# COMMONWEALTH *of* VIRGINIA

**DEPARTMENT OF TRANSPORTATION**
1401 EAST BROAD STREET
RICHMOND, VIRGINIA 23219-2000

**GREGORY A. WHIRLEY**
ACTING COMMISSIONER


July 14, 2006

Mr. Roberto Fonseca-Martinez
Division Administrator
FHWA, Virginia Division
400 North 8th Street, Room 750
Richmond, Virginia 23240

Dear Mr. Fonseca,

Attached is the Virginia Department of Transportation's SEP-15 application for the Pocahontas Parkway transaction. As you are aware, the Department successfully negotiated and executed a concession agreement with Transurban (USA) Development, Inc. (TUSA) that resulted in the assignment of the rights to operate, manage and collect tolls on the Parkway. In addition, the agreement requires TUSA to construct, maintain, and operate the Richmond Airport Connector subject to the receipt of TIFIA credit assistance. The Connector is one of only two new-build projects in the Virginia Transportation Improvement Plan and is a priority for the Commonwealth, particularly the Richmond region.

The SEP-15 application is to deviate from the definition of "eligible project costs" to allow for the effective utilization of the federal Transportation Infrastructure Finance and Innovation Act ("TIFIA") for the Pocahontas Parkway and construction of the Richmond Airport Connector. The Department fully and strongly supports the approach described.

We appreciate the support and assistance provided by the Division, FHWA Headquarters, and USDOT staff in developing this approach. Mike Saunders in FHWA Headquarters has requested that you notify him of the application upon its delivery.

If you have any questions, please contact Barbara Reese. She can be reached at (804) 786-5128.

Sincerely,

for Barbara W Reese

Gregory A. Whirley

cc: Mrs. Barbara Reese, VDOT CFO
Mr. Michael Kulper, Transurban (USA) Development Inc.
Mr. Conor Kelly, DEPFA
Ms. Deborah Brown, VDOT

**Virginia Department of Transportation**

**SEP-15 Application**
**Pocahontas Parkway (Route 895)**

This SEP-15 application to the Federal Highway Administration represents the culmination of more than eighteen months of negotiations between the Virginia Department of Transportation ("VDOT") and Transurban (USA) Development Inc. ("TUSA"), a private toll road operator based in Australia with subsidiaries in New York and Richmond, Virginia. TUSA will immediately seek Transportation Infrastructure Finance and Innovation Act ("TIFIA") funding for the Pocahontas Parkway (the "Parkway") project (described below) upon approval of this application.

This SEP-15 application is being submitted to seek the US DOT's approval to deviate from the definition of TIFIA "eligible project costs" to include the cost of refunding long-term project debt that TUSA has raised to acquire the Parkway. Approval of the application, and subsequently successful negotiation of TIFIA credit assistance, will allow for the construction of the Richmond Airport Connector by TUSA under the terms and conditions in the agreement between VDOT and TUSA.

This application includes a project description, a description of the experimental nature of the project, an explanation of the benefits the project will have for the Commonwealth of Virginia and the TIFIA program, and an explanation of VDOT's proposed performance measures.

## Introduction

Based on the terms of the agreement between VDOT and TUSA, TUSA has acquired the rights to operate, manage and collect tolls on the Parkway. In addition, TUSA is obligated to construct, maintain, and operate the Richmond Airport Connector ("RAC") if $150 million of TIFIA credit assistance is made available for that purpose. The agreement between VDOT and TUSA has been fully negotiated and was signed on June 29, 2006.

The RAC is a project of critical importance to the Commonwealth, and particularly the Richmond region, but is not economically feasible on a stand-alone basis. Like the Parkway, beginning in 1989, it was originally planned to be built simultaneously with the Pocahontas Parkway but funding limitations prevented its construction. As a result, the Connector and Parkway became two unique projects and the RAC for the last four years is one of only two new-build projects in the Virginia Transportation Improvement Plan.

The Pocahontas Parkway concession is unique among US toll road projects in many respects. It has been developed over an extended period by two committed parties through a completely transparent negotiation process. The result is an equitable sharing of risks and rewards between the public and private sectors. Evidence of this is that

VDOT and TUSA have agreed to share revenues above a real total return on investment of 6.5%.

