HOUSTON – WE HAVE A PAYMENT HERE

ON MAY 9 2016, THE TEXAS DEPARTMENT OF TRANSPORTATION (TXDOT) AND BLUERIDGE TRANSPORTATION GROUP LLC, A SIX-MEMBER TEAM LED BY ACS INFRASTRUCTURE DEVELOPMENT AND SHIKUN & BINUI CONCESSIONS USA, SUCCESSFULLY CLOSED A US$815M PUBLIC-PRIVATE PARTNERSHIP (PPP) FOR THE TEXAS STATE HIGHWAY SH 288 TOLL LANES PROJECT. THE PROJECT IS THE FIRST US TOLL LANE OR MANAGED LANE PROJECT FOR WHICH THE PROCURING AUTHORITY HAS RECEIVED A CONCESSION PAYMENT. BY **JOSEPH SELIGA**, PARTNER, AND **SARA HESS**, ASSOCIATE, **MAYER BROWN LLP**, WHO ADVISED TXDOT.

SH 288 is located near the centre of Houston. The highway serves as a vital transportation link for commuters, freight and commercial trucking, is a principal access corridor to the Texas Medical Center and is designated as a hurricane evacuation route. It is considered to be one of the most critical corridors in Texas for economic growth and development. This corridor serves an average of 150,000 vehicles per day. Extensive development is forecast in the area and is expected to contribute to increased traffic in the future.

The toll revenue concession project will provide additional capacity, improved mobility and more reliable travel time through the construction of four new tolled lanes, two new tolled lanes in each direction, within the existing median of SH 288.

Blueridge Transportation Group LLC (BTG) made a concession payment of about US$25.5m to TxDOT to design and construct the approximately 10-mile stretch of new toll lanes, as well as various direct connectors, and will operate and maintain both the new toll lanes and the existing general purpose lanes on SH 288 for 52 years, in exchange for the right to retain toll revenues over the contract term.

Responsibility for financing the project rested on BTG, which committed over US$375m in equity contributions and is financing the remainder of project costs with an approximately US$357m federal TIFIA loan and about US$273m in private activity bonds.

Right-sizing risk-sharing

Procurement of the project began in May 2013, when TxDOT issued a request for qualifications for the project. While project construction was not expected to be particularly complex or costly for a highway PPP in the US, the transfer of toll revenue risk to the private sector on a new construction, greenfield project presented a greater level of complexity than in many other PPP arrangements.

Greenfield highway projects, particularly toll lane projects relying on projected congestion levels, necessarily involve a degree of uncertainty with respect to traffic projections and expected revenues. Ultimately, a significant amount of market interest in the project led to TxDOT being able to bring the project to fruition without a public subsidy to the successful bidder.

The project provides a unique opportunity to manage congestion in the booming Houston metropolitan area. The population of Harris County, where Houston is located, is projected to grow to 5.8m in 2035, an increase of 41%. The population of neighbouring Brazoria County is projected to grow 58% by 2035. Population growth in Harris and Brazoria counties is associated with new residential and commercial development expected to continue over the next 20 years.

SH 288 provides principal access to the Texas Medical Center, which is one of the largest medical complexes in the world. The project involves the addition of direct connectors between SH 288 and the Texas Medical Center, providing direct access and facilitating mobility for emergency vehicles and the Center's many visitors and employees. SH 288 also serves as a connector to trade, allowing approximately 500 trucks loaded at the Port of Freeport to deliver goods each day.

During the procurement process, TxDOT sought to maximise the value it received through a competitive bidding process by right-sizing the risk transferred to the private developer. TxDOT did this by analysing the appropriate scope of the new construction elements in consultation with industry and other stakeholders.

TxDOT's original plan for the project included the construction of improvements to the interchange of SH 288 with Interstate Highway (IH) 610. Based on feedback TxDOT received expressing concerns about project construction costs, TxDOT ultimately requested proposals on a smaller project scope that did not include the planned improvements to the IH 610 interchange.

Of the three qualified teams shortlisted by TxDOT to compete for the PPP in September 2013, all three submitted proposals by the January 27 2015 deadline. BTG's winning bid included as an "alternative technical concept" the reconstruction of eight new direct connectors at the IH 610 interchange, the majority of TxDOT's initially planned improvements. For the BTG team, the additional revenue potentially stemming from the IH 610 improvements outweighed the increase in upfront construction costs.

No extension of construction time has been granted for this additional work. The 52-year term of the concession begins from the March 4 2016 effective date of the contract between TxDOT and BTG, providing incentives on both sides for construction to be completed in a timely manner.

Opening the project to traffic earlier allows the developer to make the most of its 52-year concession term, collecting revenue over the longest possible service period, while allowing the travelling public earlier access to the new, congestion-relieving lanes and reducing the pain of an extended construction period for motorists.

Revenue-sharing provisions ensure that TxDOT shares in the benefits and incentives of prompt service commencement. Additional terms in the concession agreement, design-build contract and TIFIA loan agreement provide incentives for timely completion – and penalties for late completion – of the project. Accordingly, the facility is still expected to open to traffic by the summer of 2019.

Performance standards and lane rental charges with respect to the general purpose lanes help ensure that service on the new tolled lanes is not achieved at the expense of decreased access to and service on the general purpose lanes.

The result is that Texas will see the delivery of the SH 288 project, including additional capital improvements to the IH 610 interchange valued at approximately US$180m, sooner than TxDOT had expected when it tendered the reduced project scope and without a public subsidy being paid for this work.

Significant market interest

Significant market interest in the project enabled BTG to arrange a strong financial plan for the scheme. Prior to final award and commercial close of the project on March 4 2016, BTG, led by ACS and Shikun & Binui, assembled an international consortium of six equity members.

