Maryland Department of Transportation
The Secretary's Office

Martin O'Malley
Governor

Anthony G. Brown
Lt. Governor

James T. Smith, Jr.
Secretary

October 7, 2013

The Honorable Thomas V. "Mike" Miller, Jr.
President of the Senate
H-107 State House
Annapolis MD

The Honorable Michael E. Busch
Speaker of the Maryland House of Delegates
101 State House
Annapolis MD 21401

Dear President Miller and Speaker Busch:

The Maryland Department of Transportation (MDOT) is requesting an extension to the November 1, 2013 deadline to report recommendations to the Governor and the General Assembly. In accordance with HB 1515, Chapter 429, Acts 2013, the statute specifically directs:

> *"...the State maximize the delivery of transportation projects through public-private partnerships, the use of an infrastructure bank, or other alternative financing mechanisms when appropriate.*
>
> *The Department of Transportation shall:*
> *(1) Evaluate the opportunities for future alternative financing strategies for the Red Line, Purple Line, Corridor Cities Transitway, highway projects, commuter rail projects, and any other relevant transportation projects; and*
>
> *(2) Submit a report that includes specific findings and recommendations concerning alternative financing strategies to the Governor and, in accordance with § 2-1246 of the State Government Article, the General Assembly on or before November 1, 2013..."*

Identifying alternative financing strategies to address future transportation infrastructure needs is critical to Maryland's continued growth and development. In order to provide the necessary scope and depth of coverage needed to determine solutions compatible with existing or modified statewide transportation funding and financing policies, the Department respectfully requests an extension to December 31, 2013.

The Honorable Thomas V. "Mike" Miller, Jr.
The Honorable Michael E. Busch
Page Two

Thank you for your consideration of this request. Should you have any additional questions, please contact Mr. Bruce W. Gartner, Assistant Secretary, Transportation Policy and Freight, at 410-865-1091. Of course, you may always contact me directly.

Sincerely,

James T. Smith, Jr.
Secretary

cc: The Honorable Martin O'Malley, Governor
The Honorable Edward J. Kasemeyer, Chairman, Senate Budget and Taxation Committee
The Honorable Norman H. Conway, Chairman, House Appropriations Committee
Mr. Bruce W. Gartner, Assistant Secretary for Transportation Policy and Freight, MDOT

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February 5, 2014

The Honorable Martin O'Malley
Governor
State House
Annapolis MD 21401-1991

Dear Governor O'Malley:

The Transportation Infrastructure Investment Act, Chapter 429, Acts of 2013 (HB 1515) requires the Maryland Department of Transportation (MDOT) to:

> *"(1)Evaluate the opportunities for future alternative financing strategies for the Red Line, Purple Line, Corridor Cities Transitway, highway projects, commuter rail, and any other relevant transportations projects;*
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Pursuant to HB 1515, the enclosed report provides background and discusses relevant policy issues for alternative financing strategies currently under consideration at MDOT, including: public-private partnerships (P3), state infrastructure banks (SIB), revenue-backed bonds, and Grant Anticipation Revenue Vehicles, as well as an overview of MDOT's efforts to increase funding opportunities for local entities in Maryland.

In this period of ongoing fiscal uncertainty, I look forward to continuing to work together to advance critical transportation projects by using existing revenues more efficiently and employing innovative techniques and strategies to better leverage existing funds.

If you have any additional questions or concerns, please do not hesitate to contact Mr. Leif Dormsjo, Deputy Secretary for Planning and Project Management, at 410-865-1002. Of course, you should always feel free to contact me directly.

Sincerely,

James T. Smith, Jr.
Secretary

cc: The Honorable Edward J. Kasemeyer, Chair, Senate Budget and Taxation Committee
The Honorable Norman Conway, Chair, House Appropriations Committee
Mr. Leif Dormsjo, Deputy Secretary for Planning and Project Management, MDOT

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February 5, 2014

The Honorable Thomas V. "Mike" Miller
President, Maryland Senate
H-107 State House
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Secretary

cc: The Honorable Edward J. Kasemeyer, Chair, Senate Budget and Taxation Committee
The Honorable Norman Conway, Chair, House Appropriations Committee
Mr. Leif Dormsjo, Deputy Secretary for Planning and Project Management, MDOT

A Report to Governor Martin O'Malley

and

the Maryland General Assembly

Concerning

Future Alternative Financing Strategies

as required in the Transportation Infrastructure Investment Act, House Bill 1515

(Chapter 429, Acts of 2013)

January 2014

The Secretary's Office

The Maryland Department of Transportation

Future Alternative Financing Strategies
as required in House Bill 1515 (Chapter 429, Acts of 2013)

Introduction

In recognition of the growing need to fund transportation investments through non-traditional financing mechanisms, the Maryland General Assembly tasked the Maryland Department of Transportation (MDOT) in the Transportation Infrastructure Investment Act, Chapter 429, Acts of 2013 (HB 1515) to:

> *"(1) Evaluate the opportunities for future alternative financing strategies for the Red Line, Purple Line, Corridor Cities Transitway, highway projects, commuter rail, and any other relevant transportations projects;*
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On May 16, 2013, Governor Martin O'Malley signed the Transportation Infrastructure Investment Act of 2013, Chapter 429, Acts of 2013 (HB 1515), which is estimated to generate $4.4 billion from FY 2014 to FY 2019 in additional revenue and bond proceeds to support highway and transit investments across Maryland. Prior to enactment of HB 1515, few funding opportunities existed for expanding Maryland's transportation system. With HB 1515 revenue, the Transportation Trust Fund (TTF) is better equipped to address the needs of the State's transportation system. Additionally, the long-term solvency of the federal Highway Trust Fund continues to constrain MDOT's ability to plan for future investments throughout the State. As the cost of building, maintaining, and operating Maryland's transportation system continues to increase, the State must pursue opportunities to use existing revenues more efficiently and employ innovative techniques and strategies to better leverage existing funds to advance projects, including alternative financing options.

This report provides background and discusses relevant policy issues for four alternative financing strategies currently under consideration at MDOT: public-private partnerships, state infrastructure banks (SIB), revenue-backed bonds, and Grant Anticipation Revenue Vehicles. This report also provides an overview of MDOT's efforts to increase funding opportunities for local entities in Maryland and concludes with recommendations for the Maryland General Assembly to consider as members seek opportunities to deliver transportation projects more efficiently and effectively.

Public-Private Partnerships (P3)

A P3 is a method for delivering public infrastructure assets using a long-term, performance based contract between a sponsoring agency and a private entity where appropriate risks and benefits can be allocated in a cost effective manner between contractual partners. The private entity performs functions normally undertaken by the government, but the sponsoring agency remains ultimately accountable for the asset and its public function. The State usually retains ownership of the public infrastructure asset and the private entity may be given additional decision-making rights in determining how the asset is developed, constructed, operated, and maintained over its lifecycle.

Background

Although P3s have been used globally for decades, Maryland decisionmakers did not implement P3s for transportation infrastructure until the late 2000s. Faced with a growing backlog of repairing, replacing, and expanding public infrastructure and budgetary challenges, MDOT began examining P3s as a method to deliver transportation projects more efficiently and cost-effectively. Maryland completed its first P3 agreement in 2009 for new berth construction, operation, and maintenance of the Seagirt Marine Terminal at the Port of Baltimore, which was followed by a 2012 agreement for the redevelopment, operation, and long-term maintenance of the Maryland and Chesapeake House travel plazas along I-95.

Most P3s require underlying or additional revenue sources for implementation and therefore, should be considered a delivery method for projects, not a new funding source. Under traditional methods of project procurement, the public sector may contract with the private sector to provide discrete functions, such as project design, construction, operation, or maintenance, through separate procurements. P3s consolidate responsibility or financial liability for all or most of these functions with a single entity and produce efficiencies by allocating risks to the public or private party best positioned to undertake the activity. More optimally allocating risk between public and private partners increases the likelihood of delivering the project on-time and on-budget.

In addition to shared risk, P3s, like Seagirt and the I-95 travel plazas, offer an array of public benefits, including operational efficiencies, accelerated project delivery, and the possibility for innovative construction techniques. P3s, particularly arrangements in which the concessionaire is responsible for multiple project functions, improve life cycle planning and cost optimization for the project. For example, a concessionaire responsible for designing and building a project, operating and maintaining it over the course of its life cycle, and handing the asset back to the public owner at a pre-defined quality and service level, has greater financial incentive to make investment decisions that are optimized over the life of the project. P3 agreements can also incentivize schedule discipline by providing payments only after specific milestones or performance goals have been met. Similarly, P3s facilitate greater opportunities for innovation by specifying an end goal, not necessarily the means to achieve it. As a result, a private concessionaire is afforded the flexibility to use alternative delivery methods that could improve the long-term asset performance.

Legislative Actions

Before 2010, a collection of overlapping laws, regulations, and opinions guided the implementation of P3s in Maryland. The lack of comprehensive statute authorizing P3s during MDOT's 2008 consideration of a P3 for the Seagirt Marine Terminal resulted in several notification provisions and review procedures specific to the Seagirt project. The legislative uncertainty surrounding the Seagirt project prompted enactment of SB 979 (Chapters 640 and 641, Acts of 2010), which created the first statutory framework for P3s. In addition to slightly modifying the definition of P3s and creating more robust legislative notification and analysis procedures, Chapters 640 and 641 established the Joint Legislative and Executive Commission on Oversight of Public-Private Partnerships (Commission) to evaluate the State's framework and oversight of P3s.

The Commission studied best-practices and lessons learned from other states and countries and evaluated the statutory definition of P3s. The Commission's recommendations for improving how Maryland defined, analyzed, oversaw, and approved future partnerships became the foundation of comprehensive P3 legislation signed in April 2013.