In addition to the tangible benefits the project offers to the Commonwealth (including a potential revenue stream and the construction of the RAC) the proposed project will also benefit the TIFIA program. This project represents TIFIA's first opportunity to participate in an existing toll road project refinancing and to test how European and Australian-modeled PPP concessions perform in the United States. We are confident that the agreement between VDOT and TUSA will become a model for future PPP projects.

Upon acceptance of this application and an invitation from the TIFIA Joint Program Office, TUSA will apply for a TIFIA loan that will be used in part to construct an innovative project that will complete and enhance the Parkway as originally planned and envisioned by the Commonwealth, including the Richmond Metropolitan Planning Organization. The TIFIA loan will be used to begin construction of the RAC as soon as the funds are made available, to update the electronic toll collection system, and to refinance a portion of the long term senior debt that was used to acquire the Parkway from the Pocahontas Parkway Association (the former 63-20 not-for-profit operator). The TIFIA loan will enhance the credit quality of the project and provide the economic leverage needed to justify the increased liabilities associated with the construction of the RAC.

The overall intent of the SEP-15 program is to foster innovation and explore the full range of opportunities to make the project delivery process more efficient. This project will improve the delivery time, quality, and expense of the project for VDOT and for the private investor. This project will undoubtedly influence future Federal-aid policy and procedures particularly with respect to refinancing, making it a unique educational opportunity for FHWA. VDOT will secure the services of an independent third-party financial advisor, subject to the approval of the US DOT, to evaluate how the experimental features contribute to the overall success of the project upon its completion.

## Project Description

*1. The Acquisition*

The Pocahontas Parkway (Route 895) is an 8.8-mile tolled highway seven miles south of Richmond, Virginia. It was the first project to be constructed under Virginia's Public Private Transportation Act ("PPTA") of 1995. It was built by a joint venture of Fluor Enterprise and Morrison Knudsen (now Washington Group) with oversight from VDOT. Ground-breaking occurred in the fall of 1998 and the Parkway was opened to traffic in stages beginning in May 2002. The Parkway was completely opened to traffic in October 2002.

The Parkway was constructed in part using funds generated by tax-exempt bonds issued by the Pocahontas Parkway Association ("PPA") in 1998. PPA was a not-for-profit, non-stock corporation without members, commonly referred to as a 63-20. It was established for the sole purpose of financing the construction of the Parkway. The Parkway's total development costs were funded through tax-exempt revenue bonds ($354 million) issued by PPA, a State Infrastructure Bank loan ($18 million) and Federal funding for roadway design ($9 million). VDOT provided operations and maintenance services and assumed subordinate loans for these services. These loans were paid in full by TUSA as part of the agreement to acquire the right to operate the road. Maintenance and toll operations work was carried out by VDOT through internal resources and private contractors hired by VDOT per VDOT's agreement with PPA.

TUSA executed an Asset Purchase Agreement with PPA and entered into the Amended and Restated Comprehensive Agreement ("ARCA") with VDOT on June 29, 2006. Under the terms of those agreements, TUSA has acquired the sole rights to enhance, manage, operate, maintain and collect tolls on the Parkway for a period of 99 years. All existing PPA debt has been legally defeased/repaid as part of this transaction.

The acquisition was financed with private debt and equity. DEPFA Bank plc New York Branch (domiciled in Ireland), Banco Espírito Santo de Investimento, New York Branch (domiciled in Portugal), and Bayerische Hypo-Vereins Bank, New York Branch (domiciled in Germany) committed to finance $420 million in long term senior loans. Transurban is providing $195 million in subordinated debt and equity. The financing has been structured to offer the flexibility necessary for the TIFIA loan to be contributed after closing. Per the TIFIA application requirements, TUSA engaged Fitch Rating Service to review the project. Fitch has provided an indicative rating of BBB- for the senior debt facilities and a rating of BB+ for the proposed TIFIA mezzanine facility. This compares favorably to current ratings of TIFIA subordinated debt on other privately financed toll road facilities in the US.

*2. The Richmond Airport Connector*

Below is an explanation of TUSA's responsibilities under the ARCA pertaining to the RAC, a description of the RAC as it is currently envisioned, the motivating factors for constructing the RAC, the status of the RAC planning and design, and the role envisioned for TIFIA financing in the Parkway transaction.

The Pocahontas Parkway project includes a secondary component that makes the entire transaction particularly attractive to VDOT. Subject to the availability of $150 million of TIFIA financing, TUSA will have the obligation to construct the RAC, which will connect the Parkway to the Richmond International Airport ("RIC") and provide a missing link in Virginia's existing road network. Under the terms of the ARCA, TUSA is obligated to construct the RAC only if TIFIA financing is secured within 150 days of the signing of the ARCA.

