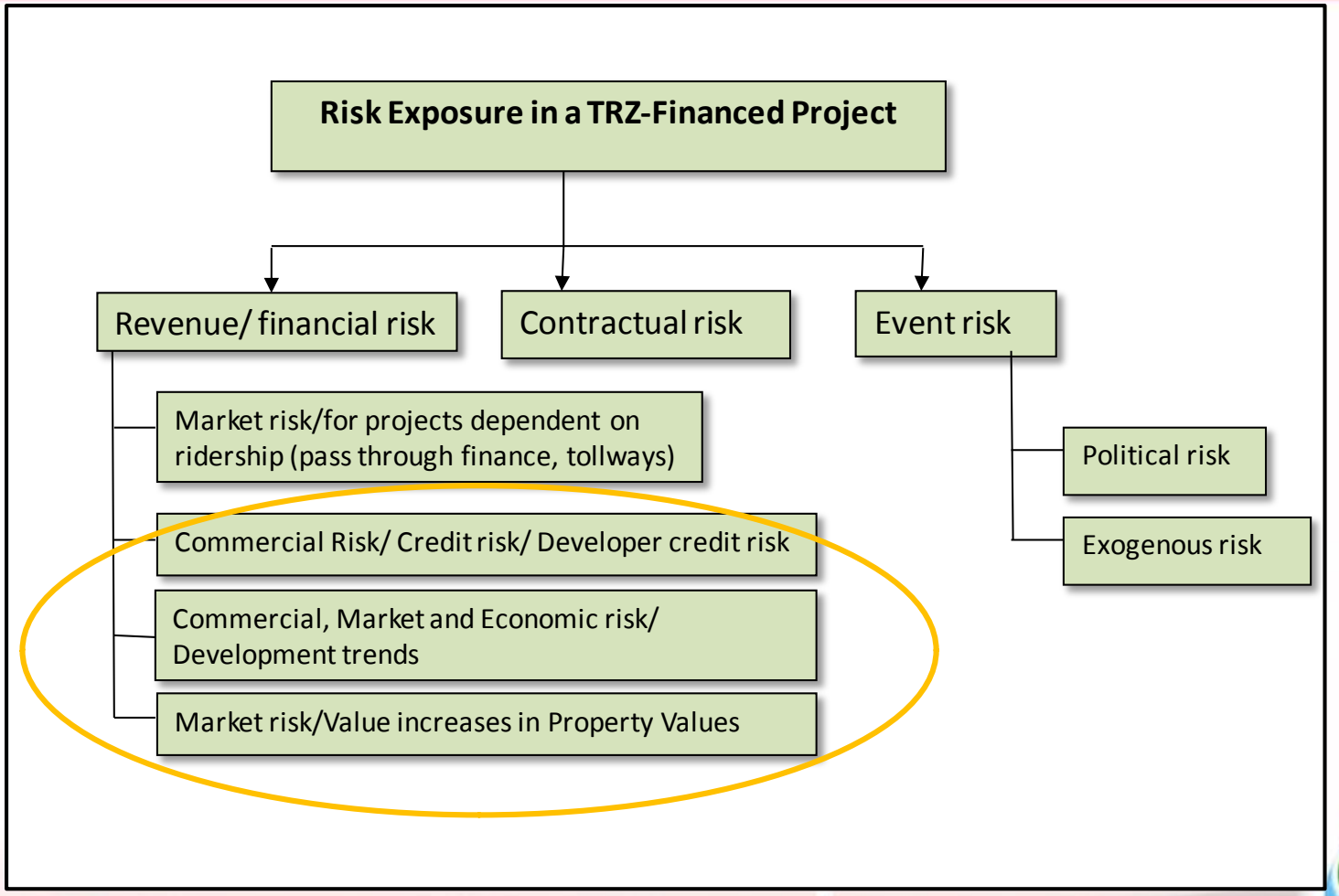




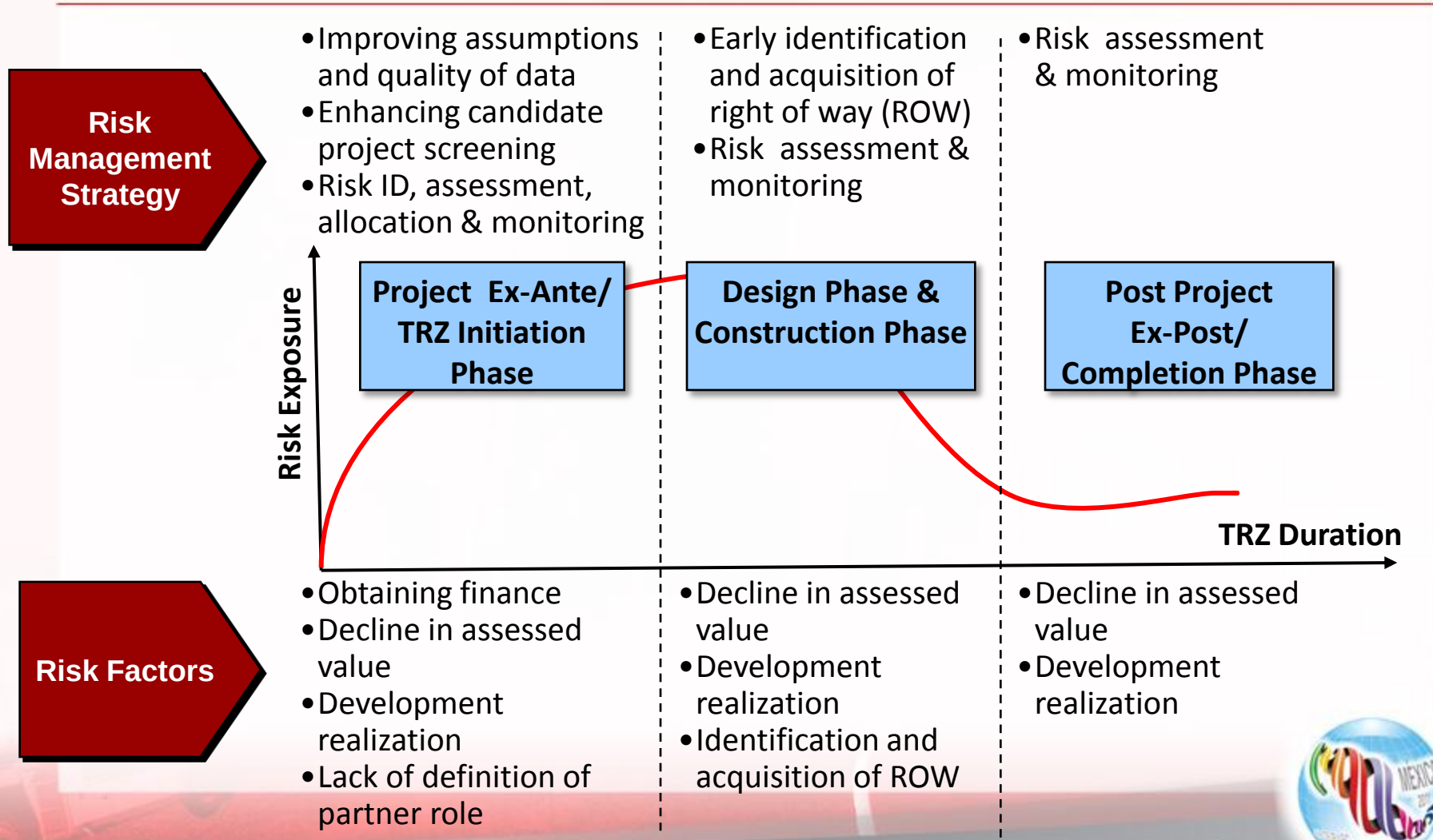
VALUE CAPTURE IN A TRZ



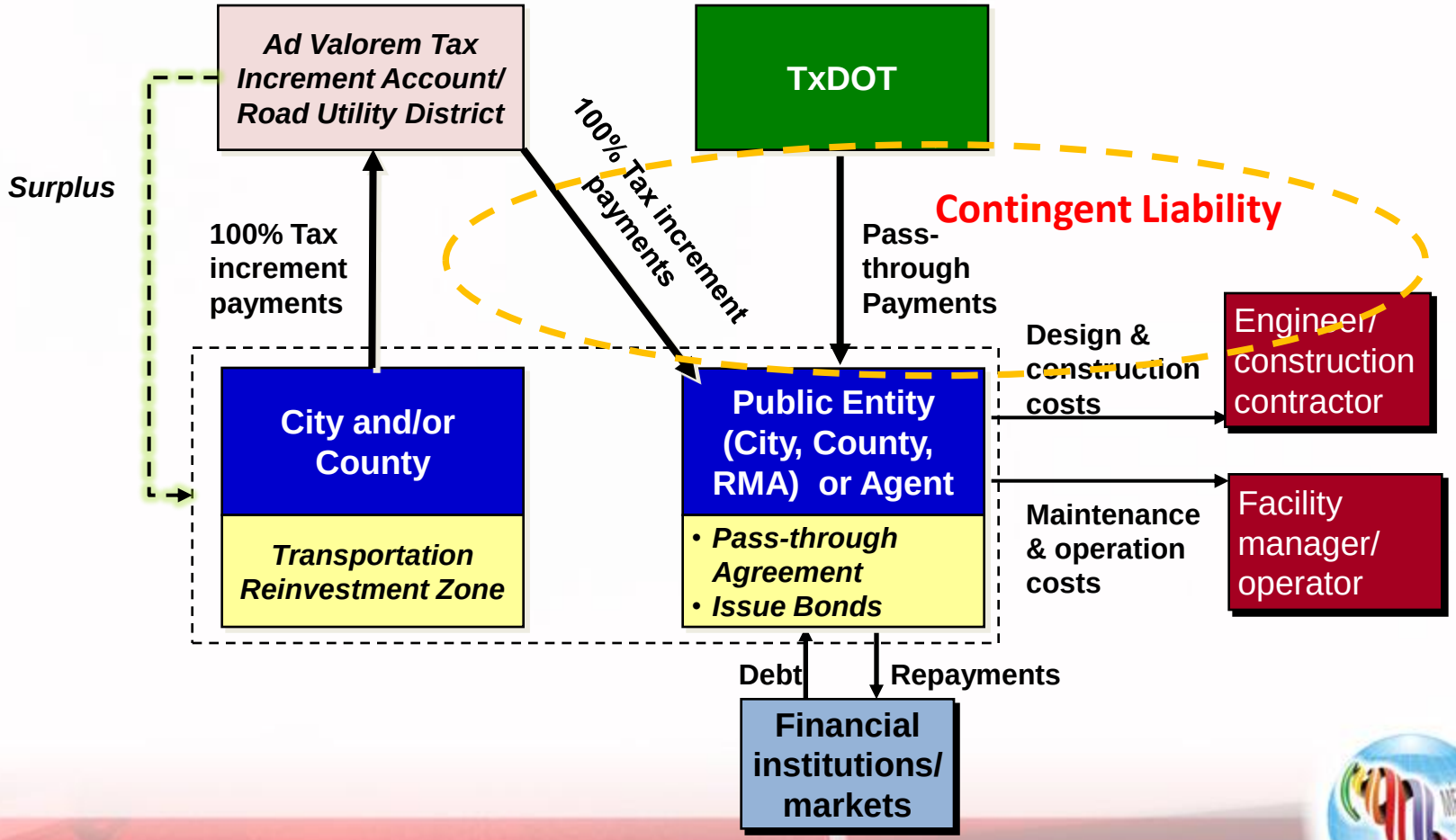
SOURCES OF RISK IN A TRZ



TRZ LIFECYCLE – EVOLUTION OF REVENUE RISK



FLOW OF FUNDS IN A MUNICIPAL TRZ – IMPLIED REVENUE RISK ALLOCATION



TRZ OPTIMAL RISK ALLOCATION

- Risk allocation in PPPs
  - Apportioning responsibility for bearing the costs that result from each identified project risk materializing
  - Optimal risk allocation is the apportionment of risk between parties to a contract that minimizes the total cost of risk bearing to the project
- Although TRZ finance is a relatively simple form of PPP, it is important to address its implied risk allocation according to the principles of optimal risk allocation

OPTIMAL TRZ RISK ALLOCATION COULD ALLOCATE RISKS DIFFERENTLY

Risk Bearing Hierarchy

Partner Best Able to Manage Risk	Partner Best Able to Anticipate/Respond To Risk	Partner Best Able to Absorb Risk at the Least Cost
State DOT Via screening procedures for projects	**Local Government** At all phases is in a better position to respond to the risk via its policies and actions to encourage development	**State DOT** As a less risk averse partner in the PPP and the consideration of shadow toll payments in conjunction with TRZ funds.
Local Government Via proactive policies	**State DOT**	**Local Government** Via proactive policies

CONCLUSIONS

- The PPP approach of the Texas TRZ is innovative and when subjected to rigorous screening can lead to win-win situations for the local governments and TxDOT
- However, the allocation of TRZ revenue risk in the legislation should be clarified
  - Allocation is currently neither clear nor explicit
  - The conceptual flow of funds seems to imply a contingent liability for local governments
  - An optimal risk allocation analysis shows that allocating it to the State DOT may be more efficient