Memorandum

To: CHAIR AND COMMISSIONERS

Date: April 5, 2010

From: BIMLA G. RHINEHART
Executive Director

File: Book Item 4.6c
Action

Ref: **Public Private Partnership Project - Presidio Parkway Project (Doyle Drive) Request for Approval**

ISSUE:

The Department and the San Francisco County Transportation Authority have submitted a project proposal report requesting the Commission's approval to enter into a public private partnership agreement with a private entity for the development of the Presidio Parkway project. Should the Commission grant this approval?

RECOMMENDATION:

Staff recommends that the Commission not grant the requested approval because the project proposal report does not provide an adequate basis for the Commission to make all of the findings outlined in the Commission's Public Private Partnership Policy Guidance, as adopted in October 2009. The primary concerns are (1) that the project does not appear to be consistent with a statutory requirement that tolls or user fees be collected and applied to the project cost, and (2) that approval of the project's financial plan would create a new long-term commitment from the State Highway Account, which is already oversubscribed and underfunded. These and other concerns are described in the attached analysis of the project proposal.

BACKGROUND:

Section 143 of the Streets and Highways Code was amended by Senate Bill 4, Second Extraordinary Session (2009), to authorize the Department of Transportation and regional transportation agencies to enter into comprehensive development lease agreements with public or private entities for transportation projects, commonly known as public private partnership (P3) agreements. Section 143 provides that P3 projects and associated lease agreements proposed by the Department or a regional transportation agency shall be submitted to the California Transportation Commission, and that the Commission shall select and approve the projects before the Department or regional agency begins a public review process leading to a final lease agreement. Section 143 further provides that the Commission shall certify the Department's determination of the useful life of a project in establishing lease agreement terms and that the Commission shall adopt the criteria to be used by the project sponsor(s) to make a final evaluation of project bids based on qualifications and best value.

This is the first P3 project proposal submitted to the Commission under the authority granted by Section 143. In October 2009, the Commission adopted its Public Private Partnership Policy Guidance to assist and advise those contemplating the development of P3 agreements. The Commission's action on this proposal will establish a precedent that further delineates the Commission's policy in carrying out its statutory role in selecting and approving P3 projects.

PROJECT DESCRIPTION:

The Presidio Parkway P3 project being proposed by the Department and the San Francisco County Transportation Authority (project sponsors) is described as the Phase 2 portion of the Doyle Drive Replacement project. Phase 1 of the Doyle Drive Replacement project is now under construction and will shift traffic from the existing seismically deficient structures on to a temporary alignment. Phase 2 (Presidio Parkway P3 project) would reconstruct the existing six-lane facility south of the Golden Gate Bridge in San Francisco to current seismic standards.

According to the FHWA Major Project Financial Plan (May 2009), the overall project had a full funding plan on a design-bid-build basis. The Financial Plan identified the estimated cost for the Phase 2 work as $499 million in 2009 dollars. According to the project proposal report, committed and anticipated funds total $473 million, including $175 million in SHOPP, $50 million in federal TIGER funds, and $248 million in locally controlled funds.

Under the P3 proposal, a private developer would be engaged to design, build, finance, operate and maintain the Presidio Parkway projects over 33 years. For comparison to the design-bid-build option, the project proposal posits a "business case" under which the developer would be paid a $150 million milestone payment at the end of construction, with availability payments of $1.13 billion over a 30-year period. Users would not be assessed tolls; availability payments would be made from the State Highway Account.

PROJECT REVIEW:

The Commission's Public Private Partnership Policy Guidance sets forth the Commission's policy for carrying out its statutory role under Section 143. Section 2 of the Policy Guidance states that the Commission will approve each project with reference to a P3 project proposal report, and that the approval will include and apply to (1) the description of the scope of the project, including construction work and the performance of maintenance and operations, and (2) the project financial plan. Section 3 of the Policy Guidance states that the Commission will approve a P3 project if, after reviewing the project proposal report, it makes an affirmative finding in each of six specific areas.

Staff engaged a consultant team headed by System Metrics Group to perform an independent evaluation of the reasonableness of the proposal, assumptions, financial data and other information presented in the project proposal report. Staff also reviewed the project scope and financial plan with reference to the project described in the project proposal report and other referenced documents. Staff and the consultant independently analyzed the proposed project in each of the six areas identified in Section 3 of the Policy Guidance. The findings of that staff and consultant analysis are attached.

Attachments

- Staff Analysis Report
- Consultant Project Proposal Assessment Findings Report
- Section 143 of the Streets & Highways Code
- Commission Policy Guidance for Approval of Public Private Partnership Projects

Presidio Parkway Public Private Partnership Proposal

Staff Analysis of Project Description, Financial Plan, and Approval Criteria

April 5, 2010

The California Department of Transportation and the San Francisco County Transportation Authority submitted a project proposal report (PPR) for the Presidio Parkway public private partnership (P3) project to the California Transportation Commission on February 11, 2010. The Department requests Commission approval of the P3 proposal pursuant to Section 143 of the Streets and Highways Code. The staff of the Commission, with support from the consultant team, has reviewed and evaluated this P3 proposal relative to the criteria for Commission project approval set forth in the Commission's Public Private Partnership Policy Guidance, as adopted in October 2009. The documents reviewed included:

- The PPR as submitted on February 11, including the following attachments incorporated in the PPR by reference:
    - Attachment 1 - "Analysis of Delivery Options for the Presidio Parkway Project," dated February 2010, by the Arup/PB Joint Venture (the "Business Case").
    - Attachment 2 – Availability Payments
    - Attachment 3 – Draft term sheet
    - Attachment 4 – Draft Public-Private Partnership Agreement and Draft Lease Agreement, together the Draft P3 Agreement
- The FHWA Initial Financial Plan for the South Access to the Golden Gate Bridge, Doyle Drive, dated May 12, 2009, submitted in partnership by the Federal Highway Administration, San Francisco County Transportation Authority, and the California Department of Transportation. This Plan formed the base for the financial plan in the PPR.

PROJECT DESCRIPTION:

The description of the proposed P3 project is rather complex. The PPR describes "*the overall Presidio Parkway Project*" as "*the successor name to the Doyle Drive Replacement Project, to reconstruct 1.6 miles of existing route 101 with a new six-lane facility south of the Golden Gate Bridge in San Francisco*." According to the PPR, "*the overall project was split into two major construction phases:*

- *Phase I consists of contracts 1 through 4. It will ensure that seismic safety is achieved as soon as possible. At the completion of Phase I all traffic will be on either new structures or detour roads that meet seismic standards. Phase I started construction in November 2009 and is estimated to cost approximately $450 million.*
- *Phase II consists of contracts 5 through 8, with an estimated cost of approximately $473 million. As planned, Phase II would start in 2011 and be completed by 2013*."

The PPR then describes the proposed P3 project as consisting of:

- the design, construction and financing of Phase II, and
- the future operation and maintenance of the work completed under both Phase I and Phase II, except for certain local streets to be specified in the P3 lease agreement. The operation and maintenance period would extend for 30 years beyond a 3-year construction period.

The overall project is described more completely by reference to the "Refined Presidio Parkway" alternative in the Doyle Drive Final Environmental Impact Statement/Report, for which the Federal Highway Administration rendered its Record of Decision in December 2008.

Staff Comment: The staff finds that this description of project scope is sufficient to support project approval.

PROJECT FINANCIAL PLAN:

According to the PPR, the costs of the project will be financed by the private developer, with payment to the developer dependent on the final terms of the lease agreement. The PPR anticipates that payment will be made through some combination of a milestone payment at the substantial completion of construction, followed by availability payments over the 30-year operation and maintenance period. According to the PPR, the costs will be payable from the State Highway Account (SHA), except for "supplemental funds" from local and federal sources that may reduce the SHA obligation. The project would generate no toll or other user fee revenues.

The business case used to compare the P3 proposal with a conventional design-bid-build option assumed a milestone payment of $150 million followed by availability payments that would begin at $35 million per year in 2013 and increase to $41 million by 2043. It estimated a total cost to the Department of $1.378 billion, including $51 million for oversight and transaction costs, $47 million for retained risk reserves, $150 million for a milestone payment at the end of construction, and $1.130 billion in availability payments.

The amount and timing of "supplemental funds" is unclear from the PPR. The PPR cites $472.9 million in funds that are either already committed or anticipated to be committed for Phase II under the FHWA Financial Plan. Of that amount, $174.8 million is from the State Highway Operation and Protection Program (SHOPP), which is funded by the SHA. The balance of $298.1 million includes $50.0 million in federal TIGER, and $248.1 million in funds committed or anticipated from regional and local agencies, including STIP funding. The PPR notes that *"the Sponsors are working on the timing of the receipt of these funds by the Department."*

Staff Comment: The financial plan is incomplete without resolution of the commitment of sources and timing of funding other than the SHA. The anticipated “supplemental funding” appears to exceed the near-term payments assumed in the business case, and it appears that reimbursement of the Department’s availability payment obligations would be an ineligible cost for most of this funding. In the absence of clarification of the financial plan, it appears that nearly all project funding would come from the SHA, either through SHOPP capital funding or from the Department’s annual operating budget for maintenance and operations.

CRITERIA FOR COMMISSION APPROVAL:

Section 3 of the Commission’s Public Private Partnership Policy Guidance states that the Commission will approve a P3 project if, after reviewing the PPR, it makes an affirmative finding in each of six areas. Following are the staff’s findings and comments for each of these six areas.

(1) That the project as described in the project proposal report is consistent with the requirements of statute.

The proposed project appears not to meet this test. Section 143(j)(1) specifies, “Agreements entered into pursuant to this section shall authorize the contracting entity or lessee to impose tolls and user fees for use of a facility constructed by it, and shall require that over the term of the lease the toll revenues and user fees be applied to payment of the capital outlay costs for the project, the costs associated with operations, toll and user fee collection, administration of the facility, reimbursement to the department or other governmental entity for the costs of services to develop and maintain the project, police services, and a reasonable return on investment.” Section 143(j)(2) specifies, “Lease agreements shall establish specific toll or user fee rates.”

The P3 proposal would not authorize the developer to impose tolls or user fees, nor would the lease agreement establish specific toll or fee rates. The project would be funded mostly from the SHA, which is derived from fuel tax revenues.

(2) That the Commission’s approval of the project and its financial plan does not in and of itself create a new commitment of state transportation revenues or create an undue risk to state transportation revenues committed to other projects.

The proposed project and its financial plan appear not to meet this test. Before its development as a P3 proposal, this project was fully funded as a conventional design-bid-build project. The P3 proposal would shift the burden of funding to the SHA. In particular, it shifts most of the burden to the Department’s annual maintenance and operating budget, reducing the amount available for the SHOPP.

According to the PPR, the P3 proposal would free up $175 million in SHA funding in early years for use on other projects. This early funding, however, is the product of borrowing from future year SHA revenues. In the longer term, this P3 proposal would reduce SHA funding for other projects. The SHA is the sole source of funding available for the SHOPP. That funding has been declining because of reduced fuel consumption, funding shortfalls in the Federal Highway Trust Fund, redirection of funding for highway maintenance, and bond debt service obligations. According to the Department's 2009 Ten-Year SHOPP Plan, the SHOPP is now funded at a level that is about 24 percent of the estimated need. As it stands, there is a growing backlog of highway rehabilitation work. In effect, the state is already borrowing by deferring highway maintenance and rehabilitation work. For comparison to the design-bid-build option, the P3 proposal posits a "business case" under which the developer would be paid a $150 million milestone payment at the end of construction, with availability payments of $1.13 billion over a 30-year period, all from the SHA. The SHA needs new revenue, not a new commitment from existing revenue.

The PPR cites the Department's internal policy to limit annual debt service from the SHA, including GARVEE bonds and P3 availability payments, to 15 percent of the available federal transportation funds. With the transfer of transportation bond debt service to the SHA enacted through ABX8 6 and ABX8 9 (signed into law on March 22, 2010), the level of existing debt service will be about $1.3 billion in 2010-11, about 40 percent of federal transportation revenues. This amount would drop to about $800 million in 2011-12, and grow thereafter peaking at approximately $1.3 billion in 2017-18.

(3) That the project, consistent with Section 143(c)(3), is primarily designed to achieve the following performance objectives, as evidenced in the project proposal report:

- ***Improve mobility by improving travel times or reducing the number of vehicle hours of delay in the affected corridor.***
- ***Improve the operation or safety of the affected corridor.***
- ***Provide quantifiable air quality benefits for the region in which the project is located.***

The proposed project appears to meet one of the three performance objectives, improving the operation or safety of the corridor. The PPR cites specific safety improvements, including increasing lane widths, adding shoulders, constructing median barrier, and enhancing the seismic, structural, and overall traffic safety of Doyle Drive.

The PPR cites specific mobility objectives. However, it does not provide any quantification of improved travel times or reduced hours of delay.

