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# METRO'S 28 BY 2028 PLAN: A CRITICAL REVIEW X. METRO'S PUBLIC-PRIVATE PARTNERSHIP: REVENUE ESTIMATES ARE NOT CREDIBLE

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# X. METRO'S *28 BY 2028 PLAN* – A CRITICAL REVIEW: METRO'S PUBLIC-PRIVATE PARTNERSHIP REVENUE ESTIMATES ARE NOT CREDIBLE

One of Metro's proposed methods for making its *28 by 2028 Plan* feasible is use of public-private partnerships ("P3s"). The *Plan,*[1] Slide 25, identifies three P3 projects: the West Santa Ana Branch Light Rail Corridor, the Sepulveda Transit Corridor, and the East San Fernando Valley Light Rail. The *Plan* reports a "potential to save $5.1 billion."

An examination of the details shows that any savings from implementing P3s that will be available to fund projects prior to the end of the 2028 construction period totals a small fraction of this amount.

## PUBLIC PRIVATE PARTNERSHIPS

Metro defines a P3 as follows:[2]

> *A Public-Private Partnership (PPP) is a mutually beneficial collaboration between a public agency and a private sector entity. Through this contractual arrangement, the skills and assets of each sector are shared in delivering a service or facility for the use of the general public. In addition to the sharing of resources, each party shares in the risks and rewards potential in the delivery of the service and/or facility.*
>
> *The public agency usually assumes the project definition risk by undertaking the environmental clearance effort, assessing financial feasibility and garnering stakeholder and political commitment. The private sector can best assume the financial risk, such as project financing, construction and perhaps facility management.*

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1 Metro, PowerPoint™ presentation. *28 by 2028 Financial Plan – Laying the Groundwork,* December 6. 2018 Board meeting. Slide 18.

http://metro.legistar1.com/metro/attachments/e48e3ad9-7f42-4011-849c-5666ed4f0cc6.pdf

2 Metro, "Public-Private Partnerships for Major Transportation Projects. https://www.metro.net/projects/public_private_partnerships/

Slide 24 of the *Plan* associates the following advantages with P3s:

- Capital Cost Savings:
  - DBFOM procurements in the U.S. have achieved cost savings through competitive pricing, design innovation and avoided cost inflation.
- Operations & Maintenance/State of Good Repair (SOGR) Cost Savings:
  - Lower O&M costs and lower escalation rates reduce cumulative costs during operations.
  - P3 developers perform SOGR work earlier and more frequently, optimizing lifecycle investments.

"DBFOM" refers to the five most common components of major capital projects that can and have been transferred to private sector partners: Design/Build/Finance/Operate/Maintain. In this context, "Operations" means "Operations and Maintenance, or "O&M." This includes scheduled and breakdown maintenance, including collision repairs, but does *not* include capital renewal and replacement expenditures, which is part of the "M" in DBFOM, also known as "State of Good Repair."

Two other advantages of P3s are:

- Significant acceleration of project delivery. This is generally a good outcome, but it can mean that operating expenses start earlier than originally foreseen.
- Through P3s, it is possible to transfer certain types of risk from Metro to a private party or parties, as Metro discusses in the *Plan*. This can be a useful benefit when properly understood and applied, but it is effectively impossible to transfer political risk.

If private parties are asked to take on too many large risks, particularly those that are difficult to calculate and/or are largely out of their control, such as site conditions being different from what was specified in the procurement documentation, then P3 proposers must increase their proposed costs to reflect these conditions. It is best to have a detailed and candid discussion between the public owner and private P3 partner before any agreement is finalized, including who bears what risks, and the costs of transferring such risks.

While the transfer and assumption of risk will be a major factor in Metro's decisions to use P3s on the three proposed projects, without more detailed knowledge of which risks are proposed to be transferred, we cannot comment further.