The 2013 Public-Private Partnership legislation, Chapter 5, Acts of 2013 (HB 560), created a stronger, predictable, transparent, and streamlined process for implementing P3s in Maryland. Specifically, the bill:

- created a more comprehensive definition of P3s focused on partnership and the delivery of assets;
- authorized specified State agencies to enter into P3 agreements;
- established a process and associated reporting requirements for State oversight of P3s, including the promulgation of regulations by specified agencies for the development, solicitation, evaluation, award, and delivery of future P3 projects; and
- instituted a process for both solicited and unsolicited P3 proposals that must be observed before the Board of Public Works (BPW) may approve a P3 agreement to ensure P3 projects receive the highest level of scrutiny before the State seeks proposals from potential private partners.

Purple Line

The Purple Line is a 16.2-mile light rail transit line extending from Bethesda in Montgomery County to New Carrollton in Prince George's County. The project is intended to:

- improve connectivity and access to existing activity centers and planned developments;
- increase service for transit-dependent populations, connecting with Amtrak, Maryland Area Regional Commuter (MARC) service, and Washington Area Metropolitan Transit Authority (WMATA);
- provide faster and more reliable transit for the region's east-west travel market;
- strengthen and revitalize communities in the corridor; and
- increase potential for Transit Oriented Development (TOD) at existing and proposed stations in the corridor as indentified in local land use plans.

In accordance with HB 560, MDOT adopted P3 regulations in July 2013 that formally established an MDOT P3 program, as well as described the process for developing, soliciting, evaluating, awarding, and delivering P3s. Prior to and following the implementation of P3 regulations, MDOT and MTA conducted a series of analyses and outreach efforts to thoroughly consider project delivery options for the Purple Line, including risks and mitigation strategies. To further ensure due diligence, MDOT issued a Request for Information (RFI), as required by HB 1515, on April 9, 2013 and hosted an Industry Forum on May 15, 2013. MDOT and MTA leaders determined that delivering the Purple Line as a Design-Build-Finance-Operate-Maintain (DBFOM) project offers potential for long-term savings over traditional project delivery approaches.

On November 6, 2013, the BPW approved MDOT/MTA's plan to deliver the Purple Line as a P3, as well as the proposed competitive solicitation method for selecting a concessionaire. BPW's review helps to ensure the project continues to receive the highest level of scrutiny before the State receives proposals from potential partners. MDOT/MTA issued a Request for Qualifications in November 2013 and announced a shortlist of four qualified private teams on January 8, 2014. MDOT/MTA will issue a request for proposals to the shortlisted teams this spring to submit complete proposals by fall 2014. In late 2014 or early 2015, MDOT/MTA will select a preferred partner and recommend the final agreement to the BPW for its review and approval. Construction could begin in spring 2015.

The proposed DBFOM structure for the Purple Line will involve a long-term, performance-based agreement between MDOT/MTA and a private entity in which appropriate risks and benefits can be allocated in a cost-effective manner between the contractual partners. The private entity, also referred to as the concessionaire, will be responsible for key aspects of final design, construction, financing, operations, and maintenance of the Purple Line asset over an operating period of approximately 30 years. MDOT/MTA would retain ownership of the asset and remain ultimately accountable for the Purple Line and its public function, including setting fares. By holding the concessionaire responsible for long-term operations and maintenance, as well as the handback condition, the concessionaire has incentive to manage risks and design a project that is well-operated and maintained over the long-term.

In the proposed P3 model, the concessionaire would be paid using an availability payment structure in which the public agency pays the concessionaire milestone or construction progress payments during the construction period and regularly-scheduled payments during the operating period of the P3 agreement. MDOT/MTA would make deductions from these payments if the concessionaire does not meet predetermined performance targets. These payments to the concessionaire would be paid from a combination of sources including Maryland's TTF appropriations, federal grants, and local government contributions. Based on the preliminary concept for the Purple Line P3 financial structure and preliminary financial analyses performed by MDOT/MTA, there is a strong rationale to expect the Purple Line P3 transaction will not affect the State's capital debt affordability. MDOT/MTA will pursue a formal determination on this issue from the State's Capital Debt Affordability Committee.

Preliminary findings of MDOT/MTA's assessment of the policy, operational, and financial factors support the P3 delivery method for the Purple Line. MTA conducted a Value for Money analysis, which compared the risk-adjusted costs to the State over a 35-year period under traditional Design-Bid-Build contract with the expected costs of a DBFOM approach, and found that financial value could be derived from operational benefits, risk transfer efficiencies, life-cycle planning, schedule discipline, and innovative opportunities. Moreover, as a stand-alone operation, the use of single contract accountability will increase the likelihood of consistently excellent, highly responsive service, including reliable on-time performance, safe and clean vehicles and stations, and improved customer service.

