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## Highway Tolling Has Entered the Mainstream

More than a year ago, we observed that highway tolling, an idea that lay dormant for many years, suddenly appeared to be catching on. Borrowing the notion from author Malcom Gladwell that some ideas reach a "tipping point" and begin to spread rapidly when the right stimulus comes along, we suggested that the idea of charging for the use of highways, i.e. tolling, seemed to be following that same pattern. ("Highway Tolling Has Reached the Tipping Point," March/April 2006).

The stimulus in the case of highway tolling came from a growing mismatch between transportation needs and available resources. With maintenance and reconstruction of existing facilities consuming most of the available transportation funds, with little prospect of significant increases in state and federal fuel taxes, and with the balance in the Highway Trust Fund approaching zero, tolls began to look like an attractive source of revenue with which to finance future transportation capacity. Using toll revenue bonds and private equity capital, states would be able to fund new transportation facilities that otherwise would remain on the drawing board for years to come.

According to Gladwell, ideas that have reached the tipping point and begin to spread, soon become part of the mainstream and turn into powerful agents of change. We think that is where the concept of highway tolling finds itself today. ***As we approach 2008, tolling has entered the mainstream and has begun to influence local transportation decisions throughout the country.*** Some recent headlines tell the story: "Florida Governor Crist Considers Toll Concessions," "South Bay (**San Francisco**) Toll Lanes Plan Moves Ahead," "Legislature Authorizes Study of Tolls on **Maine's** Interstate Highways," "**Massachusetts** Transportation Finance Commission Urges Larger Role for Tolls," "**Alabama** Governor Riley Considers Tolls to Pay for Road Construction," "**South Carolina** Begins Plans to Build I-73 Under a New Pilot Program for Tolling Interstates," "I-80 Tolls May Be Inevitable, (**Pennsylvania**) Turnpike Chief Says," "**Virginia** DOT Approves Toll concession for Capital Beltway HOT Lanes," "**North Carolina** Turnpike Authority Plans a Series of Toll Roads," "Tolls Studied for Managing **Seattle** Highways," "Private Sector Ready to Bet Billions on **Georgia** Toll Roads," "**Texas** DOT Plan Would Convert Some Interstates to Toll Roads."

A combination of factors has helped to propel highway tolling into the mainstream.

1. The growing transportation budget shortfalls have been keeping the tolling option front and center before governors, state legislatures and state transportation officials. The needs for highway infrastructure investment are enormous— \$3.1 trillion over the next 30 years, according to a recent NCHRP report by Parsons Brinckerhoff, "Future Options for the National System of Interstate Highways" (Project 20-24(52)). As Texas Governor Rick Perry observed, "Congress has failed to come up with adequate resources to help states meet their infrastructure funding needs, so states are moving on their own to fill the vacuum. For many states this means resorting to tolls to supplement existing sources of transportation revenue and soliciting private sector help to finance future highway capacity. States have come to this conclusion not because they are ideologically committed to "privatization" but because, pragmatically, they view the prospects for significant increases in the fuel tax— both at the state and federal level— as remote in these times of record high fuel prices." (Letter to Reps. Oberstar and DeFazio, July 2, 2007). The U.S. Department of Transportation, under the leadership of Secretary Mary Peters, has been actively encouraging this posture. "A substantial increase in the nation's gas tax is ill-advised," the Secretary wrote in response to an editorial calling for a gasoline tax increase. "Of far greater promise than traditional gas taxes is direct pricing of road use similar to how people pay for other

utilities." (The Washington Post, August 25, 2007). Secretary Peters' skepticism about the potential of increasing the fuel tax is well founded. As the New York Times recently observed, "The mere mention of raising gasoline taxes remains almost tantamount to political suicide." (The New York Times, This Week in Review, September 30, 2007)