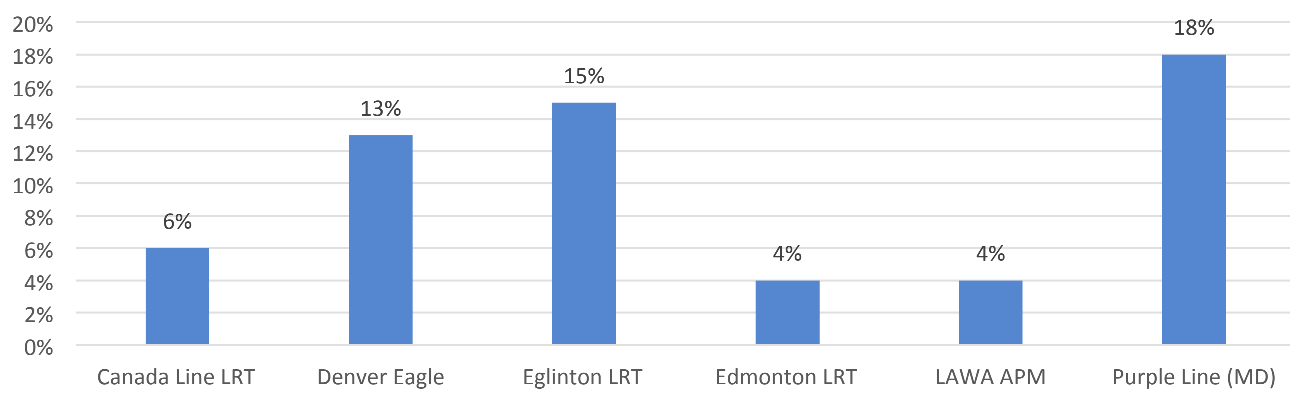
*The White Paper*[3] (pages 3 and 16) shows the costs for the three projects with a projected total cost of $16,466 million:

- West Santa Ana Branch: $6,312 million
- Sepulveda Transit Corridor (Phase 2): $8,591 million
- East San Fernando Valley Light Rail Corridor: $1,563 million

The first two projects were scheduled to be completed in 2041 and 2033, respectively, in the 2016 Measure M Ordinance,[4] but are being moved up to 2028. The third is unchanged, scheduled for 2027 completion. The other two transit projects Metro proposes should be speeded up to 2028 completion are the Gold Line Eastside Extension (originally 2035 completion) and the South Bay Light Rail Extension (also known as "Green Line Extension to Crenshaw Boulevard in Torrance"—originally 2030 completion).[5] Since these are not proposed to be constructed or operated *via* P3, they would have to be constructed and operated in the usual Metro fashion.

The projected $5.1 billion would be a 31% savings on projects with a total cost of $16,466.0 million, which is very large. The *White Paper*[6] has a graphic that shows the percentage of capital cost savings for six previous P3 projects that range from 4% to 18%, for an average of 11.7% (see **Figure 1**).

**Figure 1: Historical P3 Capital Cost Savings (Percent of Estimated Pre-Bid or PSC Capital Cost)**




**Source: *Twenty-Eight by '28 Program Financing/Funding White Paper.***

3 *Twenty-Eight by '28 Program Financing/Funding White Paper.* Board Report attachment. http://metro.legistar1.com/metro/attachments/18984512-fa10-4b43-aa52-524cfd8bb69a.pdf

4 Proposed Ordinance #16-01, Measure M – Los Angeles County Traffic Improvement Plan. http://theplan.metro.net/wp-content/uploads/2016/09/measurem_ordinance_16-01.pdf

5 *28 by 2028 Plan.* Slide 6.

6 *Twenty-Eight by '28 Program Financing/Funding White Paper.* Board Report attachment, *p. 16,* http://metro.legistar1.com/metro/attachments/18984512-fa10-4b43-aa52-524cfd8bb69a.pdf

On the same page, the *White Paper*[7] provides a table that shows a potential savings of $1,317 million on the $16,466 in the capital costs estimated if the projects are constructed without a P3, or 8%. Projects constructed with a P3 would likely have a lower total cost. The paper estimates a savings of $3,265 million on operations and maintenance (O&M) and state of good repair (SOGR) against a total estimate of $23,321 million, for a total of 14% savings.