While a P3 has potential for Purple Line delivery benefits relative to more traditional delivery methods, the P3 approach cannot eliminate all risks from a project. MDOT/MTA is actively managing risks through the use of risk management plans and mitigation measures. Planned risk mitigation measures include incorporating the use of performance criteria focused on outcomes instead of prescriptive design specifications that limit the ability of private partners to innovate, partnering with the concessionaire to establish responsibilities consistent with market and industry standard so as to minimize excessive contractual burdens, and minimizing delay and undue cost by developing a right of way acquisition plan, addressing stakeholder requests and concerns early, and addressing key policy issues upfront in the solicitation process.

The proposed Purple Line DBFOM approach will seek to achieve specific project delivery goals in a more timely and cost-effective manner than traditional project delivery options. Through implementation of the proposed P3 approach for the Purple Line, MDOT/MTA intend to demonstrate their commitment to efficiently using limited public resources and will be a national leader in innovative project delivery.

Red Line and Corridor Cities Transitway

In addition to the Purple Line, a P3 delivery method has been under consideration for two additional transit lines:

- The Baltimore Red Line (Red Line) is a proposed 14-mile east-west light rail line in the Baltimore region. Project construction is planned to begin in 2015 with revenue service scheduled for December 2021.
- The Corridor Cities Transitway (CCT) is a 15-mile bus rapid transit (BRT) line in Montgomery County that would extend from the Shady Grove Metrorail Station in Rockville to COMSAT, a former communications satellite industrial site located just south of Clarksburg. Phase I includes the nine-mile segment from Shady Grove to Metropolitan Grove. Phase II will extend six miles from Metropolitan Grove to COMSAT. The construction timeline for Phase I would run from 2018 to 2020, with operations commencing in 2020. An implementation schedule has not been developed for Phase II.

Red Line

MDOT/MTA is investigating key questions related to potential contract terms, financial structures, and risk transfer for the Red Line. On April 9, 2013, MTA issued a RFI to the transportation industry regarding project delivery and financing for the Red Line. At the same time, MDOT/MTA announced an industry forum for the Red Line on June 10, 2013. This industry forum was attended by approximately 400 individuals. The series of presentations focused on the scope and key technical considerations of the Red Line, its status in the environmental and engineering processes, potential contract packages, and the project schedule.

The full set of presentations can be found at http://www.baltimoreredline.com/red-line-industry-forum.

Considerations that support delivering the Red Line as a P3 project include:

- The vehicle, vehicle maintenance, track, and signal systems are critical to safe, reliable service over an extended period. Delivering this work under a single, integrated contract will help ensure the best quality service for the region.
- Systems and equipment within this scope are likely to be different from existing MTA systems due to obsolescence of existing equipment as well as unique aspects of configuration of the Red Line, so new skillsets, parts inventories, and maintenance practices are needed.
- This work is typically procured through a design-build process already, so contractors are accustomed to responding to a specification.
- A scope of work can be defined that has limited and well understood interfaces with the portions of the project that remain outside the P3.
- This scope of work has no interface with communities or third party stakeholders.
- The capital cost should be financeable by a wide-range of proposers. The differential between the cost of public and private debt would be less than for a larger project.

Corridor Cities Transitway (CCT)

Based on a preliminary understanding of the proposed project, P3 or other alternative delivery methods could also be appropriate for the CCT. Some key factors include:

- CCT could operate independently of existing networks, with a fully dedicated transitway and bus fleet. This will make the operation relatively simple and minimize the challenge of coordinating with other operators.
- The civil design features (2-lane concrete roadway, 14 at-grade stations, bridges) are well understood by a large community of builders and should attract competition.
- There are many experienced bus operators in the region likely to be interested in providing this type of service.
- MTA has limited organizational capacity and resources to operate the CCT, and the geography does not overlap with any existing or proposed MTA service. MTA has no experience operating BRT on a dedicated running way.
- There are notable opportunities for coordination with private property owners (King Farm, Crown Farm, DANAC, Belward, Medimmune) where a concessionaire could negotiate agreements to construct features in exchange for contributions to the capital and operating costs.
- Some significant share of the CCT could be funded by private property owners either through a special tax district, Tax Increment Financing, or negotiated contributions. This revenue would flow directly to the concessionaire or the public sponsors
- The capital cost ($500-600 million) should be financeable by a wide-range of proposers. The differential between the cost of public and private debt would be less than for a larger project.

Additional P3 Opportunities

The P3 law requires that all reporting agencies adopt regulations and establish processes for the development, solicitation, evaluation, award, and delivery of P3s. MDOT's P3 regulations (COMAR 11.01.17) became effective under emergency action in July 2013 and as final action in October 2013. Under the new P3 law and guided by new P3 regulations, MDOT is developing a more programmatic approach to identification, screening, and advancement of potential future transportation P3s. Over time, this will result in a substantial pipeline of future P3 projects across all transportation modes.