The PPR states that the overall project meets air quality conformity requirements and conforms to the state air quality implementation plan. However, the PPR does not quantify air quality benefits for the region.

(4) That the project, consistent with Section 143(c)(4), addresses a known forecast demand, as determined by the Department or regional transportation agency and evidenced in the project proposal report.

Section 143(c)(4) seems to anticipate the need for a forecast demand to support the collection of toll revenues or user fees. The PPR cites current traffic counts on Doyle Drive and a forecast for 2030, the source of which is not stated. The PPR notes that because the P3 proposal does not include tolls or user fees, the sponsors did not commission a traffic and revenue forecast.

(5) Where applicable, that the criteria that the Department or regional transportation agency proposes to use for a final evaluation of proposals based on qualifications and best value are consistent with statute.

The evaluation criteria proposed by the project sponsors do not appear to meet this test. Section 143(g)(1)(C) states that the California Transportation Commission shall develop and adopt criteria for making the final evaluation of proposals based on qualifications and best value. The Commission's policy guidance called for the PPR to include the evaluation criteria for the Commission to adopt. Although the PPR includes general evaluation criteria, it does not specify how the project sponsors would use these criteria to select the private developer. The PPR states, "*Further refinements and details of the evaluation criteria, to be developed in conjunction with the development of the RFP, are anticipated to follow and be consistent with the evaluation criteria…*"

(6) For a Department project, that the Department has made a determination of the useful life of the project in establishing the lease agreement terms that is consistent with the terms of the lease agreement.

The project appears to meet this test. The Department has determined that the useful life of the Presidio Parkway pavement is 40 years and that the structures and tunnels will have a useful life of 75 years. The proposed P3 agreement is anticipated to be for 33 years (three years to construct and 30 years of operation).

California Transportation Commission (CTC)

PRESIDIO PARKWAY
PUBLIC PRIVATE PARTNERSHIP
PROJECT PROPOSAL ASSESSMENT

FINDINGS

April 5, 2010

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Executive Summary

This draft report summarizes the main findings of System Metrics Group, Inc. (SMG) in association with Jeffrey A. Parker & Associates, Aldaron, Inc. and Nixon Peabody LLP (the "Consultant Team") in evaluating the Presidio Parkway Public Private Partnership ("P3") Project Proposal Report (P3 Project Proposal) and related attachments.

The evaluation conducted is based on the California Transportation Commission (Commission or CTC) scope and criteria for approval as described in the Commission's policy guidance for approval of P3 projects, including the statutory requirements of Section 143 of the California Streets and Highways Code. *However, this report does not provide a legal opinion as to whether the project proposal report meets Section 143 of the statute. Rather, it represents the professional judgment of the consulting team.*

The consulting team focused on two specific categories of the Commission's policy guidance as follows:

1. Completeness of the Project Proposal Report ("PPR") submitted by the project sponsors pursuant to Section 4 of the policy guidance; and
2. Assessment of the proposal vis-à-vis the specific criteria for Commission approval listed in Section 3 of the Commission's policy guidance, including an assessment of the consistency of the proposal with the requirements of statute.

Overall, the Consultant Team found that the submittal addresses many of the requirements of the statute and the elements of the Commission's policy guidance. The remaining statute requirements and/or elements of the policy guidance can be divided into two groups:

1. Elements that depend on the interpretation of specific statute sections and/or policy guidance, including:

    - Performance objectives – the project is not primarily designed to achieve either mobility improvements or provide quantifiable air quality benefits under normal operational conditions, and our review of the PPR and referenced information leads us to conclude that such benefits will not eventuate (unless compared to a post-disaster scenario). The submittal only identifies such benefits during post-disaster conditions.
    - Useful life determination – the project does not provide a useful life determination for all the project assets. It does provide a defensible useful life determination for only pavement and structures. Other assets such as signals and ITS equipment that may have shorter useful life are not included.
    - The availability payments during the lease period represent funding commitments over a 33-year period. Discounting these payments to a net present value is useful to compare the economics of a P3 implementation against other forms of delivery. However, these future payments can still be considered to be new commitments upon execution of a contract if the total year-of-expenditure dollar amount required from state funds is higher than under a conventional delivery method. In addition, while an estimate of the availability payment amount is provided, no binding limit is proposed. To our knowledge, a separate or simultaneous action to commit State funds has not been sought.

2. Elements that require or expect additional information not contained in the project proposal, such as:

    - A cash-flowed funding plan:
        - Covering the whole lease period, showing the specific sources and uses of state, local and federal funds, any restrictions on the use of each source, together with a disbursement profile; and
        - Identifying any currently committed funds that are to be reprogrammed to other projects.
    - A complete description of how best value will be defined, judged and determined, as well as confirmation that at the time of proposal evaluation, the proposers will be confirmed as meeting the qualifications requirements of Section 143(h);

- Key elements of the draft Concession Agreement, including the definitions of capitalized terms, the performance standards, handback requirements and referenced “Lease Agreement” among others; and
- A useful life determination for assets other than pavement and structures and a delineation of performance standards expected at handback.

I. Summary of Findings

This section addresses completeness and consistency with policy guidance criteria only to the extent that the PPR does not or may not have adequately addressed them.

However, before presenting the findings for each of the two aforementioned categories, the Consultant Team believes it is important to note that the policy guidance is not well-aligned with a P3 reconstruction project based on availability payments from future state funds such as the Presidio Parkway project. There are several reasons for this, including:

- A reconstruction project by its very nature does not generally produce mobility or air quality benefits, except in post-disaster conditions. The statute and the policy guidance both state that a P3 project shall be “primarily designed” to achieve three performance objectives as follows:

    - Improve mobility by improving travel times or reducing the number of vehicle hours of delay in the affected corridor.
    - Improve the operation or safety of the affected corridor.
    - Provide quantifiable air quality benefits for the region in which the project is located.

  Any reconstruction project will likely not address two of these three objectives during normal conditions. Whether the statute and the commission guidance are intended to require that projects address *all three* performance objectives or *one or more* of them during normal or during special conditions may be subject to interpretation.

- A reconstruction project with availability payments from future state funds represents a type of risk-adjusted loan to the State with de facto loan payments over a period of time (in this case 30 years). As such, future availability payments inevitably create new commitments of state transportation revenues. Although discounting future payments to present value is a reasonable approach to comparing project costs under different implementation approaches, it does not negate the fact that new commitments of state transportation revenues are being proposed.

In addition, in undertaking this first review of a project using the new CTC Guidelines, the Consultant Team observes that there appears to be a tension between the need for project sponsors to gain CTC approval prior to investing too greatly in advancing a project versus the level of information that is required for approval. Certain guidelines involve threshold questions about a project that could be answered (at least provisionally) at the planning stage. Other guidelines require more complete development of contract and procurement documents, expensive activities that should only be pursued by the Department or regional transportation agency for a project that is almost certain to be approved if statute and guidance are followed. Even the relatively accelerated Presidio Parkway P3 Project only has been able to provide some of the necessary materials.

The CTC may wish to consider a process for providing indicative feedback to earlier stage projects. Once several P3 projects have been implemented, there also will likely be a body of precedents that are acceptable to the CTC and can be more easily adapted and applied with lessons learned to future projects.

A. Project Proposal Completeness Findings

Section 4 of the policy guidance expects the PPR and request for P3 project approval to include or make reference to a number of items. This section is intended only to present the Consultant Team's findings as to degree to which each of these items was <u>included</u>; an evaluation of the submission based on the policy guidance follows in Section I (B).

- Financial plan elements
  - Commitments of state and local revenues to the project or to any neighboring or ancillary projects necessary or desirable for full implementation of the project
    Finding – The description of funding commitments is very general and the State Highway Account is identified without limit as the source for all future milestone and availability payments. The PPR also is silent about the funding plan for the Phase I works, upon which the Phase II construction as well as the operations and maintenance of the contemplated P3 are dependent.
  - Public financial responsibility for meeting project costs in case of default by the contracting entity
    Finding – The report is incomplete and only describes the calculation of Caltrans' termination liability towards the Developer in case of default. The report does not provide a complete plan to address the obligation to fund such a termination payment in lump sum nor does it analyze Caltrans' ongoing exposure (if any) for meeting costs to complete the project in a default scenario.
- Estimates, with supporting documentation, the extent to which the project will be designed to achieve each of the following performance objectives:
  - Improve mobility, including travel times or reducing the number of vehicle hours of delay
    Finding – Specific mobility improvements or travel time reductions during normal operational conditions are not included in the submittal. Submittal mentions that during post disaster conditions, delay costs would be reduced by $1.4 million per day.
  - Improve the operation or safety of the affected corridor
    Finding – Submittal mentions safety improvements due to the seismic improvements and the new median. It does not quantify these improvements.
  - Provide quantifiable air quality benefits for the region
    Finding – Specific quantifiable air quality improvements during normal operational conditions are not included in the submittal.
- Project addresses a known forecast demand
  Finding – The submittal states that the project sponsors, who include the Department, have estimated a certain level of demand. The submittal does not mention the source of the demand forecast. It does mention that traffic and revenue forecast has not been commissioned because it is unlikely the Parkway will be tolled or subject to direct user fees pursuant to Section 143(s).
- The terms of the draft lease agreement associated with the project
  Finding – Draft Term Sheet and Concession Agreement have been provided, however, referenced sections including the definitions of all defined terms, a referenced separate Lease Agreement, and Handback Requirements among others are not included.
- Criteria to make a final evaluation based on qualifications and best value
  Finding – The evaluation criteria have been provided in the submittal, but the scoring process (including factors to consider, weightings and other formula) that would explain how those criteria are to be scored and how best value would be determined has not been provided.

- For a Department project, the Department's determination of useful life of the project
  Finding – The submittal includes a determination of useful life for pavement and structures, but is silent on other project assets.

B. Consistency with Policy Guidance Findings

Section 3 of the policy guidance defines specific criteria that the Commission will use to evaluate project proposals submitted for approval. This section provides a summary of the Consultant Team findings by criterion. More complete discussions are provided in Sections II – VI which follow.

- Is the project as described in the project proposal consistent with the requirements of statute?

  - *Relevant findings include:*

    - *Section 143 (c)(3) - The submittal does not state that the project in designed to improve mobility or provide quantifiable air quality benefits, except during post-disaster conditions. This is not unusual for a reconstruction project.*
    - *Section 143 (d) – The submittal does include a useful life determination for pavement and structures. But it does not include a useful life determination for other, less expensive assets such as ITS equipment and signals, which may require replacement during the lease time.*
    - *Section 143(e) - The draft instructions to proposers (or similar RFP procurement document) has not been provided; and it is unclear from the draft Agreement whether the Developer is specifically authorized to use the design-build method as set forth in the applicable statutes.*
    - *Section 143 (g) – The Department intends to evaluate proposals based on qualifications and best value. The submittal does provide a high-level overview of the evaluation criteria, but does not provide enough detail to assess how the criteria will be used.*
    - *Section 143 (j) - The project documents generally indicate that the project' scope does not really contemplate tolling, although Section 11.6 of the draft Agreement gives the Developer the theoretical right to do so, subject to satisfaction of numerous conditions.*
    - *Section 143 (h) – The submittal does not include the qualifications required of contractors. The Request for Qualifications was not included, nor was a draft Instructions to Proposers for the final proposals. Tthere is no indication as to whether these qualifications will be affirmed at the time of final proposal submission.*

- The Commission's approval of the project does not in and of itself create a new commitment of transportation revenues or create an undue risk to state transportation revenues committed to other projects (see Section II):

  Finding – While the Business Case argues that there could be a net present economic benefit to delivering Phase II of the Presidio Parkway Project as a P3, as presented in the PPR, the P3 delivery would require State funding in excess of the currently programmed amounts in the STIP/SHOPP and therefore create a new commitment of State transportation revenues. Despite being subject to appropriation, the availability payments might, as a contractual obligation of the State, have first call on State transportation revenues, ahead of outlay support, SHOPP and STIP programming. To our knowledge, a separate or simultaneous action to commit State funds has not been sought. In addition, while an estimate of the availability payment amount is provided, no binding limit or other form of affordability *ceiling is yet established. Risks relating to relief events (likely) and default and termination (not likely) could also lead to additional funding commitment requirements.*

- Project is primarily designed to achieve the following performance objectives, as evidenced in the project proposal report (see Section III):

  Finding: Refer to discussion above on similar statute requirement.

- Projected addresses a known forecast demand, as determined by the Department or regional agency.

  Finding: The submittal states that the project sponsors, who include the Department, have estimated a certain level of demand. The submittal does not mention the source of the demand forecast. It does mention that traffic and revenue forecast has not been commissioned because it is unlikely the Parkway will be tolled or subject to direct user fees pursuant to Section 143(s). Generally speaking, a "known" forecast refers to an official forecast such as the one used to develop a Regional Transportation Plan (RTP) or conducted for a special study that updates a regional or statewide forecast. Therefore, the submittal address a forecast, but the source of the forecast is unknown.