As had been done by the Richmond Metropolitan Planning Organization and in the Transportation Improvement Plan, these two project components have been separated to allow for the expeditious completion of the Parkway acquisition and to simplify TUSA's efforts to obtain private financing to fund the transaction. By placing the 150-day limit on the procurement of TIFIA funding, VDOT has incentivized TUSA to move forward with their TIFIA application and to start construction of the RAC as soon as possible.

VDOT's 150-day time-frame limited TUSA's risk exposure and made the project credit more attractive to the financial institutions involved. Additionally, incorporating the RAC into the ARCA allowed TUSA to complete their extensive and costly due diligence process more efficiently than would otherwise have been possible.

The RAC is envisioned to be a 1.58 mile, four-lane roadway that will provide motorists with direct access to the Richmond International Airport. The roadway will be located in Henrico County, Virginia and will begin at a bridge constructed from the Parkway approximately 0.38 miles west of Monahan Road. The 4-lane road will be constructed on a non-developed location from the Parkway to Seven Hills Blvd. From Seven Hills Blvd north to Sprouse Road, the existing four-lane Settler Road will be utilized. From Settler Road north, the proposed Project re-enters a non-developed location.

In addition to its inclusion in Commonwealth and regional transportation plans since 1989, the RAC was added to the *Major Thoroughfare Plan* that is a component of the *2010 Henrico County Land Use Plan* in 1999. The RAC is identified in both the Richmond Regional Planning District Commission's *2026 Constrained Long-Range Plan* and *Richmond Area Metropolitan Planning Organization (MPO) Transportation Improvement Program.* In addition, the RAC is included in the *MPO's Congestion Management System* roadway network. The RAC is partially funded in the Commonwealth Transportation Board's Six-Year Improvement Program.

The need for the RAC is based on the lack of any connection between Route 895 and the Richmond International Airport and in turn a direct gateway to the Airport from areas south and southwest of the city of Richmond. The purpose of the proposed project is to improve system linkage between the Parkway and Richmond International Airport, which would improve access and reduce travel times to the airport and other area businesses. The RAC will reduce vehicular traffic and improve the safety of the traveling public and freight carriers by separating the movement of Airport and non-Airport traffic.

Primary access to the Seven Hills Industrial Center is from Charles City Road. Eastport Industrial Park, Inter Air Center Industrial Park, and Richmond Industrial Interport facilities are located on Laburnum Avenue. Each of these facilities generates large volumes of vehicular and truck traffic. In addition, the Airport area is a designated Foreign Trade Zone.

The projected rise in airport operations and growth and development in and around RIC contribute to the need for the proposed project. The Federal Aviation Administration has forecasted annual enplanements at RIC to increase from approximately 1.7 million in the Year 2000 to approximately 2.8 million in the Year 2015. As a result of anticipated growth, RIC is undergoing extensive renovation that is expected to be complete in spring 2007. TIFIA loans, if available, will complement the locally-raised funds that are being used to expand capacity at the airport. The RIC has had the benefit of federal earmarks for enhancing the road network on the airport property which will directly connect to the RAC.

Environmental review is being completed by VDOT and a FONSI is expected in September 2006. VDOT has substantially completed acquisition of the Right-of-Way for the RAC with state funds and the design of the RAC is largely complete.

Without TIFIA funding, the Commonwealth's plan is to use traditionally available federal funds for construction as such funding may become available. At this time, the funding required to construct the RAC is not available from traditional state, local, and federal sources within the Commonwealth's Transportation Improvement Plan. With TIFIA credit assistance, these costs will be covered by TIFIA loans that will be repaid by TUSA with proceeds from the tolling of the Parkway and RAC. The project represents an excellent opportunity for US DOT to maximize funding in support of an innovative and timely project.

Under TUSA's financing plan, a TIFIA mezzanine loan of $150 million will be requested. The TIFIA funds would be used to refinance approximately $95 million of the long-term senior bank debt, $7 million needed to upgrade the electronic tolling system and approximately $48 million towards the construction of the RAC (including $2.8 million of ancillary costs).