State Infrastructure Bank (SIB)

A SIB is a revolving loan fund operated at the state level that provides direct loans, credit assistance, or other forms of financial backing to local, regional, or statewide infrastructure projects. SIBs sustain themselves by using the repayment of principal interest to support a new cycle of capital projects. SIBs are not a revenue source, but financing tools to help expedite projects by providing more favorable or flexible loan terms than are often available in the private market. Most SIBs only provide direct loans to project sponsors from the initial capitalization, but some offer initial capital as collateral on bond issuance or other financing mechanisms.

SIBs offer private bank-like functions to public borrowers who may be excluded from traditional lending mechanisms, especially smaller municipalities with limited revenue streams or profit opportunities. In this sense, transportation-focused SIBs that leverage initial capitalization to help local jurisdictions secure low cost loans are similar to bond banks or state programs that pool debt of smaller communities to issue more cost-effective debt than the communities could have obtained individually.

Background

SIBs became popular in the late 1990s, after the Federal government authorized a pilot program to allow ten states to use a portion of their federal transportation allocation for the initial capitalization of a SIB. The pilot expanded in 1997 after Congress broadened eligibility to all states and appropriated an additional $150 million to use as seed money. Congress has not provided additional funding for SIB capitalization since 1997, so capitalizing a SIB requires either identifying a new revenue source or transferring existing funds.

As of December 2010, 32 states and Puerto Rico established SIBs, but approximately one-third are currently inactive. Those states entered into an estimated 700 loan agreements worth more than $6.5 billion collectively. The most active SIBs received federal seed money for capitalization; only Kansas and Georgia operate state capitalized transportation revolving loan funds[1]. Other states operate state capitalized infrastructure revolving loan programs, but they are generally focused on water or energy infrastructure projects. Transportation projects are not

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[1] Puentes, Robert and Jennifer Thompson. *Banking on Infrastructure: Enhancing State Revolving Funds for Transportation.* Brookings-Rockefeller Project on State and Metropolitan Innovation. September 2012.

always eligible to receive loans from broad infrastructure loan programs.

The South Carolina SIB is the largest in the nation and has provided more than $3 billion in loans since 1997. South Carolina received modest federal funding for initial capitalization, but leverages future tax revenue from the state gas tax and car and truck registration fees to support bond repayment. While South Carolina's SIB only finances projects over $100 million in size, other SIBs provide as little as $100,000 in assistance for projects such as local road rehabilitation. The Virginia Transportation Infrastructure Bank was established in 2011 and capitalized with $282.7 million by dollars appropriated from the State legislature ($32.7 million from the Commonwealth's General Fund and $250 million from the Commonwealth Transportation Fund.) As of April 2013, Virginia entered two loan agreements worth a combined $231 million and had an additional $36 million agreement pending.

SIBs are structured differently throughout the country to reflect the unique statutory authorities, political realities, and infrastructure goals of the state in which the SIB is implemented. The main differences between SIBs are:

- the initial capitalization source with most states relying on federal funds and others capitalizing from state sources;
- whether the SIB is leveraged to issue bonds against the initial capitalization or unleveraged to lend directly to project sponsors;
- operational structure, including project eligibility; and
- type of financial assistance offered.

Regardless of the structure, a strong pool of potential borrowers with repayment options is needed for a SIB to be successful.

Maryland Programs to Increase Access to Bond Markets

Maryland's counties and larger municipalities currently have high credit ratings and can borrow at competitive rates, which minimizes the need for a SIB to help these jurisdictions access credit markets. Additionally, several Statewide programs already exist to help local jurisdictions access capital through municipal bond markets in the same manner as a SIB. The Maryland Department of Housing and Community Development's (DHCD) Local Government Infrastructure Financing Program (LGIF), for example, issues bonds on behalf of counties and municipalities to finance projects that serve the community at large, including transportation capital improvements. Since 1988, LGIF has administered 30 distinct bond issues, raising nearly $341 million in capital to fund hundreds of infrastructure projects, including transportation improvements, for 56 municipalities, four counties, and two instrumentalities of counties.

LGIF is particularly suitable for Maryland's jurisdictions that do not issue bonds on a routine basis. These municipalities have limited access to the capital markets and administering a public bond offering on their own can be inconvenient and/or cost prohibitive. Maryland's counties and large municipalities are generally able to access capital at more reasonable terms and at a lower cost, so they rarely access this program. As a result, LGIF tends to serve Maryland's smaller municipalities. The LGIF Program relies on a bifurcated (senior/subordinate) bond structure, multiple layers of liquidity facilities, credit enhancements, and a State-aid intercept pledge in order to obtain favorable bond credit ratings and secure low cost capital for participating local governments.