- The criteria that the Department or regional transportation agency proposes to use for the final evaluation of proposals based on qualifications and best value are consistent with statute.

  Finding: The Department intends to evaluate proposals based on qualifications and best value. The information provided in the PPR is insufficient to determine Caltrans' objectives, priorities or overall approach to best value determination.
- The Department has made a determination of the useful life of the project in establishing the lease agreement terms.

  Finding: Refer to discussion above on similar statute requirement.

II. Financial Review (Approval Guidelines Criteria #2)

Neither the PPR nor its attached Business Case provides a long-term funding plan showing specifically how Caltrans intends to meet its payment obligations and any potential costs associated with Caltrans-accepted risks under the draft agreement over the 33-year term. The Business Case simply states that the "*milestone payment and the availability payments to the Developer will be payable from the state Highway Account (or from other funds set aside for such purpose from funds already committed and anticipated to be committed to the Presidio Parkway P3 Project).*" An estimate of the annual stream of availability payment amounts is provided. However, there does not appear to be any proposed limit on the amount of availability payments to which Caltrans could ultimately commit.

From a financial planning perspective, the portion of future availability payments that will be used to defease capital investment by the Developer under a Design-Build-Finance-Operate-Maintain ("DBFOM") structure should be considered by the state to be similar to a debt obligation. As with other forms of borrowing, entering into an availability payment contract provides a new source of cash to pay for near-term expenditures (potentially freeing up previously committed cash for use on other projects) while creating long-term obligations that include financing costs (consequently reducing funding capacity in future years). The Business Case, under its stated assumptions, calculates an overall positive impact to these tradeoffs in net present value dollars due to the time-value of money (less expenditure today offsets more expenditure in the future) and other factors including better risk management and efficiency gains when the Public-Private-Partnership ("P3") delivery structure is used.

However, while the PPR and its attachments (collectively described herein as the PPR) are focused on this economic aspect of the delivery method analysis, the PPR does not address the budgetary implications to the state of California in detail (although figure 10 of the PPR indicates that the DBFOM clearly has a higher nominal cost over time). Given the different timing of public payment obligations, the funding obligations associated with the DBFOM delivery are dissimilar in terms of budget amounts and programming, than the ones associated with a traditional Design-Bid-Build ("DBB") procurement. To the extent funds may be freed-up in the near term, the PPR also is silent as to whose/which funds are freed, how they will now be programmed, and which capital grants funds can and will be used to fund availability payments after construction completion.

As a policy matter, in approving projects – and in particular, availability payment-based P3s - the CTC may wish to consider not only forecasted present cost savings of different delivery methods (encouraging efficiency) and qualitative/performance benefits, but also cash flow implications over the short-term and long-term. While the Presidio Parkway P3 Project does have programmed funds, from a precedent standpoint, the approval of availability payment-based P3s without consideration of long-term cash flow implications could lead to circumvention of previous prioritization of projects and/or the erosion of debt capacity via de facto borrowing.[1] It may also be appropriate in approving an availability payment-based P3 to specify an affordability ceiling on the amount of availability payments authorized for a given project (subject to revision under a separate action). Otherwise, projects that underestimate the level of availability payment at the CTC approval stage, prior to receipt of bids, might not need to return to the CTC even if the winning bid or executed contract's availability payment substantially exceeded the estimated amount.[2]

[1] For this reason, the state of Florida established a statutory limit on all P3obligations including those contracted as part of DBFs, toll concessions and availability payment projects (similar to California's approach applied to GARVEE Bonds). No more than 15% of the projected State Transportation Trust Fund for any future year can be committed to future availability payments. As discussed later in this memo, the PPR identifies that similar provisions have been proposed by Caltrans. Note that for Florida, this is a cap, not a pool of reserved funds.

[2] While this is a concern from a policy perspective, as discussed below, the bids on Contracts 3 and 4 of Phase I of the Presidio Parkway project have been nearly 40% below estimates (excluding contingency and supplemental agreements).

It appears that Approval Guideline Criteria #2 may not have fully contemplated an availability payment-based P3 for a project already included in the STIP. Assuming that Guideline Criteria #2 is meant to contemplate state funding requirements in general (as opposed to state funds programmed by the CTC in the STIP, SHOPP or other funding programs), and unless a separate action – either prior or simultaneous – commits the required state funds, then the delivery of the Presidio Parkway P3 Project as presented in this PPR would require state funding in excess of the currently programmed amounts in the STIP and therefore create a new commitment of state transportation revenues. However, it should be noted Caltrans' milestone and availability payment obligations under the Agreement would be subject to annual appropriation[3].

The review below is intended to provide the CTC with a more complete understanding of the financial implications to the state of developing the Presidio Parkway Project as a P3, including:

- The long-term funding implications to remunerating the Developer as proposed in the draft Agreement;
- The reasonableness of the base case assumptions made in the Developer's financial plan; and
- An assessment of the risks retained by Caltrans under the P3 structure that could potentially lead to increased costs in the future (including potential supplements or increases to the milestone and availability payments, claims and the financing cost premium added to most claims, design and delivery interface with Phase I, and Caltrans' termination liability).

In addition, areas where there is limited information in the PPR or attachments are identified.

A. Long-Term Funding Considerations

(1) Total Funding Requirements

The P3 agreement will be in force for about 30 years after construction completion and utilizes availability payments that recoup both capital and operating expenses during the operations period. However, the PPR does not provide an appropriate detailed funding plan showing, from Caltrans' perspective, how such payments will be made, stating only that they would be payable from the State Highway Account (SHA). In addition, the PPR explains that delivering the project under a P3 method would entail a different approach to oversight and maintenance as well as to the scheduling and performance of routine maintenance and major rehabilitation work. Not only would this impact the cost profile during the 33-year concession, but the profile of life-cycle expenses during the three subsequent decades (see Figure 7 of the PPR). Thus the impact on the state's transportation revenues will extend over at least a 63-year period. (For similar reasons, the Business Case undertook a "value for money" analysis over the same duration.)

Analysis of the data provided in the Business Case[4] suggests that, given the Business Case assumptions and outputs, delivering the project as a DBFOM would impact the state's budgets over the full 63-year period as follows in year-of-expenditure dollars:

[3] As discussed below in this memo and in the PPR, some form of prioritization of availability payments along with GARVEE bonds debt service commitments under the state transportation budget is under consideration and could involve a continuous appropriation or a budget covenant insulating those financial obligations from annual appropriations. This would alter the programming and financial planning approach for future availability payment projects and, more generally, capital improvements in California.

[4] Excluding the tax adjustments and assuming Phase I and II's $950.9M capital funding plan to be fully committed, programmed, and disbursed as required (including the final $46M TIGER grant award amount).

- In the short-term, DBFOM delivery would address the DBB alternative's apparently identified problem of lacking a confirmed funding plan,[5] and at the same time potentially frees-up up to $175M of SHA capacity for a SHOPP reallocation to other projects.
- However, when compared to the DBB scenario, in the long-run this would create an additional $483M[6] of capital outlay commitments to future state transportation budgets over the entire 33 years, and create SHA disbursement or Caltrans operating budget obligations for operations, maintenance and rehabilitation costs through 2073 that are $263M higher than the ones necessary under a DBB delivery. This would reduce capacity for projects not yet programmed in the 5-year STIP or 4-year SHOPP to be funded in the future.
- Further, the Business Case assumed substantial adjustments to the construction cost estimates for the DBB and DBFOM delivery methods (see Business Case, Exhibit 34), increasing the relative cost of the DBB. In the event that the cost overruns or required risk contingencies assumed for the DBB were not as detrimental as stated in the Business Case, the additional capital funding requirement for a DBFOM delivery method relative to the DBB would be in excess of the $483M differential identified above.
- Finally, the PPR does not clearly explain how, in the DBFOM P3 scenario, the grants from multiple sources would be disbursed to fund the $150M milestone payment or the up-to $79M in contingency reserve and other Caltrans costs identified in the PPR and eligible to be funded from such grants. The PPR also does not address whether the various funding partners involved in the Presidio Parkway would agree to the $175M SHA contribution being postponed. There is also no affirmation as to whether or not there may be legal or other impediments to using some of the grants to fund the capital outlay portion of the availability payments after construction completion.

Note that all figures from the below tables were extracted from the PPR/Business Case and the provided FHWA Initial Finance Plan (dated May 12, 2009).[7]

[5] The DBFOM capital funding does not present any shortfall during the construction period through 2013 because the draft Agreement limits Caltrans payment obligations to a $150M milestone payment and defers the balance of capital funding obligations (and new financing costs) to the 2014-2043 operating period. The DBB funding gap could ultimately be partly or fully reduced by applying cost savings on Phase I and II works – Contract 3 and 4 bids came in $31M and $40.7M below engineers' estimates, respectively (although there are likely to be some draws on contingency and supplemental costs).

[6] The Business Case (Section 3.7.4.) states that taxation impacts are neutral across all delivery options. Consequently we have not included those as part of the above analysis. Even if corporate and state income tax cash flows are shown as a benefit of the DBFOM method, such taxes do not accrue to the state transportation funds. However, if the 9% state income tax – which may indirectly affect SHA - was accounted for out of the 41% effective corporate tax paid by the Developer during operations, this would reduce the operating funding requirement differential for the DBFOM delivery by $37M (in YOE$ and calculated using Caltrans' tax liability assumptions).

[7] There were several instances of slightly inconsistent numbers, and some numbers were interpolated because of rounding and missing or not-sufficiently detailed information, but these were not material to the above findings.

Table 1. Status of Capital Funding Sources

CAPITAL FUNDING PLAN SPLIT PER PROJECT PROPOSAL REPORT			
	Phase I	**Phase II**	**TOTAL**
SHOPP	$230.2	$174.8	$405.0
Federal Stimulus - ARRA (through SHOPP)	$50.0		$50.0
Federal Stimulus - TIGER		$46.0	$46.0
STIP RIP (SF)	$15.0	$69.1	$84.1
MTC Bridge Toll Funds	$80.0	$0.0	$80.0
GG Br. District Funds		$75.0	$75.0
Sonoma CTA/TA of Marin		$5.0	$5.0
SF Prop K	$29.1	$38.8	$67.9
Urban Partnership Agreement	$34.1	$13.2	$47.3
Federal Earmark Funds	$28.6		$28.6
SLPP	$9.0	$12.0	$21.0
Port Sonoma Ferry Funds		$20.0	$20.0
TCRP	$15.0		$15.0
Devil's Slide Earmark		$6.0	$6.0
Total	**$491.0**	**$459.9**	**$950.9**

Notes to Table 1:

The PPR (Figure 8) states that as of May 2009 when the FHWA Initial Finance Plan was submitted, there was $473M of local, state and federal grant funding planned for the project, approximately $76M of which was anticipated but not yet committed. (Note that Figure 12 shows $13M more of uncommitted but anticipated funding than Figure 8 – we assume this is an error.)

USDOT awarded the project on February 17, 2010 a $46M TIGER grant, rather than the $50M applied for and assumed in the FHWA funding plan. Assuming the remaining $20M Port Sonoma Ferry and $6M Devil's Slide federal earmark funds are eventually committed to the project, $469M of funds should be available for this project, $175M of which has been committed by SHOPP. Because the ultimate commitment of those funds is not guaranteed, there is a risk that substitute sources of funding – such as SHA monies - would be needed.

In addition, as the $38.8M amount of Proposition K funds shown is part of the overall $67.9M committed to the project Phases I and II and represents an acceleration of estimated sales tax collections between FY2004 and FY2034, it is unclear whether the amount would be subject to a downward adjustment should estimates be revised. Given the recent sales tax collection data and revised next years' outlook, this could affect this source of funds.

Note PPR Figure 12 is missing a categorization of $9M of funding for Phase II as compared to Figure 8. As a placeholder, we have assumed that the total Phase II funding from SFCTA is $119.9M rather than $128.9M.

Table 2. Summary of Total Phase I & II Funding Requirements *(in Year-of-Expenditure million dollars)*
Draws from multiple information sources in the PPR/Business Case to expand upon figure 10 of the PPR.