**Table 1: Metro's Estimates of Potential P3 Savings for Three Projects**

| Project | Estimated Capital Cost ($ millions) | Potential Capital P3 Savings | Estimated O&M/SOGR Cost | Potential O&M/SOGR P3 Savings | Total Estimated Project Cost | Total Potential P3 Savings |
|---|---|---|---|---|---|---|
| West Santa Ana Branch | $6,312 | ($505) | $7,761 | ($1,269) | $14,073 | ($1,592) |
| Sepulveda Transit Corridor | $8,591 | ($687) | $10,569 | ($1,727) | $19,160 | ($2,167) |
| East San Fernando Valley | $1,563 | ($125) | $4,991 | ($816) | $6,554 | ($824) |
| Totals | $16,466 | ($1,317) | $23,321 | ($3,265) | $39,787 | ($4,582) |

**Source: *Twenty-Eight by '28 Program Financing/Funding White Paper.***

The calculation of the $5.1 billion in savings Metro reports is not explained or detailed in any public Metro document. The total of the projected savings in the *White Paper* is $4.6 million (rounded), which is more than half a billion dollars less than the $5.1 billion Metro reports. The overwhelming majority, perhaps all, of the O&M/SOGR savings would not occur until well after the end of the FY28 timeline for the *Plan*, and should not be considered part of the $5.1 billion that Metro reports.

In the *Board Report*,[8] all four of the transit projects added to the original 20 projects from the Measure M Ordinance are shown as going into operation in 2028. The East San Fernando Valley Line, the third P3 project, is shown as entering revenue service in 2027. None of these projects would be in operation in the *28 by 2028 Plan* period for more than two years and, most likely, the grand total of years of operation across individual rail lines will be far fewer than five. The O&M costs for them would be relatively small during the *28 by 2028* time period and the SOGR costs smaller still. Therefore, any savings from a DBFOM P3 strategy that could be used to finance the *28 by 2028 Plan*

7 Ibid.

8 *The Re-imagining of LA County: Mobility, Equity, and the Environment (Twenty-Eight by '28 Motion Response)*. Regular Board Meeting, January 24, 2019. Agenda Number 43, Attachment A. "Twenty-Eight by '28 Project List Delivery Status." https://boardagendas.metro.net/board-report/2019-0011/

during the *2028* period would be minimal. In fact, since two of the three proposed P3 projects were not scheduled for operation until after the end of the *2028* period, any savings would be against *added* operating costs, so it appears feasible that the strategy would *add* to total costs.

It makes no sense to present potential O&M/SOGR savings as a financing tool to support the *28 by 2028 Plan*. The time line for realizing any savings that might be achieved in this category makes them irrelevant to the 10-year financial plan.

Still, properly utilized, P3s can provide significant cost savings and other advantages, and the proposed P3s in the *Plan* should be pursued—but the $5.1 billion Metro projects in savings is overstated relative to the all-important 10-year period of the *Plan*, and is unfeasibly large.

## METRO'S MISUNDERSTANDING

There is a possible explanation for why Metro projects such large savings. At 1:00:45 of the Board meeting recording,[9] Metro CEO Phil Washington states, "… and we also understand that P3s, it's not free money, it's money that we have to pay back, but we can pay these back in the out years ..."

"Out years" apparently refers to the period after FY28, but the logic in Washington's statement is faulty, and identifying the flaw makes it clear that P3s cannot create $5.1 billion in savings to finance the *Plan*.

The "F" in the acronym "DBFOM" is for finance. It is clear that Washington and the *Plan* refer to the P3 finance role. This means that, rather than Metro issuing bonds to cover the construction costs of these projects, to be repaid over a future period of decades, the P3 partner would take on this debt, and Metro would repay the P3 partner over time, rather than making debt service payments to bond holders. This is a common P3 structure, generally described as "availability payments." In this case, the owner, Metro, would begin to make fixed, pre-defined payments to the private partner at a specified point in time, or when a specific event occurs, such as the project entering passenger service.

This could mean that Metro does not sell any debt—or sells less debt—under its own name to construct these projects. In some cases, availability payments begin after the project goes into service. In this case, there might be no such payments until after FY28. From a cash flow perspective, Metro could have little expenditures for the construction of these projects until the availability payments begin. It is common for the owner to make some payments to the private partner prior to

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9 Metro staff presentation remarks and Board Member and public comments from the December 6, 2018 meeting. http://metro.granicus.com/MediaPlayer.php?view_id=2&clip_id=987

the beginning of revenue service, because private partners like the government partners to have some "skin in the game." It is feasible to structure a deal in which there would be no payments until after revenue service begins, but this would likely increase the owner's overall costs. If Metro wanted to push back availability payments as far as possible, the total debt could turn out to be substantially *more* than $16.5 billion.