2. Private capital markets, especially institutional investors with long term investment horizons such as pension funds, have discovered transportation infrastructure to be an attractive investment opportunity. Toll facilities in particular, produce a steady cash flow that is relatively unaffected by economic downturns, and offer stable, long term investment returns with a relatively low risk. Although states have other ways to raise money, notably through the tax-exempt municipal bond market, the needs are so great that ignoring the tolling option and the willingness of the global capital markets to fund infrastructure would be "a tragic mistake," in the words of one investment bank executive (quoted in a recent *Fortune* article about infrastructure funds by Bethany McLean, September 2007.) While toll road investments have long enjoyed popularity with public pension funds in Canada, Australia and Europe, they have only recently begun to attract the attention of U.S. pension funds. CalPERS, the nation's largest public pension fund (\$246 billion in assets), may have been the harbinger of the new mindset when it announced in September that it was creating a \$2.5 billion pilot infrastructure program and establishing a new asset class focused on investments in new roads, bridges, airports and other utilities. In announcing the decision, Charles Valdes, Investment Committee Chair, said "CalPERS could become a major player in solving some pressing public policy problems related to transportation."

3. The attractiveness and popularity of toll road investments has been enhanced by the willingness of state legislatures and public authorities to recognize the need for periodic toll increases to keep up with inflation. Traditionally, state legislatures and toll authorities have been reluctant to raise tolls and often let them remain unchanged for many years, so long as toll receipts covered existing bond repayment obligations and current operating expenses. As a result, average toll rates on existing toll roads seldom exceed the range of \$0.03-0.06 per mile (as documented in recent national survey of toll rates by AAA Mid-Atlantic.) Inflation-indexed tolls, first introduced in the long-term concession agreements for the Chicago Skyway and Indiana Toll Road, and recently adopted in Florida by legislation, will allow future toll roads to be placed on a more business-like basis. The growing acceptance of automatic toll increases geared to inflation is a key reason why private capital markets now consider toll roads a sound long-term investment.

4. Contributing to the public sector's embrace of tolling has been a willingness by private toll concessionaires to accept availability payments and toll revenue sharing as methods of financial compensation. From the perspective of the public sector, these arrangements have several advantages over outright concessions. They allow the state to retain the toll revenue – an arrangement which is politically more defensible than letting a private concessionaire pocket the toll proceeds. Second, by tying payments to the volume of traffic, the state creates a profit incentive for the private concessionaire to manage the facility efficiently and attract a maximum number of customers. Third, the state owes money to its private sector partner only to the extent the facility generates revenue. If traffic is lower than forecast, the private partner bears the risk.

5. Unlike the politically unpopular private leases of existing public toll roads (as exemplified by the Indiana Toll Road and Chicago Skyway deals), concession agreements involving *new* toll roads have received a positive reception. Even Rep. James Oberstar, certainly no great friend of toll roads and privatization, has conceded that "public-private partnerships that expand capacity and provide a service that otherwise cannot be provided by public resources may be a good idea," (Letter to Governors, May 10, 2007). That is also the position of Timothy Carson, Vice Chairman of the Pennsylvania Turnpike and a vocal opponent of leasing the Turnpike in return for a large upfront payment, a transaction that he considers as nothing more than "a leveraged buyout of an irreplaceable public asset." The true function of public-private toll road partnerships, he says, should be developing capacity-enhancing "greenfield" projects.

In a May 2003 Brief entitled "It's Time to Take a Fresh Look at Highway Tolls" we speculated that "tolls may assume a dominant role in the funding of new highway capacity perhaps as early as the next decade." We think that prediction is still on the mark. Our conclusion does not stem from an ideological preference for "privatization" nor from a libertarian impulse to seek a reduced federal presence in the nation's transportation program. Rather, it is grounded in the reality that every last cent we can raise through the gas tax will be needed to maintain and modernize our aging infrastructure.

Resorting to tolls and private capital to help finance future highway capacity is not only the logical way — it's the *only* way to ensure the growth and long-term vitality of our surface transportation system without imposing an unacceptable tax burden on the American people.

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