POTENTIAL STATE BUDGET REQUIREMENTS	TOTAL	CAPEX	OPEX
DBFOM delivery	$1,510	$702	$808
DBB delivery	$764	$219	$545
Difference	$746	$483	$263

DBFOM DELIVERY	TOTAL COSTS	CAPITAL EXPENDITURES			O&M / REHAB EXPENDITURES		
		TOTAL	Thru 2013	Post 2013	TOTAL	Thru 2043	2044-2073
Phase I Delivery(1)	$491	$491	$491				
Availability Payments(2)	$1,131	$933		$933	$198	$198	
Milestone Payment	$150	$150	$150				
Public Sector O&M+R&R Cost Post Handback	$591	$0			$591		$591
Public Sector Transaction Costs(3)	$51	$32	$32		$19	$19	
Public Sector Retained Risk(4)	$47	$47	$47				
Total Cost	**$2,461**	**$1,653**	$720	$933	**$808**	**$217**	**$591**
Capital funding committed/anticipated		-$951					
Remaining capital funding requirement		$702					
Future State funding requirements for operations (SHOPP)					$808		
Total state budget requirements thru 2073	**$1,510**	**$702**			**$808**		

(1) Assumes all development, design, capital and oversight actual costs will total the funding split assumed per the PPR
(2) The ~15% portion attributed to O&M/R&R costs is drawn from the availability payment table (Attachment 2 to the PPR). Amortization of the upfront debt is allocated as capital expense
(3) Caltrans' oversight and inspection costs are allocated separately as "support" costs but are still funded from transportation revenues so included here
(4) This assumes a contingency equal to the PPR's estimated "Public Sector Retained Risk" would be programmed by Caltrans

DBB DELIVERY	TOTAL COSTS	CAPEX CATEGORIZATION			O&M / R&R CATEGORIZATION		
		TOTAL	Thru 2013	Post 2013	TOTAL	Thru 2043	2044-2073
Phase I Delivery(1)	$491	$491	$491				
Construction Payments Phase II	$458	$458	$458				
Operations Costs(2)	$52				$52	$18	$34
Routine Maintenance and R&R Costs(3)	$494				$494	$110	$383
Public Sector Transaction Costs(4)	$96	$96	$96				
Public Sector Retained Risk(5)	$125	$125	$125				
Tax adjustment(6)							
Total Cost	**$1,715**	**$1,170**	$1,170		**$545**	$128	$417
Capital funding committed/anticipated		-$951					
Remaining capital funding requirement		$219					
Future State funding requirements for operations (SHOPP)					$545		
Total potential state budget requirements thru 2073	**$764**	**$219**			**$545**		

(1) Assumes all development, design, capital and oversight actual costs will total the funding split assumed per the PPR
(2) Excludes costs for outsourced activities such as policing, insurance from any service patrol and utilities assumed to equal under all delivery methods, per Business Case App. F2
(3) Based on Business Case App. H - because of missing cashflows for years 2014-19, we have allocated an extra $3M to match the $494M total shown in the summary
(4) Caltrans' oversight and inspection costs are allocated separately as "support" costs but are still funded from transportation revenues so included here
(5) This assumes a contingency equal to the PPR's estimated "Public Sector Retained Risk" would be programmed by Caltrans
(6) As a baseline, we have discarded the $166.78M tax adjustment per the "neutrality" comment made in the Business Case analysis.
The inclusion of tax adjustments would also not be relevant to a Caltrans funding plan as federal and state income tax do not affect SHA balance.

(2) Utilization of Federal Transportation Funds

To the extent federal transportation funds are to be used to make availability payments, there are several key considerations. While, contractually, availability payments can be established as unitary for accounting purposes, they are often disaggregated into a capital portion (e.g., including interest/dividends and principal on debt and equity raised to fund capital expenses), an operation / routine maintenance portion, and a capital renewal and replacement portion. The breakdown also ensures that the use of grant monies to fund availability payments does not breach any associated statutory requirement or contractual covenant. In particular, Section 80.13(c) of the TIFIA Regulations (49 CFR Part 80) provides that federal funds many not be pledged as security for the repayment of TIFIA loans. In addition, there may be some federal monies which cannot be used to fund operations and routine and/or major maintenance expenses. With respect to the proposed Presidio Parkway P3 Project, because the disbursement of the various grants under the P3 delivery cannot be determined using the information provided in the PPR, we cannot determine whether the overall financial plan is consistent with all grants' covenants.

B. Reasonableness of DBFOM Concessionaire Model Base Case Financial Assumptions and Sensitivity Analysis

The PPR itself identified several of the risks and financing assumptions used in the DBFOM base case that would adversely affect the cost of the project in the immediate and/or longer term, even if the construction and operating costs are held constant. However, the PPR does not include a sensitivity analysis on the potential availability payment levels that might result. To better understand the requirements for and potential risks to state funds posed by the Presidio Parkway P3 Project, the Consultant Team has used the limited information available from the PPR/Business Case to create a shadow financial model and conducted limited sensitivity testing.

Adopting less aggressive baseline financing assumptions – as explained below – may increase the starting FY2014 $35M annual availability payment by $4M to $7M, depending on the assumptions varied. Subsequent years' availability payments would also rise commensurately with escalation through the term of the concession. This represents an additional $30M to $55M on a net present value basis with an 8.5% discount rate (increased to $50M to $85M with a 5.5% rate). This would alter the quantitative value for money analysis' results (but not necessarily change the sign from positive to negative), and it would also require additional future funding from the state to make those Availability Payments

However, it should also be noted that the winning bids received on Phase I Contracts 3 and 4 both have been approximately 40% below estimate (prior to consideration of claims, contingency and supplemental agreements). Assuming these bids reflect discrepancies between engineers' estimates and current market conditions and if such market conditions hold, it may be expected that the underlying construction costs of Phase II could be lower than anticipated and the overall risk that state funding requirements will exceed the levels shown in the Business Case would be proportionally diminished.[8] The Consultant Team estimates that under a scenario whereby the contractor's bid is priced 25% below current estimates, the FY2014 starting availability payment would be decreased by $12-14M ($95 to $115M on a net present

[8] Given this wide variance from estimate to actual cost, the validity of inputs to and results from the DBB vs. DBFOM comparison is difficult to assess. For example, the DBB case assumed costs substantially above estimate and the DBFOM assumed costs near estimate. Both would seem high given current pricing environment.

value basis with an 8.5% discount rate or $145M to $170M with a 5.5% rate). Likewise, a higher than expected construction price would result in a higher required availability payment.

Given this pricing volatility, the CTC may wish to consider approving availability payment-based P3 projects such as Presidio Parkway based on an availability payment ceiling amount that is demonstrated as affordable under a separately adopted funding plan. It is common in RFPs for similar projects to include an upset limit for responsive proposals.[9]

Following is a more detailed discussion of two major financing assumptions used in the PPR base case that could adversely affect the cost of the project in the immediate and/or longer term if proven to be aggressive: the creditworthiness of California Availability Payments, and the terms and availability of a federal TIFIA loan.

(1) Creditworthiness of California Availability Payments

The PPR may be aggressive in assuming that the project (and specifically its senior debt and TIFIA loan tranches) can achieve a similar or better credit rating than the two U.S. DBFOM concessions often referred to in the Business Case, Florida's I-595 and Port of Miami Tunnel (POMT) availability payment P3 precedents which closed in 2009. In particular, while the levels of debt-to-equity leverage and equity returns experienced on those two Florida projects are consistent with the Presidio Parkway P3 base case, the PPR assumes the senior debt would be priced exactly as in POMT and that the TIFIA loan would achieve an investment-grade rating. However, <u>in neither Florida project was the TIFIA loan investment grade</u>. Further, it is unlikely in the current budget and political environment that a commitment by the state of California to make availability payments (and, if necessary, relief event compensation and/or termination payments) subject to appropriation would be viewed as favorably from a credit rating perspective as a similar commitment by the state of Florida.

At this time, California appropriation risk bears a different, lower credit than Florida appropriation risk at the time of POMT and I-595's closings:

- California general obligations are rated A/BAA/Baa1, compared to Florida AAA/AA+/Aa1 ratings at the time of the closings.

- In addition, Florida has a credit history of issuing appropriation risk debt for its state Infrastructure Bank debt; this debt was typically rated only one notch below other Florida debt. Beyond providing a clear benchmark, the creditworthiness of this appropriation risk debt gave comfort to P3 lenders because a failure to appropriate availability payment would also negatively impact the state Infrastructure Bank debt.

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[9] While the Instructions to Proposers ("ITP") was not provided for the Presidio Parkway P3 Project, it is possible that such future document is already planned to include an upset limit amount for responsive proposals. As examples of domestic precedents, the Port of Miami Tunnel ITP included an upset limit which the winning bid was substantially beneath. On I-595, the upset limit was relaxed during the procurement based on feedback from bidders; the winning bidder submitted below the original limit while another team was above the original. On the Oakland Airport Connector DBFOM procurement in 2007, BART established an upset limit that was too aggressive and failed to received any responsive proposals, leading to a re-procurement with additional funding and a revised contract structure.

- Florida's statute prioritizes P3 payments over other agency payment obligations for new projects and caps those P3 payments liabilities at 15% of annual budgets. While contemplated, California does not have such a statutory covenant at this time.

On the other hand, as discussed previously, we understand (per the Business Case) (i) that an internal Caltrans policy limits annual GARVEE Bonds and availability payment commitments to 15% of annual federal transportation dollars; and (ii) a prioritization of those GARVEE Bonds and availability payment obligations in the state Highway Account is under consideration, as well as other possible enhancements such as continuous appropriation or a budget covenant allowing Caltrans to make payments without appropriation. In addition, similar to Florida DOT commitments provided in the I-595 and POMT projects, the draft Agreement commits Caltrans to include the milestone and availability payments in its STIP Fund Estimate for adoption by the CTC and its total, bundled legislative budget request, minimizing the risk of non-appropriation.

However, as a final point of comparison, although Caltrans is the sole agency party to the prospective concession agreement and would apparently backstop all its funding partners' contributions, the liquidity of the public funding is a key consideration to lenders and investors. The PPR and Business Case are unclear regarding the liquidity of federal, state and local funding partners' monies. The Business Case vaguely refers to credit support or letters or credit arrangements – but it unclear that these would or could be implemented for most of the grants. At the time they reached financial close, the Florida precedents had letters of credit signed and necessary bond proceeds already issued and escrowed by Florida's local funding partners as backstops to their respective contributions.

(2) TIFIA Loan Availability and Terms

While not provided nor referenced in the PPR, we assume that Caltrans submitted a Letter of Interest ("LOI") for TIFIA by the mandatory March 1, 2010, deadline established in the recent federal register Notice of Funding Availability ("NOFA"). However, <u>the granting of TIFIA credit assistance is not generally guaranteed, nor are the conditions assumed in the PPR and Business Case under which assistance would be given</u>. If the TIFIA loan or a similar federal credit is not available or is only available in reduced amounts, a greater financing share of more expensive senior debt (costing approximately 6.5% to 7.0% and potentially bearing refinancing risk) would be needed.

Several risks related to TIFIA assumptions are noted in the PPR Business Case but are not quantified. In general, assumed parameters (and derived financial benefits) of the TIFIA loan appear to be optimistic. For example:

- Section 3.7.4 of the Business Case assumes that the entire cost of the loan subsidy will be paid from federal budget authority. However, the NOFA made clear that there likely are more worthy projects than subsidy funds available to pay for the TIFIA credit assistance's loan loss reserve, and recent media[10] reports suggest that 39 LOIs for nearly $13 billion of TIFIA assistance were submitted in response to it. The subsidy required to honor all interested projects would likely be roughly 10 times the total 2010 budget authority. On the newest TIFIA projects, including the Port of Miami Tunnel, the borrower has been required to pay a portion of their own subsidy. To address this capacity problem, the NOFA contemplated the establishment of a pilot program in which projects would pay 100% of their subsidy cost.

[10] PWFinancing, March 2010

While the Presidio Parkway P3 may well be a strong, "shovel ready" candidate for a TIFIA loan, a conservative base case analysis should assume the project would have to pay upfront for some or the entire loan subsidy, typically 7-10% of the loan amount (~$22-$30M for a $309M loan). This would add to the upfront $10M project costs assumed for the bidding and initial development of the project per the PPR (which themselves also may be on the low side for this type of project).

- The assumed 4.15% TIFIA interest rate dated from September 2009, needs to be revised upwards. The SLGS rate, the basis for the TIFIA lending rate, had stabilized in the 4.50%-4.80% range over the past 4 months, and was at 4.77% as of March 29, 2010.

- The TIFIA statute provides that only 1/3 of eligible project costs may be financed via TIFIA. The $309M TIFIA loan amount shown in the PPR assumes that the costs of Contracts 1 through 4 will be deemed eligible project costs for the Presidio Parkway P3. Should this not be accepted by the TIFIA Joint Program Office, only a ~$170-200M loan amount might be allowed, depending on the eligible costs to be spent on Phase II works per the TIFIA loan federal rules. Although precedents exist for the inclusion of such costs, the assumption in the PPR of such a large TIFIA loan based on approximately $330M of Phase I costs that have already been incurred, appears to be aggressive at this stage.[11]

- Even if the Phase I costs were deemed eligible, having a TIFIA loan size larger than the senior debt facility ($118M) statutorily requires the TIFIA loan to receive an investment-grade rating. As discussed above, this might be challenging given that the Florida precedents did not receive an investment grade rating and that California's credit rating is lower than Florida's.