MDOT's County Transportation Revenue Bond program, under which the State issues debt for terms of up to 15 years to provide counties with financing for transportation capital projects, provides similar opportunities for local jurisdictions to access bond markets to fund transportation infrastructure. This program has been used four times since 1993, all by Baltimore City, when the debt was transferred from State to local debt. Prior to 1993, this program was widely used by counties throughout the State.

In addition to the LGIF and County Transportation Revenue Bond programs, counties and municipalities can create tax increment financing (TIF) districts to provide additional tax revenue to support development within the district. Bonds issued through a TIF can be used for transportation infrastructure within the district. However, few local entities availed themselves of TIF districts that primarily support transportation infrastructure. The Sustainable Communities – Designating and Financing Act, Chapter 624, Acts of 2013, (HB 613) broadened eligibility for TIF bonding authority to designated sustainable communities, thus expanding opportunity for local entities to access bond markets for infrastructure.

Establishing a SIB in Maryland

Over the past decade, transportation leaders in Maryland intermittently discussed establishing a SIB to stretch public dollars and provide a tool to help local jurisdictions borrow at favorable interest rates. Most recently, the 2013 Maryland General Assembly considered legislation establishing a SIB, and a SIB was specifically referenced as an alternative financing tool in HB 1515.

MDOT is engaged in ongoing discussions with stakeholders to gauge interest in using a SIB to finance transportation capital projects and to consider opportunities and challenges, including identification of an initial capitalization source. Overall, representatives from local jurisdictions indicated a preference for increased funding for local maintenance and showed limited interest in establishing a SIB for capital projects, unless the SIB could offer below market rates or more favorable financing terms than currently available. However, more competitive lending rates may jeopardize the SIB's ability to maintain levels of capitalization for projects over the long term and compromise the SIB's ability to sustain itself. Local jurisdictions did not identify a capitalization source, but would likely oppose any effort to capitalize a SIB with Transportation Trust Fund (TTF) dollars.

Discussions with stakeholders also indicated that SIBs may have appeal to smaller jurisdictions for whom accessing capital is difficult. Therefore, an appropriately capitalized SIB may offer opportunities for local jurisdictions to finance capital projects, especially if the seed money does not threaten existing revenue sources. A SIB would complement existing Statewide programs that provide collateral for local entities to borrow in the bond market.

MDOT shares the concern over local jurisdiction's ability to meet their capital transportation needs. The General Assembly may wish to explore opportunities to establish a SIB in Maryland. Before establishing new statutory authorities, however, decisionmakers may wish to undertake important policy considerations about the potential benefits and challenges of implementing a SIB in Maryland.

The identification and sizing of an initial capitalization is a key step in the establishment of a SIB and could involve significant funding trade-offs. The use of existing State transportation funds to capitalize a SIB would have a direct impact on existing program commitments. For instance, the use of highway user revenues (HUR) for SIB capitalization would severely impact outstanding debt commitments, including Baltimore City's repayment of over $100 million in County Transportation Revenue Bonds. Similarly, HUR is pledged to MDOT's outstanding Consolidated Transportation Bonds (CTB). Even a partial redirection of HUR could impact existing debt commitments as ratings agencies may regard this as justification for downgrades. In addition to identifying the initial capitalization source, other considerations should include potential projects that could benefit from this financing tool, the types of financing instruments the SIB could use, project eligibility, and governance.

The General Assembly may also consider determining additional assurances or enhancements with DHCD that would encourage use of the existing LGIF program, which offers similar borrowing mechanisms for local jurisdictions.

Revenue Backed Bonds

MDOT is not currently authorized to directly issue revenue backed bonds. Instead, the Maryland Transportation Authority (MDTA) must serve as the conduit for this type of MDOT debt issuance, in which principal and interest payments from a specific revenue source retire debt obligations from bond proceeds. For example, MDTA has issued revenue backed bonds for large-scale projects on MDOT's behalf, including various major projects at Baltimore Washington International Thurgood Marshall Airport (BWI Marshall) with airport fees serving as the specific revenue source. While this arrangement has functioned in the past, the complexity of revenue backed bonds implemented through MDTA has grown in recent years, resulting in cumbersome and overlapping efforts to issue debt, and inefficient and duplicative uses of government resources. As MDOT seeks to spend limited transportation funding more efficiently, with an increased focus on more innovative funding options, it would be most cost-effective for MDOT to be authorized to directly issue revenue backed bonds.

MDOT is already well-staffed and experienced in issuing debt, most commonly as CTBs, which are fixed rate bonds with maturities of up to 15 years that are primarily issued to fund the State's long-term Consolidated Transportation Program (CTP). CTBs are supported by certain taxes and fees in the TTF, but are not backed by the full faith and credit of the State of Maryland. The existing staffing resources that currently support MDOT's debt program, including both internal staff and external advisors, have sufficient capacity and expertise to develop revenue back bonds issuances for future projects, as needed. They already provide technical support to the MDOT conduit financings through MDTA, which results in significant duplication of efforts. Furthermore, MDOT has a much stronger understanding of the infrastructure investment needs, budgetary considerations, and revenue streams of each modal agency, making it the most appropriate issuer of revenue backed debt for modal agency projects.