If this is how Metro proceeds, this type of P3 will *not* produce the $5.1 billion in savings that Metro hopes can be used to fund a major portion of the *Plan* shortfall. This is because, for this type of capital project, with Metro incurring debt under a DBFOM or similar agreement, the future stream of availability payments is *Metro's* debt, and must be so disclosed. This will limit the amount of debt that Metro can sell under its own name.

For an overview of the structure of a successful transit P3, the Comprehensive Annual Financial Report (CAFR) for the Denver Regional Transit District (RTD) is detailed in the appendix.[10] It describes the P3 arrangements RTD entered into for the Eagle P3 and North Rail Lines and the Southeast Rail Extension.

Metro has not explained the details of how its projection that a P3 DBFOM availability payment can increase public agency debt capacity because this type of debt is counted differently. Metro CEO Phillip Washington was the CEO at Denver RTD, so he is familiar with how P3 availability payments debt impacts agency debt capacity. Metro may have additional grounds for the full value of its P3 savings projections, but they have not been disclosed to the public.

Metro seems to understand the statutory limits it faces with respect to debt. The *White Paper* (page 16) shows the three proposed P3 projects with a total capital cost of $16.5 billion. There is insufficient detail to know how much of this Metro would propose to finance through P3 private parties, but it would have to be a very substantial portion of that $16.5 billion. Depending on the contract details, Metro might not be responsible for this debt if the P3 contractor were to default for some reason. However, if the effective Metro debt was only two-thirds of this amount, $11 billion, it would still exceed the calculation of $10.8 billion for Metro's available debt capacity shown in the Plan (Slide 20). This is a contradiction, because Metro does not propose to use any of this available debt capacity at this time. In *Re-imagining* (page 1), the summary of staff recommendations concerning strategies to pursue the *Plan*, the option to "Change Debt Policy," with a "10-yr Estimate" of $10.8 billion is in the original:[11]

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10 "Denver Regional Transportation District (RTD) Comprehensive Annual Financial Report (CAFR) Fiscal Year Ended December 31, 2017 And 2016." Note to Financial Statements (pages 80-81). http://rtd-denver.com/documents/financialreports/2017comprehensive-annual-financial-report.pdf

11 *The Re-imagining of LA County: Mobility, Equity, and the Environment,* attachment to *Board Report*. This is available through links at the meeting agenda web page, item 43:

*Not Recommended – This is not recommended as Twenty-Eight by ’28 faces a funding issue, not a financing issue. Issuing additional debt for Twenty-Eight by ’28 will encumber future revenue sources to service that debt. This will prohibit Metro from delivering remaining projects in Measure M schedule, as mandated by statute. Metro should continue to issue debt on a project-by-project basis, when dedicated funding sources are available for the project and when actual project costs are to be incurred (during construction). Issuing debt too far in advance of construction can violate IRS rules, putting Metro’s tax-exempt status in jeopardy and potentially incurring substantial costs for noncompliance.*

# CONCLUSIONS

1. Metro should explore the use of P3s as a method to undertake the construction of major capital projects. Properly performed, P3s can provide important benefits, including cost savings, faster implementation, and the transfer of some risks to other parties.

2. Metro’s opportunity to generate $5.1 billion in savings by performing these projects as P3s is overstated by well more than half a billion dollars in Metro’s own presentation.

3. Metro will generate little and likely no Operations & Maintenance/State of Good Repair Cost savings during the *Plan*’s 10-year period. P3s may offer Metro cash flow and other advantages, but even subsequent O&M/SOGR savings may be offset by the additional cost of earlier operations.

4. Metro may be intending to use private partners to finance the three projects it identifies as P3 candidates, and believes that P3 availability payments debt does not impact agency debt capacity. Even if Metro is able to partner with private entities that agree to defer availability payments until after these projects are in service, this would still limit the debt Metro can sell under its own name.

5. If Metro is able to partner with private entities that agree to defer availability payments until after these projects are in service, it would raise the total cost of Metro’s estimates for its P3 candidate projects. The longer Metro wants to delay before paying the costs of these projects, the more its private partners will demand that they be paid.