- As discussed previously (with respect to the use of Federal Transportation Funds) the Consultant Team does not have sufficient information to understand whether there would be additional constraints on SHA funding or use of capital grants for making the availability payment would be allowed – in particular with respect to the statutory prohibition on making TIFIA loan repayments using federal funds.

C. Risks Retained by Caltrans under the Contemplated P3 Delivery Structure

Under a number of circumstances during the procurement and subsequent term of the P3 agreement, there may be risks *to state transportation revenues committed to other projects*. In many cases these are parallel risks that would exist should the project be advanced using a DBB approach. Examples of clears risks that have potential to increase the annual availability payment from the amount assumed in the PPR and Business Case are discussed below (although it should be reiterated that if bids come in below current estimates, as has been the case for the Phase I DBB contracts, the starting availability payment level may be lower, all else being equal).

In the discussion which follows, risks arising during the procurement period or from the availability payment mechanism itself are reviewed first. There are also substantial potential claims / relief event risks during the construction and operations period which are discussed in the second and third sub-sections. An analysis of reasonable contingencies for likely relief events is appropriate – as well as

[11] As a background, Section 80.5(b) of the TIFIA Regulations provides that costs incurred prior to a project sponsor's submission of an application for credit assistance may be considered eligible project costs only with the approval of the Secretary. As such, to the extent that the overall funding plan covers Phase I and II costs and a significant portion of Phase I costs were incurred and paid for prior to the date of application submission, it is questionable whether those costs would be treated as eligible project costs for purposes of sizing the TIFIA loan.

consideration of major force majeure events (we note that the PPR values public sector risks retained under the DBFOM at $47m) . As the final element, financial considerations in case of termination of the P3 are also addressed in the fourth sub-section.

(1) Payment Mechanism and Procurement Period Risk for the State's Budget

- Unlike in a self-funding toll-road, the availability payment amount is bid – and the higher the bids, the greater the budgetary impact. To state the obvious, should the PPR's estimate for financial costs (likely) or construction pricing (less likely it would seem) prove to be more expensive than the Business Case assumptions presented, then the required availability payment amounts could be larger than anticipated. As discussed above, an affordability ceiling could be established to limit this exposure. [12]

- If the Developer, in its proposal and actual implementation, finishes construction ahead of Caltrans' engineering estimate, it could trigger an earlier financial obligation for the milestone and availability payment streams and the obligation to pay more availability payments overall. This appears likely to be mitigated to some degree through an "early completion date" limit to be specified in the Agreement, but the exact date has not been provided yet so it is impossible to evaluate the magnitude of potential effects from early completion.[13] Note that late completion would have the opposite – and commensurately beneficial – effect from a budget standpoint, at least partially offsetting the intrinsic harm of delayed completion. (A benefit of availability payment contract structures is that delays – so long as not owner-caused – result in budget savings rather than additional construction cost for the public owner.)

- Even if the agreement is executed with the current availability payment estimate, it could increase over time beyond baseline expectations if actual inflation turns out to be above the Business Case's expectations (because 15%[14] of the availability payment is indexed to the Consumer Price Index ("CPI")). This is rather likely because the 30-year 2.2% annual CPI rate assumption used in the PPR is on the low end of economic forecasts. With a 3.0% inflation rate, Caltrans would end up paying an extra $1M per year by the middle of the concession, and approximately $3M more every year just prior to the term end. In addition, the insurance premium benchmarking regime as currently

[12] In addition, while the Instructions to Proposers has not yet been provided, it is typical for bid prices to be subject to adjustment to account for interest rate fluctuations (up or down) between bid submission and financial close, since such rates cannot be controlled or hedged by proposers during that period. Although financial market volatility is no longer at the record levels experienced during the worst period of the financial crisis, it should be anticipated that adjustments for interest rates could potentially swing the base availability payment upward or downward by up to approximately a million dollars.

[13] While the $150M milestone payment is currently scheduled for December 2012, the first availability payment would occur in July 2013. An early completion would require Caltrans to program additional SHA monies for fiscal year 2012-13, depending on how many months of "early completion" the Developer could benefit from under the payment mechanism. This risk to the state was introduced in both of the Florida precedents (that are being followed closely in the Presidio Parkway concession agreement) in order to encourage the Developer's schedule adherence and acceleration, essentially serving as a bonus/damages system. Given a fixed 33-year concession term, a baseline 3-year construction would entitle the Developer to 30 annual availability payments. However, a 2.5-year construction would mean 30.5 annual availability payments, and on the other hand a late construction completion after 4 years would reduce the availability payment stream to only 29 annual payments.

[14] This amount is roughly equivalent to the portion of the availability payment that is attributable to operations, maintenance and rehabilitation expenditures, which are exposed to inflation.

contemplated in the draft Agreement could lead to supplements to the annual availability payment stream, although this risk is not as high as the CPI exposure.

However, it should be noted that if Caltrans retained O&M responsibility (i.e., under a DBB), it too would face exposure to CPI in the form higher O&M costs if inflation exceeds expectations.

(2) The Cost of Project Risks Allocated to Caltrans

As stated in the PPR, project risks are more extensively transferred to the private sector under a DBFOM delivery versus in a traditional DBB with subsequent public performance of operations, maintenance and rehabilitation. However, under the contemplated draft Agreement, it must be recognized that Caltrans would still retain some or all responsibility for key construction risks (such as right-of-way, utility relocation, pre-existing hazardous materials, etc.). The appendices to the draft Agreement which define these risks and the exact allocations of them have not been developed.

Further, it should be assumed that Caltrans will need to carry contingency funds for these risks. Note that this subsection does not intend to debate how substantial the risk transfer to a private entity under a DBFOM will be as compared to a DBB. Rather it is simply to note that Caltrans will assuredly retain some risks under a DBFOM and that those risks could be meaningful and warrant contingency. Caltrans has assumed a $47M risk reserve under a DBFOM structure, a $91 reserve under a DBF structure, and a $125M risk reserve under a DBB structure. Although certain construction risks have been quantified in the PPR/Business Case, we do not have access to the underlying risk register so it is difficult to assess whether these stated risk reserves are appropriate.

Relief events for which Caltrans will likely be expected to provide schedule and/or cost relief (such as owner's changes but also owner-caused delays, force majeure, change in law, pre-existing hazardous materials or archeological findings, utility owner delays, delays in obtaining permits or right-of-way acquisition, and more generally, events outside of the Developer's control) are typically cited as more expensive under a P3 than what such claims would have cost the owner under traditional delivery methods. This is due to the additional private financing costs incurred by the Developer during the critical path delay – the draft Agreement (and generally, all P3 contracts) includes compensation provisions directing the owner to pay for additional interest during construction, to some extent lost revenue, and extra work costs and delay costs traditionally recoverable by the contractor under a DBB or DB delivery. Under the terms set forth in the draft Agreement, the "financial clock ticking" would cost Caltrans up to 85% of the availability payment prorated on the delay period (according the draft Concession Agreement) plus the interest incurred on the delayed $150M milestone payment, or a little over $3M for a 1-month delay.[15]

(3) Design and Interface Risks with Phase I Delivery

These "cost of financing compensation" considerations are even more critical to the Presidio Parkway P3 Project given the interrelation and interdependency of the Developer's responsibilities with the Phase I

[15] This financial cost may be one reason why public owners are less likely (and willing) to direct owner changes or cause delays under a P3 than a traditional delivery method, a fact which is not always clearly accounted for in the studies drawing schedule and cost overruns statistics for P3 and traditional delivery methods. Another reason for the relatively high incidence of overrun in public sector delivery of projects, as identified by Robert Bain, PhD in Project Finance International, January 2010, is that many global studies tend to calculate overruns from estimates that were made prior to detailed design.

delivery currently procured by Caltrans under a traditional DBB method. The PPR does not identify or address most of these risks in detail, if at all. However, the PPR/Business Case identifies the broad potential for $47M in publicly retained risks under the DBFOM delivery method (versus $125M for the DBB).

- Per the draft Agreement, Caltrans' final acceptance of Phase I works is a condition precedent to the commencement of Phase II works. As the appendices to the draft Agreement have not been provided, we are not in a position to determine to what extent a potential delay in Phase I works could lead to claims and schedule and compensation relief to the Developer. Per the PPR, financial close and start of design and construction for the P3 procurement is currently scheduled for the summer or fall of 2011. Contracts 3 and 4 are currently in their construction and procurement phases, respectively, and are expected to be complete in spring 2011. There are only a few months of "overall float" and a few months delay of Contracts 3 or 4 could push the Phase II delivery schedule and give rise to Caltrans' additional payment obligations as described above.

- The landscaping work involved in Contract 8 requires third-party stakeholder coordination with the Presidio Trust, the National Park Service and other governmental agencies – potential completion delays caused in this respect could (this cannot be yet determined with the draft Agreement without the appendices) also trigger the portion of compensation described above attributed to the delayed start of the availability payments.[16]

- In addition to schedule interdependency, it should be considered as to whether the advanced state of the design and prescriptive specifications for Phase II in the context of U.S. and California law, as well as the allocation of lifecycle cost responsibility for segments not built by the Developer, will lead to Phase II segments having exposures for overrun / delay / latent defect risks (and related claims from the Developer) that are dissimilar to P3s in which the Developer has substantial flexibility to design, construct and manage a project to meet performance specifications. Innovation potential may be reduced here, and an analysis, given these interface risks, of the probability of relief event claims and their budgetary impact has not been provided for the P3 case.

- Similarly, the operations and maintenance performance specifications and deductions regime for the P3 should be expected to be subject to claims for relief or compensation to the extent the performance is impaired by a specified design and/or problems arising from latent defects. The provisions of the draft Agreement illustrate this: per Section 4.14, Caltrans is financially responsible for any Phase I structural latent defect arising until [3.25 to 5.25] years after the commencement of Phase II construction works, provided (i) the Phase I contractor is not affiliated with the Developer and (ii) those structural latent defects are not the result of substandard maintenance and repair.

- While there are many examples of P3s involving reconstruction of existing highway infrastructure, in hindsight, it would appear that the Presidio Parkway project might have achieved more complete risk transfer and offered greater innovation potential should the Developer been given responsibility for both Phases I and II (perhaps excluding Contract 8, as discussed above). As it stands now, the Phase II P3 may face some of the very risks attributed generically to DBB projects in the PPR Business Case.

[16] From a budget standpoint, it may merit consideration as to whether or not Contract 8 should be included in the Agreement as it is a significant driver of O&M cost and could lead to "gold-plating". Caltrans may be able to better negotiate (and renegotiate over the next 33 years) with these stakeholders if it is directly responsible for the landscaping costs.

- Last, because limited information has been provided about the funding plan for the project, we are unsure whether some of Caltrans' funding sources for both Phases I and II have been obligated or have covenants requiring them to be used on one particular phase or another. We assume that the allocation of some of the federal / state / local grants to the Phase II funding plan as shown in the PPR was driven by the grants' disbursement schedules. The potential commingling of all sources of funds between Phases I and II could create funding shortages for Phase II, should Phase I works incur cost overruns on the level projected in the Business Case for the DBB scenario– eventually leading to a potential additional state budget requirement. However this risk appears to be reduced due to the low bids received for Contracts 3 and 4 -- indeed the overall project may now be close to having a full capital funding plan.

(4) Compensation on Termination Liability and Cost-to-Complete Perspective

The draft Agreement assigns long-term financing responsibilities to the Developer, compensating it with a combination of a $150M completion milestone payment and the estimated 30-year stream of availability payments during the operations period. Under this form of indirect borrowing, Caltrans does not fully pay for the value of the construction works during the course of construction advancement (as it would with progress payments under a DBB delivery). However, in the event the Agreement is terminated, this "compensation shortfall" could come due immediately creating a payment obligation of up to several hundred million dollars owed by Caltrans.[17] Considered another way, the public sector will not be able to receive something of value (the completed or partially completed works) without compensating for it. The compensation amount due would be calculated differently and vary substantially depending on the termination circumstances – i.e., Developer default, extended relief events, Caltrans default or convenience. The likelihood of such circumstances and Caltrans' maximum probable loss exposure under them is assured to vary greatly – but it is not described in the PPR.

The PPR provides the termination calculations but does not identify a source for funding them. The draft Agreement qualifies those payments as being subject to budget appropriation. Nonetheless, it is some comfort that terminating the Agreement would at the same time release Caltrans from future availability payment obligations. For example, in such cases, Caltrans may be able to use this capacity to issue debt to fund a termination payment or to procure a replacement Developer and compensate the new Developer with the same payment stream, and have the Developer be to some extent liable for the termination payment. If termination occurs before construction completion, the milestone payment would not be due, but Caltrans would need to rectify any construction defects, re-procure and pay for a contractor to complete the works.

The draft agreement could be terminated under three scenarios – for Developer default, under "force majeure" circumstances or for Caltrans default or convenience.