Subsidiaries of the three equity members that made up the BTG team when the team was initially shortlisted in September 2013 – ACS Servicios y Concesiones SL, acting through its US subsidiary ACS Infrastructure Development Inc, InfraRed Capital Partners Ltd, and Shikun & Binui Concessions USA Inc – have committed to contribute the greatest share of the team's equity contributions in the project, approximately 21.6% each.

During the course of the procurement, additional equity members were qualified by TxDOT to participate in the financing of the project, subject to various terms and conditions negotiated by TxDOT to ensure appropriate contractual and other protections for the state.

Northleaf Capital Partners Ltd contributed approximately 18% of the consortium's equity, followed by subsidiaries of Clal Insurance Company Ltd contributing a combined equity share approximately equal to 12.11%, and Star America Infrastructure Fund contributing 5%.

Consortium leaders ACS and Shikun & Binui are restricted from transferring or otherwise reducing their respective equity shares for five years after commencement of service, while the other equity members are restricted from transferring or otherwise reducing their relative equity shares for two years after the facility is opened to traffic.

Design and construction of the project is being provided pursuant to a lump-sum, fixed-price design-build contract between BTG and Almeda-Genoa Constructors, an unincorporated joint venture of Dragados USA Inc and Pulice Construction Inc, both affiliates of ACS, and Shikun & Binui - America Inc, an affiliate of Shikun & Binui.

Including the additional construction work at the IH 610 interchange, the estimated cost of the BTG team's design-build contract is US$815.5m. Parent companies of each of the joint venture members have guaranteed the obligations of their subsidiaries under the design-build contract.

Pursuant to the concession agreement, BTG will provide right-of-way to right-of-way operations and maintenance of the SH 288 corridor, both of the newly constructed tolled lanes and direct connectors and of the existing general purpose lanes. The total value of the project being delivered to TxDOT, including operations and maintenance costs and life-cycle costs assumed by BTG, is estimated to exceed US$3bn. TxDOT's funding responsibility for the project is limited to a maximum of US$17.1m for the actual costs of construction work and right-of-way acquisition associated with the direct connectors serving the Texas Medical Center.

The strength of BTG's financial plan and financing capabilities, including the contributions of its six equity members and its commitment to make an upfront concession payment to TxDOT upon financial close, along with the benefits of BTG's project development plan, including the improvements to the IH 610 interchange not required by the tender documents, led TxDOT to determine that BTG offered the best value to the state and to make the final award to BTG. Moody's Investors Service and Fitch Ratings Inc assigned investment-grade ratings of Baa3 and BBB– to the private activity bonds for the project.

Tolling

TxDOT determined that the 52-year term of the concession was appropriate to achieve efficiencies in project financing and risk-sharing with respect to lifecycle costs and operations and maintenance responsibilities. However, the project's congestion management goals and ever-evolving tolling technology require that the concession agreement permit flexibility in the tolling arrangement.

Toll rates on the tolled lanes are intended to achieve congestion relief and improve mobility in the SH 288 corridor. Consistent with other similar toll lanes in the Houston metropolitan area, toll rates will be set on a time-of-day basis.

Rates are set with the objective of maintaining a minimum average travel speed of 45 miles per hour (or the speed equal to 15 miles per hour slower than the speed limit). Tolls rates generally may vary for each half-hour of each day, according to a schedule that may be updated weekly during the first 90 days of operations and monthly thereafter. Any toll rate change is subject to advance publication requirements.

To protect consumers, rates are capped at amounts that increase annually at a rate equal to the greater of 3% or the percentage increase in the gross state product per capita for the state of Texas. Toll rates exceeding these caps will only be permitted if certain traffic performance measures cannot be met. In such cases, the toll rate will be adjusted in order to maintain minimum average travel speeds in the tolled lanes. BTG will be required to provide traffic data to support toll rates in excess of the cap.

Acknowledging emerging tolling technologies, the concession agreement permits TxDOT to authorise the use of dynamic tolling or image-based billing at a later date. If TxDOT permits dynamic tolling, toll rates cannot be changed more frequently than every five minutes, and typical toll rates will be posted publicly and displayed on toll signage for the project.

TxDOT is entitled to 80% of the forecast increase in toll revenues attributable to the implementation of dynamic tolling or image-based billing, if authorised by TxDOT. The allocation of the remaining revenues to the developer is intended to encourage the successful and efficient implementation of these technologies. Revenue forecasts for such purposes will be based on an analysis conducted by an independent tolling consultant.

Revenue-sharing

The concession agreement incentivises BTG to deliver a well-constructed, well-maintained and well-managed facility by providing that BTG will retain the risk and benefit of toll revenues collected on the project. To ensure that the state and its taxpayers share in the rewards if the facility performs better than expected, TxDOT will be entitled to a share of gross toll revenues in the event that BTG achieves a specified rate of return on its equity investment.

TxDOT's share of project toll revenues escalates as BTG achieves an ever greater rate of return on its equity investment, with TxDOT's share starting at 12.5% of gross toll revenues after BTG has achieved its base case equity IRR, and topping out at 75% of gross toll revenues after BTG has achieved its base case equity IRR plus 8%. TxDOT is also entitled to half of any financing gain attributable to any refinancing that was not anticipated in BTG's proposal.

Conclusion

The competitive procurement process for the SH 288 project and the end-result of a concession payment to TxDOT demonstrate the continued viability of toll concession P3 projects. This is particularly the case, when, as in SH 288, the project scope is right-sized and other appropriate risk-sharing is implemented.

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