To enhance its direct access to innovative financial tools, MDOT seeks approval of Senate Bill 88 (SB 88) in the 2014 General Assembly Session authorizing the Department to independently issue revenue backed bonds. This authority will:

- allow for more direct control of the alternative financing methodology used in each request;
- eliminate the burdensome process of needing to "contract out" the debt issuance portion of the financing solution;
- facilitate more timely issuance; and
- promote more efficient use of resources by streamlining the financial process for projects and reducing the costs incurred for financial advisors and bond counsel at both MDOT and conduit issuer.

Possible funding opportunities presented by P3 legislation HB 560 (Chapter 5, Acts of 2013) and the revenue increase HB 1515 (Chapter 429, Acts of 2013) underscore the need for MDOT to retain more direct control over financing structures, and SB 88 would formalize an institutional structure that already exists.

GARVEEs and GANs

Grant Anticipation Revenue Vehicle (GARVEE) and Grant Anticipatory Notice (GAN) mechanisms allow states or public entities to pay debt service on bonds, notes, or other financial instruments/ with future federal apportionments. Rather than using federal-aid highway apportionments to reimburse construction costs, the state reimburses bondholders from its federal-aid obligation authority over a multiyear term. GANs are used to issue bonds secured with a pledge of federal-aid assistance for transit projects; whereas, GARVEEs are specific to highway funds. GARVEEs essentially permit states to begin work on projects for which they anticipate future funding. GARVEEs can accelerate capital plans by generating upfront capital availability, resulting in cost savings.

According to the Federal Highway Administration (FHWA), GARVEEs are typically used to finance large transportation projects where the costs of delay outweigh financing costs, other borrowing approaches may not be feasible or are limited in capacity, the project lacks access to a revenue stream, and the sponsors are willing to reserve a portion of future federal-aid highway funds to satisfy debt service requirements[2]. It should be noted that GARVEEs do not guarantee repayment from the Federal government, which may be unpredictable given Highway Trust Fund shortfalls.

[2] FHWA Project Finance Primer. August 2010.

Maryland law currently permits the use of future federal aid to support bond repayment for transportation projects. In 2007 and 2008, MDTA issued $750 million in GARVEE bonds, backed by future federal aid payments, to support construction of the Intercounty Connector (ICC) project. Additionally, the financial plan for the Baltimore Red Line currently assumes the use of GANs in order to realize the full value of an anticipated federal grant during the construction period which is shorter than the likely payout period of the grant. However, future use of GARVEE and GANs is limited by statute that prohibits the aggregate principal debt issued as federally backed bonds to $750 million.

Since Maryland issued the maximum amount possible to support ICC construction, the State has reached its issuance cap for federally backed bonds and is not able use this financing mechanism without addressing legislative constraints. MDOT is currently exploring opportunities to introduce legislation that would expand the State's ability to issue federally backed bonds for transportation projects.

Local and Regional Funding

State and local governments share responsibility for providing transportation services and facilities in Maryland, with local governments having responsibility for constructing and maintaining local transportation systems throughout the State. Local transportation is vital to getting people to and from jobs, school, and daily activities; local community vitality; and the State economic prosperity. Maryland localities own approximately 83 percent of public road miles, which carry 28 percent of the vehicle miles of travel Statewide[3]. To assist in funding transportation services and facilities, local governments receive local highway user revenues (HUR), a portion of TTF revenues allocated by law among the State and local jurisdictions.

In the past, the local share of HUR had been 30 percent of total available HUR funds. However, as part of the State's response to the recession, various categories of State assistance to local governments were restructured, including local highway aid. Consequently, the local share of HUR was significantly reduced and is currently 9.6 percent of the Gasoline and Motor Vehicle Revenue Account. Restoring support to local transportation infrastructure would benefit local systems within the Statewide transportation network, but any efforts to do so must be compatible with the ability of the State to invest in its collective transportation network and take into consideration the impacts of any pledge to the repayment of MDOT's CTBs.

HB 1515 established the Local and Regional Transportation Funding Task Force (Task Force) to study and make recommendations on the feasibility of creating regional transit financing entities and local–option transportation revenues for the purpose of raising additional funds to support regional and local transportation system needs throughout the State. The Task Force completed its work in November 2013 and submitted its recommendations to the Governor and the General Assembly in December 2013.

[3] 2012 Maryland State Highway Administration Mobility Report. Page II-4. July 2012.

The Task Force found opportunity for local governments to both fully use existing revenue options and expand the options available to counties and municipalities to facilitate increased investment in locally-owned transportation assets. Specifically, the Task Force recommended further consideration of the following local-option revenue sources be made available for use at local governments' discretion.