- Under a Developer default scenario, the termination payment calculation is such that the Developer's lenders would be able to mitigate their own losses more completely by stepping-in and rectifying the default rather than by allowing the default to progress to termination. Thus their incentive is to mitigate the default. Based on research of hundreds of availability payment P3s in Canada and the UK, we have found almost no incidence of termination for developer default in a properly structured P3 wherein lenders are fully at-risk; however, there have been a number of cases of default with

[17] Similarly in a conventional project delivery financed via public debt, a failure of the project does not erase the public debt obligation.

lenders stepping in (similar to a surety assuring completion of a conventional project). The agreement also suggests performance and payment bonds will be required from the Developer and will provide additional security to Caltrans to remedy any defective work; however, the amounts are not yet determined.[18] This would be in excess of substantial performance security (likely letters of credit and parent company guarantees) provided by the Design-Build subcontractors to the Developer and its lenders. So, in the event of a theoretical termination for default during construction, unless the job has been vastly underestimated, Caltrans would be in a position to complete construction by reprogramming the future availability payment sourced from the SHA under short-term obligations. This could amount up to several hundred million dollars.

- The other termination scenarios would create a greater payment liability for Caltrans as they provide for a compensation of demobilization costs, debt repayment, book equity with potentially return on investment compensation in case of a Caltrans default or convenience termination. However, Caltrans can avoid or delay each of those termination circumstances by refusing Developer's notice to terminate (and continuing to make availability payments), not defaulting under its own contractual obligations or electing not to terminate for convenience. In the case of termination for force majeure, Caltrans may be able to seek compensation from FEMA (a source of relief likely unavailable to the Developer). In general, force majeure is a risk that Caltrans bears on all of its assets. However, the need to make a lump sum termination payment is distinct to the P3 approach and merits some analysis and planning. Note that it can also be required that the Developer have some insurance package, to the extent available at commercially reasonable rates (insurance requirements were referenced but not included with the draft Agreement).

In general – and pending the final development/negotiation of terms – the draft Agreement and the associated project finance structure provides substantial protections to Caltrans in the event of default, potentially more than it would receive under conventional procurement. In addition, in the event of default, lenders and the state's interests are aligned in mitigating the impacts. However, the risks and impacts of termination under the P3 are distinct with respect to their potential to impact state budget and merit consideration as the final terms of the agreement are developed.

III. Performance Objectives (Approval Guidelines Criteria #3)

Both the Commission's policy guidance and the statute state that the proposed P3 project is primarily designed to achieve the following three objectives:

- Improve mobility by improving travel times or reducing the number of vehicle hours of delay in the affected corridor

- Improve the operations or safety of the affected corridor

- Provide quantifiable air quality benefits for the region in which the project is located

The Presidio Parkway project is a reconstruction or replacement project that aims to replace an aging and structurally deficient facility, ensure its seismic safety, and provide for a wider facility with medians and shoulders to improve operations and safety.

[18] Such surety bonds may not be the most appropriate security for this project delivery structure. They were included in the precedent Florida documents because of statutory "mini Miller Act" constraints in Florida.

The statute does include reconstruction projects in its definition of transportation projects under Section 143 (a) (6) eligible for consideration for P3 delivery. However, it is not clear to the consulting team whether the statute and the policy guidance intended all proposed P3 projects to achieve *all three* performance objectives, or whether they intended all proposed projects to achieve *one or more* of the three performance objectives.

Therefore, the consulting team assessed whether the projects will achieve each of the three objectives separately so that the Commission can make its own judgment. Each performance objective is discussed separately below.

A. Mobility

The submittal states that the Presidio Parkway serves approximately 120,000 per weekday. It further states that the Presidio Parkway project is "*is designated as a regional, post-disaster, recovery route. An interruption of the traffic flow following a major earthquake would sever a principal connection to the Golden Gate Bridge and would result in major congestion impacts on the regional transportation system and local streets*."

Finally, it estimates that *"The near-term economic costs associated with such post-disaster peak period delays are estimated to be approximately $1.4 million per day for the region, or about $420 million per year (2008$)."*

In effect, the submittal states that mobility improvements will occur only in the case of disaster. This is consistent with a seismic reconstruction project. A review of the Final Environmental Impact Statement / Report (FEIS/R), as well as the traffic report appended thereto, as referenced by the Project Proposal and thereby made as part thereof, leads us to the conclusion that this project is not expected to reduce congestion in a quantifiable way except during post-disaster conditions.
Therefore, the Consultant Team's conclusion is that the proposed project does not improve mobility or travel times under normal conditions. However, under emergency, post-disaster conditions, it will provide reductions in regional delays. Again, whether the statute and the policy guidance can be interpreted to address recurrent daily congestion or only during post disaster conditions in unclear to the Consultant Team.

B. Safety and Operation

It is the Consultant Team's conclusion that the submittal clearly demonstrates both safety and operations improvements. The submittal states that: "*The overall Presidio Parkway Project will offer improved operations and safety with the following enhancements:*

- *A median barrier will be constructed to separate traffic traveling in opposite directions. This will reduce the potential for head-on collisions. In addition, the barrier will eliminate the need for the lane switching operations on Doyle Drive, thus reducing worker exposure to traffic.*

- *Inside and outside shoulders that are currently non-existent will be constructed, thus providing a clear recovery zone, as well as improving sight distance.*

- *Lane width will be increased from the current 10-foot width to 11-foot width for interior lanes and 12-foot width for outside lanes. The increased width will reduce the potential for side-swipe type collisions.*

- *Traffic management equipments will be installed, allowing the Department to monitor real time traffic conditions. The Department can provide real time traffic advisory information to motorists about congestion or collisions, improving both operations and safety."*

C. Air Quality

To evaluate the proposed Presidio Parkway Project with respect to this criterion, the Consultant Team reviewed the Project Proposal and also the Final Air Quality Study appended to the project Environmental Impact Statement / Report (FEIS/R), as referenced by the Project Proposal and thereby made a part thereof.[19] The Air Quality Study identifies negative emission impacts during both construction and operation, and finds that such impacts can be mitigated or are not significant. However, the fact that emissions impacts can be reduced to less than significant is not the same as saying that a project has quantifiable air quality benefits.

Each of the statements contained in the project proposal is reviewed below, as are the results of the Final Air Quality Study.

(1) Presidio Parkway Project Proposal

With respect to air quality, the Presidio Parkway Project Proposal Report states::

> *"The overall Presidio Parkway Project meets air quality conformity requirements and conforms to the state air quality implementation plan as determined in the adopted 2008 Metropolitan Transportation Commission (MTC) Regional Transportation Improvement Program (RTIP) on January, 23, 2008."*

Assessment: inclusion of a project in a conforming RTIP does not in and of itself demonstrate that a project has creditable emission reduction benefits, but rather only that the RTIP as a whole conforms to the State Implementation Plan.

The Project Proposal also states:

> *"A Record of Decision was rendered by FHWA for Doyle Drive Final Environmental Impact Statement / Report (FEIS/R) in December of 2008."*

That is a true statement but does not say anything one way or the other about whether the project offers quantifiable emission reductions. That would depend on the findings of the Final Air Quality Study for the project as attached to the FEIS/R, which was completed for the SFCTA in November 2004).

Finally, the Project Proposal also states:

"Specific air quality benefits of the Presidio Parkway include:

- *"To be consistent with the San Francisco General Plan and the General Management Plan Amendment Final Environmental Impact Statement, Presidio of San Francisco, Golden Gate National Recreation Area (NPS 1994a and 1994b) for Area A of the Presidio and the Presidio*

[19] SFTCA Contract 99/00-7.

Trust Management Plan: Land Use Policies of Area B of the Presidio of San Francisco (Presidio Trust 2002);

- *"To minimize the effects of noise and other pollution from the Presidio Parkway corridor on the natural and recreational areas at Crissy Field and other areas adjacent to the corridor."*

The first statement may be true, but whether this translates into quantifiable air quality benefits for the region is unclear and beyond the scope of our assignment. Reducing noise and other pollution at Crissy Field and other areas adjacent to the corridor may result from the project, but such as result is not supported by the FEIS/R Final Air Quality Study.

(2) FEIS/R Final Air Quality Study

The FEIS/R Final Air Quality Study states that, *"Construction activities associated with the project would generate emissions of criteria pollutants over the construction duration (including suspended and inhalable particulate matter and equipment exhaust emissions), and disruption of traffic routes," but goes on to say that, "the construction contractor would be required to implement BAAQMD's basic dust control procedures, to maintain project construction-related impacts at acceptable levels; this would mitigate the potential impact to less than significant."*

Also with regard to construction, the Study states that, *"Construction activities would also result in emissions of other criteria pollutants and toxic air contaminants from equipment exhaust, construction-related vehicular activity, and construction worker automobile trips,"* but that, *"construction emissions are not expected to impede attainment or maintenance of ozone standards in the Bay Area."*

With respect to *regional* air quality impacts of operations of the facility, the "…the air quality impacts for all of the alternatives when compared with the future No-Build alternative are less than significant" and that "the impacts compared to existing conditions are also less than significant." But nowhere does the Study suggest that there will be "quantifiable air quality benefits for the region."

Finally, with respect *local* air quality impacts, (CO hotspots, Park Presidio tunnels), the Study similarly concludes that, "CO impacts at key intersections would be less than significant" and, assuming adequate ventilation, that "the impact [in the tunnels and at their portals] would be less than significant."

So again, the impacts at regional and local levels are either non-significant or can be mitigated, but this is not the same as saying that the project offers quantifiable air quality benefits.

IV. Substantiation of Infrastructure Need (Approval Guidelines Criteria #4)

Section 143 (d) states that "*the projects authorized pursuant to this section shall address a known forecast demand, as determined by the department or regional transportation agency."*

The Commission policy guidance includes the following criterion for evaluating project proposals for approval: "*That the project, consistent with Section 143(c)(4), addresses a known forecast demand, , as determined by the department or regional transportation agency in the project proposal report*"

The Consultant Team reviewed all materials provided and reached the following findings:

- Generally speaking, a known forecast of demand refers to regional transportation agency model outputs or project specific model outputs vetted by stakeholders.

- The project proposal report states that "*The Sponsors have estimated that the average daily trips (ADT) on Doyle Drive are approximately 120,000 vehicles currently and that the ADT on the Presidio Parkway will be approximately 163,000 vehicles in 2030.*" Since the Department is one of the sponsors, it would seem that this estimate is based on a known forecast of demand. However, the source of this estimate is not included in the submittal.

- The project proposal states that "Since the Presidio Parkway P3 Project is currently not subject to tolls or direct user fees pursuant to Section 143(s) of the Streets and Highway Code, the Sponsors have not commissioned a traffic and revenue forecast." This leads us to ask for the source of the aforementioned forecast of demand.

The numbers listed do not seem consistent with the Final Air Quality Study appended to the project Final Environmental Impact Statement / Report (FEIS/R), as referenced by the Project Proposal and thereby made a part thereof. The final FEIS/R estimates a lower demand number as it states "Currently, over 91,000 vehicles use Doyle Drive every weekday."[20]

V. Proposals Evaluation Process (Approval Guidelines Criteria #5)

The PPR states that Caltrans and SFCTA intend to evaluate proposals based on qualifications and best value. However, a complete description of the evaluation criteria and process is not provided and there appears to be insufficient information to confirm compliance with Approval Guidelines Criteria #5.

Neither the Request for Qualifications ("RFQ") nor draft instructions to proposers ("ITP") or similar document for the anticipated Request for Proposals ("RFP") are included with the PPR.

[20] http://www.presidioparkway.org/pdfs/feis/chapter_01.pdf

(1) Qualifications

The Presidio Parkway P3 procurement involves a two-step process that first seeks to qualify and short-list potential proposers, followed by request for and submission of proposals. As the RFQ issued on February 2, 2010 (followed by several addendums) was not provided with the PPR, it has not been reviewed at this time. The Consultant Team assumes that the qualifications requirements were set out in the RFQ for the Project, and the short-listed teams invited to submit proposals will be confirmed by Caltrans as meeting the Section 143(h) requirements. However, even if this is indeed the case, there is no indication in the PPR that Caltrans will check to confirm that proposers continue to meet the Section 143(h) requirements at the time of the actual proposal submission and evaluation. (We note that the PPR overview of the proposal evaluation indicates that Caltrans' approval will be required for all key personnel and team composition from short-listing through proposal submission; however this does not fully ensure continuing compliance with the statutory requirement).