Based on the above refinancing scenario, the project sponsor has already received an indicative BBB- (investment-grade) rating from Fitch Rating Service for the post-TIFIA-financing senior loans. The financial model has been reviewed and verified for the senior lenders by an independent and internationally recognized model auditor and by VDOT's financial advisor.

The project proposal and the Parkway project will meet the following goals of the SEP-15 process by:

- Expediting project delivery,
- Increasing project delivery flexibility,
- Maximizing innovation,
- Enabling timely project construction,
- Developing and promoting public-private partnerships using current FHWA laws, regulations, and practices, and
- Allowing greater use of PPPs and private investment in transportation improvements.

### Proposed Experimental Feature

This SEP15 application is submitted to request expansion of the definition of TIFIA "eligible project costs" upon which to size the total amount of TIFIA credit assistance for the Parkway. VDOT proposes that FHWA considers TUSA's total acquisition price for the Parkway ($548 million) plus a $55 million liquidity facility provided by an affiliate of TUSA to cover the senior loan (and potentially the TIFIA loan) interest expenses for the initial years of the project when toll revenue is insufficient to service debt payments as "eligible project costs."

**Purpose:** The size of the TIFIA loan was determined through a cost-benefit analysis which showed that $150 million is the minimum amount required to (i) incentivize TUSA and the senior lenders to assume the risk of constructing and operating the RAC and (ii) to secure an investment grade rating for the remaining senior debt. Based on the discounted value of the future toll revenues expected from the RAC during the 99 year concession, TUSA determined that the RAC is not financially feasible on a stand-alone basis and independent VDOT analysis confirmed this finding. The net present value of toll revenues attributable to the incremental traffic derived from the RAC is expected to amount to only a fraction of the RAC construction cost.

Although the RAC project is of great economic importance to the Commonwealth, and particularly the Richmond region, the economic benefits do not justify the cost or risk that would be assumed by a private sector investor in undertaking the construction and operation of the RAC.

VDOT, therefore, encouraged TUSA early in the negotiation process to propose how the private sector could construct, finance and operate the RAC. The result is this SEP-15 application and the experimental refunding under the TIFIA credit program. TUSA, using its base case financial model, carried out a cost benefit analysis of constructing the RAC utilizing different amounts of TIFIA funding in order to ascertain how much was actually needed to make the RAC project economically feasible. The first sensitivity of utilizing $48 million (the estimated RAC construction cost) of federal funding would severely affect the debt service capacity on the senior and TIFIA loans. The second sensitivity assumed federal funding of $100 million (assuming that $45 million is used to refinance a portion of the senior loans and $7 million is used to fund the ETC upgrade), which demonstrated that there was no improvement on the credit quality of the remaining senior loans (as evidenced by the loan coverage ratios) and therefore it was unlikely that an investment grade rating of the senior loans would be obtainable. The third test assumed federal funding of $150 million, which in TUSA's opinion, is the minimum amount necessary to enhance the rating of the senior loans to investment grade quality. With a refinancing of $95 million of the senior loans, the project can support the additional financial burden of the $48 million for the RAC and $7 million of the ETC investment and still demonstrate acceptable probability of debt repayment under adverse revenue cases (the lenders' down side traffic and revenue assumption). This scenario has been indicatively validated by Fitch which has granted a "BBB-" rating to this proposed structure. Given that this rating is the lowest investment grade range, it is likely that a different structure will not warrant an investment grade rating. Without an investment grade rating, TUSA will be unable to refinance the existing (or proposed TIFIA) debt facilities. The Pocahontas Parkway acquisition has always been predicated on a refinancing with a longer term, more patient debt structure once the road's traffic and revenue has stabilized and following the completion of the RAC.

If the amount of TIFIA credit assistance is limited to the cost of the new investment, approximately $55 million ($48 million for the RAC and $7 million for the ETC upgrade), as the total of "eligible project costs," this would limit the amount of TIFIA credit assistance to less than \$18.3 million. However, if the definition of "eligible project costs" is expanded to include TUSA's \$548 million acquisition price for the Parkway, this would increase the maximum amount of TIFIA credit assistance available for the refinancing to a level that is consistent with the cost-benefit analysis. \$95 million of the TIFIA loan will be used to refinance long-debt debt raised by the TUSA and \$55 million will be used to finance eligible project costs for the RAC and ETC upgrade.