- A newly enabled voluntary local-option vehicle registration fee.
- An expansion of the local-option income tax increment specifically dedicated to transportation. Some counties and municipalities are already at the current cap and an increase to the cap would be required for those jurisdictions to avail themselves of this option.
- An expansion of local jurisdictions' real estate transfer tax authority.
- The facilitation of the application of value capture techniques at the project level in instances where market conditions and project dynamics allow. Such techniques are generally already enabled in State law, but could potentially require legislative or administrative refinements as specific applications are developed.

Additionally, the Task Force carefully considered the potential role of regional financing entities to enhance transit and broader transportation investment at the local and regional level. If the Maryland General Assembly decided a regional transportation authority (RTA) option would be valuable to promote certain regionally-based transportation projects, the Task Force agreed the following key issues would need to be addressed by the Legislature:

- RTA governance;
- funding sources and taxing authority;
- participation options;
- services provided by the authority (e.g. light rail, buses); and
- transportation functions provided by the authority (e.g. planning, construction, operations and maintenance, fee collection).

Findings and Recommendations

The continuing gap in Maryland between available funds and transportation needs limits the State's ability to address increasingly complex infrastructure demands. HB 1515 and the revenue it generates will go a long way toward meeting the needs of the State's transportation system, but will not provide enough funds to address every modal project or local priority. To better leverage existing funds, accelerate project delivery, and introduce private investment to State infrastructure, Maryland is continuing to explore the benefits and uses of alternative financing mechanisms, including P3s, a SIB, revenue bonds, and GARVEE bonds, as well as facilitating greater local support for transportation assets.

The benefits of alternative financing approaches may include accelerated project delivery and reduced financing and related costs. However, not all financing mechanisms are suitable for all projects. The diverse approaches currently being explored in Maryland provide a menu of financing techniques and strategies to apply to projects should the project meet specific circumstances in which the alternative mechanism provides benefit over, or in conjunction with, traditional funding methods.

The Purple Line represents MDOT's first effort to move forward with a P3 under the framework of enabling legislation that passed earlier in 2013. The proposed Purple Line Design-Build-Finance-Operate-Maintain (DBFOM) approach will help achieve the specific project delivery goals in a more timely and cost-effective manner than traditional project delivery options. In addition to the Purple Line, a P3 delivery method is under consideration for the Red Line and CCT, and MDOT is carefully studying potential contract terms, financial structures, and risk transfer as planning for these projects continues. To the extent permitted by P3 legislation HB 560 (Chapter 5, Acts of 2013) and P3 Regulations (COMAR 11.01.17), MDOT/MTA will continue to provide major updates to the Maryland General Assembly on the implementation of the Purple Line P3 to ensure ongoing consistency with P3 objectives and provide information for future P3 initiatives. MDOT will also continue to provide key updates as additional P3 concepts are screened and developed for potential future implementation.

Compared to P3s that are largely comprehensive delivery methods, SIBs are primarily a financing tool to avail local governments access to direct loans, credit assistance, or other forms of financial backing for infrastructure projects. Although legislation establishing a SIB was considered in the 2013 Session and a SIB was specifically referenced as an alternative financing tool in HB 1515, Maryland has not yet established a SIB program. If appropriately capitalized, a SIB may offer opportunities to help local jurisdictions access bond markets and secure low cost loans for infrastructure. MDOT recommends additional consideration of how a SIB may be structured in Maryland, including identifying a capitalization source and potential projects. MDOT also encourages working with DHCD to determine additional assurances or enhancements that would encourage use of the LGIF program.

Financing transportation infrastructure development in Maryland through bond sales is not a new concept. MDOT regularly issues CTBs to fund the State's long-term CTP, and MDTA has broad bonding authority including the ability to issue conduit financing for MDOT to finance revenue-generating transportation facilities. To provide greater bonding flexibility, MDOT recommends the General Assembly approve SB 88 in the 2014 Session to give MDOT independent authority to issue revenue backed bonds. Additionally, MDOT recommends the General Assembly consider legislation that would expand use of federally backed bonds for transportation projects.

Finally, Maryland's centralized approach to transportation funding facilitates extensive, efficient, and effective multi-modal transportation investment. As HUR funding to local governments declined over the past five years, some local governments have been challenged to address the maintenance and operational needs of their local systems. The Task Force offered recommendations on additional funding opportunities for local entities, as well as considerations for the establishment of regional authorities.

Conclusion

As the cost of building, maintaining, and operating Maryland's transportation system continues to increase and federal funds continue to be unpredictable, the State must pursue opportunities to use existing revenues more efficiently and employ innovative techniques and strategies to better leverage existing funds to advance projects. Alternative financing mechanisms represent an opportunity for Maryland to use innovative strategies and techniques to help deliver projects faster and more cost-effectively than traditional pay-as-you-go approaches. As Maryland seeks to diversify funding mechanisms available for transportation infrastructure projects in the State, policymakers will continue to consider approaches that expand State and local government's ability to fund and finance critical transportation projects.