(2) Best Value

The Instructions to Proposers for the RFP ("ITP"),or equivalent procurement document, typically establishes the final evaluation process, including: the best value selection criteria; the process for scoring each criteria; pass/fail requirements; and the overall mechanism, formula or protocol to be used for determining the best value given the scores for each criteria. While such document has not been provided, the PPR does include a high-level overview of the anticipated evaluation criteria and describes an overall evaluation approach comprising a pass/fail evaluation followed by a scored, qualitative review. The criteria and approach are consistent with the Port of Miami Tunnel and I-595 precedents which also used best value selection. However, some information is incomplete. For example:

- The pass/fail evaluation process described requires that all Technical Proposals must receive *an average adjectival score of at least "Fair" on each individual technical evaluation criteria* and also receive *an average adjectival score of at least "Good" on the entire Technical Proposal*. However, the range of potential adjectival scores (besides Fair and Good) is not provided. The PPR is also silent on the methodologies for assigning adjectival scores, aggregating adjectival scores from multiple scorers and calculating the average adjectival score for the entire Technical Proposal (which in some precedent might involve converting them into numerical equivalents).

- The PPR provides a list of technical and financial/commercial criteria that will be used to score all passing proposals. However, the criteria are general and do not include sub-criteria or descriptions specific to the Presidio Parkway P3 Project.

- It is not possible to determine at this time how Caltrans intends to define or determine best value for the project because, as with the pass/fail criteria, the methodologies and processes for scoring and then combining the scores of the various technical and financial/commercial criteria are not stated.

It is not uncommon on similar projects for the ITP and many of these details in it to be refined over the course of RFP development and industry review.

VI. Useful Life Review (Approval Guidelines Criteria #6)

Section 143 (d) states that *"For department projects, the commission shall certify the department's determination of the useful life of the project in establishing the lease agreement terms."* and that *"At time of the reversion, the facility shall be delivered to the department or regional transportation agency, as applicable, in a condition that meets the performance and maintenance standards established by the department or regional transportation agency"*

The Commission guidance in response to the statute states that, as part of the approval criteria, *"For a Department project, that the Department has made a determination of the useful life of the project in establishing the lease agreement terms that is consistent with the terms of the lease agreement"*.

The Consultant Team reviewed all materials provided and reached the following findings:

- In the PPR, Caltrans has determined that the pavement has a useful life of 40 years and that the structures and tunnels have useful lives of 75 years based on the "design and construction specifications in the overall Presidio Parkway Project design documentation." These two asset categories represent the largest cost elements of the project.

- The Consultant Team reviewed the Caltrans Design Manual. The table below extracted from the 2006 Caltrans Design Manual confirms that a 40-years design life for pavement is consistent with the manual. The 75 years for structures and tunnels is consistent with the useful life defined for bridge structures in the Department's bridge manuals, specifically in California's amendments to American Association of State Highway Transportation Officials' (AASHTO's) bridge specifications[21]. It is reasonable to expect tunnels to have a long useful life like bridges.

Table 612.2

Pavement Design Life for New Construction and Reconstruction

Facility	Pavement Design Life (Years)	
	AADT(3) <150,000(1) and AADTT(4) <15,000(1)	AADT ≥ 150,000(1) or AADTT ≥ 15,000(1)
Mainline Traveled Way	20 or 40 (2)	40
Ramp Traveled Way	20 or 40 (2)	40
Shoulders:		
≤1.5 m wide	Match adjacent traveled way	40
>1.5 m wide: First 0.6 m	Match adjacent traveled way	40
Remaining width (5)	20	20
Intersections	20 or 40 (2)	40
Roadside Facilities	20	20

Notes:
(1) Projected mainline AADT and AADTT 20 years after construction
(2) Use design life with lowest life-cycle cost (See Topic 619)
(3) Annual Average Daily Traffic (AADT)
(4) Annual Average Daily Truck Traffic (AADTT)
(5) If the shoulder is expected to be converted to a traffic lane with the pavement design life, it should be engineered to match the same pavement design life as the adjacent traveled way.

[21] http://www.dot.ca.gov/hq/esc/techpubs/manual/bridgemanuals/ca-to-aashto-lrfd-bds/page/sec_2.pdf

- The review to date indicates that the PPR is silent regarding any other assets of the project, including traffic signals, intelligent transportation system (ITS) equipment, or signage. Although these assets likely represent a relatively small portion of the total project costs, some of them may have a shorter useful life and would require replacement during the 30 years of operations. It is unclear whether such costs, if needed, are included in the proposal financial plan.

- Useful life of any asset depends to a large extent on timely maintenance of the assets. The draft Agreement sets aside an annual budget for operating and maintenance (O&M) work and a renewal work reserve for renewal work, compliance work, and work pursuant to the Handback Requirements. The proposed P3 agreement includes 30 years of operations, so condition of the pavement at the end of the agreement should support an additional useful life of 10 years, while the structures and tunnels should have 45 years remaining.

- The draft Agreement references Handback Requirements, but the specifications are not included in the submission.

- The draft Agreement does not define specific performance measures and mechanisms for measuring the state of repair during the concession period and at handback (e.g., International Roughness Index or IRI for pavement).

CALIFORNIA TRANSPORTATION COMMISSION

POLICY GUIDANCE
PUBLIC PRIVATE PARTNERSHIP PROJECTS
Resolution G-09-13

1. Authority and Purpose. Section 143 of the California Streets and Highways Code, as amended by Chapter 2 of the Statutes of 2009 (Senate Bill 4, Second Extraordinary Session), authorizes the California Department of Transportation and regional transportation agencies to enter into comprehensive development lease agreements with public or private entities for transportation projects, commonly known as public private partnership (P3) agreements. Section 143 further provides that P3 projects and associated lease agreements proposed by the Department or a regional transportation agency shall be submitted to the California Transportation Commission, and that the Commission shall select and approve the projects before the Department or regional transportation agency begins a public review process for the final lease agreement. For Department projects, the Commission shall also certify the Department's determination of the useful life of the project in establishing the lease agreement terms. Where the Department or a regional transportation agency uses a final evaluation of proposals based on qualifications and best value to select a contracting private entity, Section 143 mandates that the Commission adopt the criteria for making that evaluation. However, the Commission does not approve or execute the final lease agreement nor does it have a role in selecting the private entities for P3 agreements.

   The purpose of this guidance is to set forth the Commission's policy for carrying out its role in implementing P3 projects in order to assist and advise the Department, regional transportation entities, and private entities that may be contemplating the development of P3 agreements. This Commission policy guidance is not a regulation and should not be construed as imposing any requirement or imposing any deadline on any agency beyond those found in Section 143. References to timeframes in this guidance are statements of Commission intent for responding to submittals from other agencies. They are not deadlines or restrictions for either the Commission itself or for other agencies. References to the contents of submittals from other agencies are statements of what the Commission expects that it will need in order to carry out its own responsibility for project approval under statute. They are not procedural requirements. Section 143 does not modify nor does this guidance address the Commission's authority to program and allocate state funds. This guidance does not address Department and regional transportation agency P3 project procedures that are not within the purview of the Commission.

2. Scope of Project Approval. The Commission will select and approve each P3 transportation project, as defined in Section 143(a)(6), through the adoption of a resolution at a regularly scheduled Commission meeting. Before approving a project, the Commission will conduct a

public hearing on the project as a scheduled meeting agenda item. The Commission will approve each project with reference to a P3 project proposal report, as described in section 4 below, prepared and submitted by the Department or regional transportation agency. The Commission's P3 project approval will include and apply to:

- The description of the scope of the transportation project and its boundaries, including construction work and the performance of maintenance and operations.
- The project financial plan, including the allocation of financial risk between public and private entities.
- For Department projects, a certification of the determination of the useful life of the project in establishing the lease agreement terms.
- Where the Department or regional transportation agency proposes to use a final evaluation of proposals based on qualifications and best value to select a contracting entity or lessee, the criteria that the Department or regional transportation agency will use for that evaluation.

3. <u>Criteria for Commission Approval</u>. The Commission will approve a P3 project if, after reviewing the project proposal report as described in section 4 below, it finds all of the following:
   - That the project as described in the project proposal report is consistent with the requirements of statute.
   - That the Commission's approval of the project and its financial plan does not in and of itself create a new commitment of state transportation revenues or create an undue risk to state transportation revenues committed to other projects. This does not preclude the commitment of state funds as a separate, even simultaneous, action. For example, the Commission could approve an amendment of the state transportation improvement program (STIP) to commit new funds to a P3 project, subject to the constraints of STIP funding.
   - That the project, consistent with Section 143(c)(3), is primarily designed to achieve the following performance objectives, as evidenced in the project proposal report:
     - Improve mobility by improving travel times or reducing the number of vehicle hours of delay in the affected corridor.
     - Improve the operation or safety of the affected corridor.
     - Provide quantifiable air quality benefits for the region in which the project is located.
   - That the project, consistent with Section 143(c)(4), addresses a known forecast demand, as determined by the Department or regional transportation agency and evidenced in the project proposal report.
   - Where applicable, that the criteria that the Department or regional transportation agency proposes to use for a final evaluation of proposals based on qualifications and best value are consistent with statute.
   - For a Department project, that the Department has made a determination of the useful life of the project in establishing the lease agreement terms that is consistent with the terms of the lease agreement.

4. Project Proposal Report. The Commission will consider approval of a P3 project only when the Department or regional transportation agency has prepared and submitted a project proposal report to the Commission. The Department or regional transportation agency may engage in preliminary steps leading to the development of the draft lease agreement, including the general solicitation of proposals and the prequalification of potential contracting entities, prior to submitting a project proposal report. However, the Department or regional transportation agency should not issue the final request for proposals to implement a specific transportation project, and the Department or regional transportation agency shall not conduct the final evaluation of proposals, prior to the Commission's approval of the P3 project. The Commission will place a request for approval of a P3 project on its agenda when the Commission office receives the project proposal report at least 45 days prior to the meeting.

   The project proposal report and request for P3 project approval will include or make reference to the following:

   - The description of the scope of the transportation project and its boundaries, including construction work and the performance of maintenance and operations.
   - The basis of the Department or regional transportation agency for finding that it would be in the public interest to implement the project through a public private partnership agreement.
   - The Department or regional transportation agency's proposed project financial plan, including the allocation of risk between public and private entities. The financial plan will include:
     - forecasts of revenue from tolls and user fees, as determined by the Department or regional transportation agency;
     - commitments of state or local revenues to the project (including capital, operating, maintenance, and debt service) or to any neighboring or ancillary projects necessary or desirable for full implementation of the project;
     - the alternative source of project revenue should revenues from tolls and user fees fail to meet projections or otherwise be insufficient to meet project costs; and
     - public financial responsibility for meeting project costs (including costs for operations, maintenance, and debt service) in case of default by the contracting entity or lessee.
   - The Department or regional transportation agency's estimate, with supporting documentation, of the extent to which the project will be designed to achieve each of the following performance objectives:
     - improve mobility by improving travel times or reducing the number of vehicle hours of delay in the affected corridor;
     - improve the operation or safety of the affected corridor; and
     - provide quantifiable air quality benefits for the region in which the project is located.
   - The Department or regional transportation agency's forecast of travel demand, with supporting documentation.
   - The terms of the draft lease agreement associated with the project.

- Where the Department or regional transportation agency proposes to make a final evaluation of proposals based on qualifications and best value, consistent with Section 143(g)(1)(C), the criteria the Department or regional transportation agency proposes to use in making that evaluation.
- For a Department project, the Department's determination of the useful life of the project in establishing the lease agreement terms, consistent with Section 143(d), including the basis the Department used for making that determination.

5. Project Changes after Approval. The Commission does not approve or execute the final lease agreement. However, the Commission's expectation is that, pursuant to Section 143, the final lease agreement executed by the Department or regional transportation agency will implement the project approved by the Commission, consistent with project scope as described in section 2 of this guidance. After the Commission has approved a project, it will have no further role in reviewing or approving changes to the project or the lease agreement except at the request of the Department or regional transportation agency. If the Department or regional transportation agency finds it necessary or appropriate to make changes that alter the project scope, as described in section 2 of this guidance, the Commission expects that the agency will request approval of the change by submitting a supplement to the project proposal report setting forth a description of the change and the reasons for it. The Commission will approve the change if it finds that the revised project meets the criteria set forth in section 3 of this guidance. The Commission will place a proposed project supplement on its agenda in sufficient time to allow action to be taken on the requested change within 45 days after the Commission office receives the supplement to the project proposal report.

STREETS AND HIGHWAYS CODE
SECTION 143

143. (a) (1) "Best value" means a value determined by objective criteria, including, but not limited to, price, features, functions, life-cycle costs, and other criteria deemed appropriate by the department or the regional transportation agency.

(2) "Contracting entity or lessee" means a public or private entity, or consortia thereof, that has entered into a comprehensive development lease agreement with the department or a regional transportation agency for a transportation project pursuant to this section.

(3) "Design-build" means a procurement process in which both the design and construction of a project are procured from a single entity.

(4) "Regional transportation agency" means any of the following:

(A) A transportation planning agency as defined in Section 29532 or 29532.1 of the Government Code.