**Deviation from TIFIA requirements:** By statute and regulation, the total amount of TIFIA credit assistance is limited to 33% of "eligible project costs" which is defined as developmental activities, construction expenses, and related financing costs. 23 U.S.C. § 602(a)(3). Traditionally, these costs have been associated with the investments required to deliver new infrastructure. In SAFETEA-LU, the Congress gave the Secretary the discretionary authority to allow TIFIA to assist with refinancing long-term debt but it did not address how to determine the maximum amount of TIFIA credit assistance that may be provided when the Secretary approves the use of the refinancing provision.

Given the interest that Virginia and several other states have in advancing major projects as private concessions, acceptance of VDOT's application will allow the TIFIA to experiment with non-traditional financing techniques, and allow VDOT and TUSA, a sophisticated, experienced, committed partner, to provide valuable input to the US DOT as it explores what are the appropriate parameters of TIFIA credit assistance when it is used to refinance long-term debt.

The project offers substantial benefits to the Commonwealth of Virginia.

- *Construction of the RAC*
  Eastern Henrico County is poised to experience explosive economic development similar to that which occurred in western Henrico in the 1970's. This growth will not be realized without the completion of the RAC, a vital link in the road network that will provide fast, reliable access to the Richmond International Airport – a designated Foreign Trade Zone.

- *Support for a unique and innovative project*
  VDOT has expended a great deal of time, effort, and expense to develop its partnership with TUSA. The public-private partnership between TUSA and VDOT embraces the concept of optimization of risk transfer between public and private sectors. Federal recognition of this effort will encourage similar projects in Virginia and in other states.

- *Release from ongoing financial obligations*
  The Parkway acquisition removed the ongoing financial responsibility assumed by VDOT to pay for operations and maintenance of the Parkway and allowed for the reimbursement to VDOT of operation and maintenance costs previously expended. As a result of the transaction with Transurban, VDOT has been fully repaid for the operations and maintenance costs that it had accrued prior to the acquisition.

The project offers substantial benefits to TIFIA

- *Build Experience with Private Equity*
  This project will allow TIFIA to experiment with solutions to the questions raised by the new SAFETEA-LU language. By approving this application, TIFIA will remove the impediments to the use of this legislation for this project and this project only. Using the SEP-15 process for this project, TIFIA will be able to apply lessons learned to the comprehensive policy that will be implemented on a programmatic basis in future projects. Under the SEP-15 process, TIFIA will be empowered to experiment with a financially sound project involving experienced counterparties who are well-qualified to offer feedback on how best to use SAFETEA-LU to meet the goals of the US Department of Transportation.

- *Gain Valuable Feedback from Experienced Counterparties*
  TUSA has a great deal of experience in building, owning and operating toll roads. The Parkway will be its first project in the US, but all primary staff have been moved from Australia to the US to operate the Parkway. TUSA's financial advisor, DEPFA Bank, is well known for its expertise in toll road transactions in the US, Canada, and Europe. DEPFA has experience with TIFIA as it is a Mandated Lead Arranger and Technical Bank on the SR125 (CA) project. TUSA and DEPFA will be able to provide valuable feedback to the TIFIA staff as SAFETEA-LU refinancing language is considered.

- *Appropriate use of TIFIA funds*
  The proposed project meets all TIFIA requirements, terms, and conditions. TIFIA funds will enhance the credit-worthiness of a transaction that is stabilizing a financially-distressed and underperforming asset and will meet the state and local needs for additional road capacity. In retrospect, had the TIFIA program been available when the nascent Parkway was developed and financed from 1998 – 2002, VDOT's view is that the project would have been eligible for one-third of the then total development costs funded through revenue bonds ($354 million) and the State Infrastructure Bank loan ($18 million) or approximately $123 million, $28 million in excess of the currently proposed refinancing amount of $95 million.

## Proposed Performance Measures

Upon substantial completion of the RAC, VDOT will submit the independent financial advisor's report that evaluates how the SEP-15 experimental features contributed to the overall success of the project and summarizes lessons learned from the SEP-15 process. The report shall include, at a minimum, a description of the experiment undertaken, a detail of the lessons learned, an evaluation of the success of the process, its impact on the project, and recommendations on statutory and regulatory changes with an explanation of how the changes will improve the delivery of the Federal-aid highway program. In addition, the report will include the financial model illustrating how the TIFIA Loan was utilized within the capital structure to accomplish required financial measures. The main points of focus for the evaluation will be time savings, financial justification for TIFIA loan size, maximization of capital, and innovation in financing.