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http://metro.legistar1.com/metro/meetings/2019/1/1472_A_Board_of_Directors_-_Regular_Board_Meeting_19-01-24_Agenda.pdf

# APPENDIX: DENVER REGIONAL TRANSPORTATION DISTRICT COMPREHENSIVE ANNUAL FINANCIAL REPORT FISCAL YEAR ENDED DECEMBER 31, 2017 AND 2016

**Future Commitments under Construction Contracts**

In 2010, RTD entered into a public-private partnership to design, build, finance operate several of the transit improvements contemplated under the FasTracks program, including the Commuter Rail Maintenance Facility, the East Rail Corridor, the Gold Line Rail Corridor and the electrified segment of the Northwest Rail Corridor (together, the "Eagle P3 Project). The Eagle P3 Project is being delivered and operated under a concession agreement that RTD has entered into with a concessionaire selected through a competitive proposal process. The selected concessionaire is known as Denver Transit Partners (DTP), a special purpose company owned by Fluor Enterprises, Uberior Investments and Laing Investments.

The Eagle P3 Project construction was completed in two phases with Phase I completed in 2016 and Phase II completed in 2018. Under the terms of the Eagle P3 Project agreement, RTD made scheduled construction payments to DTP from 2011 through 2017 for completed project elements. RTD began commuter rail services on the University of Colorado A Line and the B Line in 2016 with testing and revenue service of the final corridor, the G Line, expected to occur in 2018. RTD will assume ownership of the entire project once certain contractual criteria and final completion occurs. Under the terms of the concessionaire agreement, RTD will make scheduled secured principal and interest payments to DTP from 2017 through 2044 in addition to service payments for the provision of operations and maintenance services by DTP. The principal and interest payments are fixed amounts for the term of the agreement while the service payments are indexed each year according to certain inflation measurements. In addition, the service payments may also be adjusted for schedule changes, special services and certain availability factors.

In 2013, RTD entered a contract with Regional Rail Partners to construct the North Metro Rail Line. The North Metro Rail Line is an 18.5-mile electric commuter rail line that will run from Denver Union Station through Commerce City, Thornton and Northglenn to Highway 7 at 162nd Avenue in North Adams County. The North Metro Rail Line is expected to open within the next few years.

In 2014, RTD entered a contract with Balfour Beatty Infrastructure, Inc. to design and construct the Southeast Rail Extension Project. The Southeast Rail Extension includes 2.3 miles extending of the existing Southeast Light rail Line from Lincoln Station through the City of Lone Tree to RidgeGate Parkway Station featuring a new Park-n-Ride with a structure of 1,300 parking spaces. The Southeast Rail Extension is scheduled to open in 2019.

**Future Commitments under Service Contracts**

The fixed commitments under the Privatization contracts (bus) in the years subsequent to December 31, 2017 are as follows:

| Year ending December 31 | |
|---|---|
| 2018 | $ 93,313 |
| 2019 | 84,072 |
| 2020 | 43,400 |
| 2021 | 28,883 |
| Total | $ 249,668 |

Denver Transit Partner's concessionaire service payment commitments under the lease in years subsequent to December 31, 2017, are as follows:

| Year ending December (sic) 31, | TABOR Secured Payment | Service Availability Payment | Total |
|---|---|---|---|
| 2018 | $ 34,437 | $ 44,787 | $ 79,224 |
| 2019 | 45,388 | 57,264 | 102,652 |
| 2020 | 45,813 | 65,317 | 111,130 |
| 2021 | 46,264 | 52,453 | 98,717 |
| 2022 | 44,618 | 54,671 | 99,289 |
| 2023-2027 | 232,812 | 348,652 | 581,464 |
| 2028-2032 | 260,982 | 407,253 | 668,235 |
| 2033-2037 | 342,887 | 472,280 | 815,167 |
| 2038-2042 | 303,855 | 542,722 | 846,577 |
| 2043-2044 | 40,224 | 286,625 | 326,849 |
| | $ 1,397,280 | $ 2,332,024 | $ 3,729,304 |

The projected amounts include an estimation for certain future inflation indexes as required by the concessionaire agreement.

These inflation indexes will be adjusted annually as projects are revised.