(B) A county transportation commission as defined in Section 130050, 130050.1, or 130050.2 of the Public Utilities Code.

(C) Any other local or regional transportation entity that is designated by statute as a regional transportation agency.

(D) A joint exercise of powers authority as defined in Chapter 5 (commencing with Section 6500) of Division 7 of Title 1 of the Government Code, with the consent of a transportation planning agency or a county transportation commission for the jurisdiction in which the transportation project will be developed.

(5) "Public Infrastructure Advisory Commission" means a unit or auxiliary organization established by the Business, Transportation and Housing Agency that advises the department and regional transportation agencies in developing transportation projects through performance-based infrastructure partnerships.

(6) "Transportation project" means one or more of the following: planning, design, development, finance, construction, reconstruction, rehabilitation, improvement, acquisition, lease, operation, or maintenance of highway, public street, rail, or related facilities supplemental to existing facilities currently owned and operated by the department or regional transportation agencies that is consistent with the requirements of subdivision (c).

(b) (1) The Public Infrastructure Advisory Commission shall do all of the following:

(A) Identify transportation project opportunities throughout the state.

(B) Research and document similar transportation projects throughout the state, nationally, and internationally, and further identify and evaluate lessons learned from these projects.

(C) Assemble and make available to the department or regional transportation agencies a library of information, precedent, research, and analysis concerning infrastructure partnerships and related types of public-private transactions for public infrastructure.

(D) Advise the department and regional transportation agencies, upon request, regarding infrastructure partnership suitability and best practices.

(E) Provide, upon request, procurement-related services to the department and regional transportation agencies for infrastructure partnership.

(2) The Public Infrastructure Advisory Commission may charge a fee to the department and regional transportation agencies for the services described in subparagraphs (D) and (E) of paragraph (1), the details of which shall be articulated in an agreement entered into between the Public Infrastructure Advisory Commission and the department or the regional transportation agency.

(c) (1) Notwithstanding any other provision of law, only the department, in cooperation with regional transportation agencies, and regional transportation agencies, may solicit proposals, accept unsolicited proposals, negotiate, and enter into comprehensive development lease agreements with public or private entities, or consortia thereof, for transportation projects.

(2) Projects proposed pursuant to this section and associated lease agreements shall be submitted to the California Transportation Commission. The commission, at a regularly scheduled public hearing, shall select the candidate projects from projects nominated by the department or a regional transportation agency after reviewing the nominations for consistency with paragraphs (3) and (4). Approved projects may proceed with the process described in paragraph (5).

(3) The projects authorized pursuant to this section shall be primarily designed to achieve the following performance objectives:

(A) Improve mobility by improving travel times or reducing the number of vehicle hours of delay in the affected corridor.

(B) Improve the operation or safety of the affected corridor.

(C) Provide quantifiable air quality benefits for the region in which the project is located.

(4) In addition to meeting the requirements of paragraph (3), the projects authorized pursuant to this section shall address a known forecast demand, as determined by the department or regional transportation agency.

(5) At least 60 days prior to executing a final lease agreement authorized pursuant to this section, the department or regional transportation agency shall submit the agreement to the Legislature and the Public Infrastructure Advisory Commission for review. Prior to submitting a lease agreement to the Legislature and the Public Infrastructure Advisory Commission, the department or regional transportation agency shall conduct at least one public hearing at a location at or near the proposed facility for purposes of receiving public comment on the lease agreement. Public comments made during this hearing shall be submitted to the Legislature and the Public Infrastructure Advisory Commission with the lease agreement. The Secretary of Business, Transportation and Housing or the Chairperson of the Senate or Assembly fiscal committees or policy committees with jurisdiction over transportation matters may, by written notification to the department or regional transportation agency, provide any comments about the proposed agreement within the 60-day period prior to the execution of the final agreement. The department or regional transportation agency shall consider those comments prior to executing a final agreement and shall retain the discretion for executing the final lease agreement.

(d) For the purpose of facilitating those projects, the agreements between the parties may include provisions for the lease of rights-of-way in, and airspace over or under, highways, public streets, rail, or related facilities for the granting of necessary easements, and for the issuance of permits or other authorizations to enable the construction of transportation projects. Facilities subject to an agreement under this section shall, at all times, be owned by the department or the regional transportation agency, as appropriate. For department projects, the commission shall certify the department's determination of the useful life of the project in establishing the lease agreement terms. In consideration therefor, the agreement shall provide for complete reversion of the leased facility, together with the right to collect tolls and user fees, to the department or regional transportation agency, at the expiration of the lease at no charge to the department or regional transportation agency. At time of the reversion, the facility shall be delivered to the department or regional transportation agency, as applicable, in a condition that meets the performance and maintenance standards established by the department or regional transportation agency and that is free of any encumbrance, lien, or other claims.

(e) Agreements between the department or regional transportation agency and the contracting entity or lessee shall authorize the contracting entity or lessee to use a design-build method of procurement for transportation projects, subject to the requirements for utilizing such a method contained in Chapter 6.5 (commencing with Section 6800) of Part 1 of Division 2 of the Public Contract Code, other than Sections 6802, 6803, and 6813 of that code, if those provisions are enacted by the Legislature during the 2009-10 Regular Session, or a 2009-10 extraordinary session.

(f) (1) (A) Notwithstanding any other provision of this chapter, for projects on the state highway system, the department is the responsible agency for the performance of project development services, including performance specifications, preliminary engineering, prebid services, the preparation of project reports and environmental documents, and construction inspection services. The department is also the responsible agency for the preparation of documents that may include, but need not be limited to, the size, type, and desired design character of the project, performance specifications covering the quality of materials, equipment, and workmanship, preliminary plans, and any other information deemed necessary to describe adequately the needs of the department or regional transportation agency.

(B) The department may use department employees or consultants to perform the services described in subparagraph (A), consistent with Article XXII of the California Constitution. Department resources, including personnel requirements, necessary for the performance of those services shall be included in the department's capital outlay support program for workload purposes in the annual Budget Act.

(2) The department or a regional transportation agency may exercise any power possessed by it with respect to transportation projects to facilitate the transportation projects pursuant to this section. The department, regional transportation agency, and other state or local agencies may provide services to the contracting entity or lessee for which the public entity is reimbursed, including, but not limited to, planning, environmental planning, environmental certification, environmental review, preliminary design, design, right-of-way acquisition, construction, maintenance, and policing of these transportation projects. The department or regional transportation agency, as applicable, shall regularly inspect the facility and require the contracting entity or lessee to maintain and operate the facility according to adopted standards.

Except as may otherwise be set forth in the lease agreement, the contracting entity or lessee shall be responsible for all costs due to development, maintenance, repair, rehabilitation, and reconstruction, and operating costs.

(g) (1) In selecting private entities with which to enter into these agreements, notwithstanding any other provision of law, the department and regional transportation agencies may utilize, but are not limited to utilizing, one or more of the following procurement approaches:

(A) Solicitations of proposals for defined projects and calls for project proposals within defined parameters.

(B) Prequalification and short-listing of proposers prior to final evaluation of proposals.

(C) Final evaluation of proposals based on qualifications and best value. The California Transportation Commission shall develop and adopt criteria for making that evaluation prior to evaluation of a proposal.

(D) Negotiations with proposers prior to award.

(E) Acceptance of unsolicited proposals, with issuance of requests for competing proposals. Neither the department nor a regional transportation agency may award a contract to an unsolicited bidder without receiving at least one other responsible bid.

(2) When evaluating a proposal submitted by the contracting entity or lessee, the department or the regional transportation agency may award a contract on the basis of the lowest bid or best value.

(h) The contracting entity or lessee shall have the following qualifications:

(1) Evidence that the members of the contracting entity or lessee have completed, or have demonstrated the experience, competency, capability, and capacity to complete, a project of similar size, scope, or complexity, and that proposed key personnel have sufficient experience and training to competently manage and complete the design and construction of the project, and a financial statement that ensures that the contracting entity or lessee has the capacity to complete the project.

(2) The licenses, registration, and credentials required to design and construct the project, including, but not limited to, information on the revocation or suspension of any license, credential, or registration.

(3) Evidence that establishes that members of the contracting entity or lessee have the capacity to obtain all required payment and performance bonding, liability insurance, and errors and omissions insurance.

(4) Evidence that the contracting entity or lessee has workers' compensation experience, history, and a worker safety program of members of the contracting entity or lessee that is acceptable to the department or regional transportation agency.

(5) A full disclosure regarding all of the following with respect to each member of the contracting entity or lessee during the past five years:

(A) Any serious or willful violation of Part 1 (commencing with Section 6300) of Division 5 of the Labor Code or the federal Occupational Safety and Health Act of 1970 (Public Law 91-596).

(B) Any instance where members of the contracting entity or lessee were debarred, disqualified, or removed from a federal, state, or local government public works project.

(C) Any instance where members of the contracting entity or lessee, or its owners, officers, or managing employees submitted a bid on a public works project and were found to be nonresponsive or were found by an awarding body not to be a responsible bidder.

(D) Any instance where members of the contracting entity or lessee, or its owners, officers, or managing employees defaulted on a construction contract.

(E) Any violations of the Contractors' State License Law (Chapter 9 (commencing with Section 7000) of Division 3 of the Business and Professions Code), including, but not limited to, alleged violations of federal or state law regarding the payment of wages, benefits, apprenticeship requirements, or personal income tax withholding, or Federal Insurance Contribution Act (FICA) withholding requirements.

(F) Any bankruptcy or receivership of any member of the contracting entity or lessee, including, but not limited to, information concerning any work completed by a surety.

(G) Any settled adverse claims, disputes, or lawsuits between the owner of a public works project and any member of the contracting entity or lessee during the five years preceding submission of a bid under this article, in which the claim, settlement, or judgment exceeds fifty thousand dollars ($50,000). Information shall also be provided concerning any work completed by a surety during this five-year period.

(H) If the contracting entity or lessee is a partnership, joint venture, or an association that is not a legal entity, a copy of the agreement creating the partnership or association that specifies that all general partners, joint venturers, or association members agree to be fully liable for the performance under the agreement.

(i) No agreement entered into pursuant to this section shall infringe on the authority of the department or a regional transportation agency to develop, maintain, repair, rehabilitate, operate, or lease any transportation project. Lease agreements may provide for reasonable compensation to the contracting entity or lessee for the adverse effects on toll revenue or user fee revenue due to the development, operation, or lease of supplemental transportation projects with the exception of any of the following:

(1) Projects identified in regional transportation plans prepared pursuant to Section 65080 of the Government Code.

(2) Safety projects.

(3) Improvement projects that will result in incidental capacity increases.

(4) Additional high-occupancy vehicle lanes or the conversion of existing lanes to high-occupancy vehicle lanes.

(5) Projects located outside the boundaries of a public-private partnership project, to be defined by the lease agreement.

However, compensation to a contracting entity or lessee shall only be made after a demonstrable reduction in use of the facility resulting in reduced toll or user fee revenues, and may not exceed the difference between the reduction in those revenues and the amount necessary to cover the costs of debt service, including principal and interest on any debt incurred for the development, operation, maintenance, or rehabilitation of the facility.

(j) (1) Agreements entered into pursuant to this section shall authorize the contracting entity or lessee to impose tolls and user fees for use of a facility constructed by it, and shall require that over the term of the lease the toll revenues and user fees be applied to payment of the capital outlay costs for the project, the costs associated with operations, toll and user fee collection, administration of the facility, reimbursement to the department or other governmental entity for the costs of services to develop and maintain the project, police services, and a reasonable return on investment. The agreement shall require that, notwithstanding Sections 164, 188, and 188.1, any excess toll or user fee revenue either be applied to any indebtedness incurred by the contracting entity or lessee with respect to the project, improvements to the project, or be paid into the State Highway Account, or for all three purposes, except that any excess toll revenue under a lease agreement with a regional transportation agency may be paid to the regional transportation agency for use in improving public transportation in and near the project boundaries.

(2) Lease agreements shall establish specific toll or user fee rates. Any proposed increase in those rates not otherwise established or identified in the lease agreement during the term of the agreement shall first be approved by the department or regional transportation agency, as appropriate, after at least one public hearing conducted at a location near the proposed or existing facility.

(3) The collection of tolls and user fees for the use of these facilities may be extended by the commission or regional transportation agency at the expiration of the lease agreement. However, those tolls or user fees shall not be used for any purpose other than for the improvement, continued operation, or maintenance of the facility.

(k) Agreements entered into pursuant to this section shall include indemnity, defense, and hold harmless provisions agreed to by the department or regional transportation agency and the contracting entity or lessee, including provisions for indemnifying the State of California or the regional transportation agency against any claims or losses resulting or accruing from the performance of the contracting entity or lessee.

(l) The plans and specifications for each transportation project on the state highway system developed, maintained, repaired, rehabilitated, reconstructed, or operated pursuant to this section shall comply with the department's standards for state transportation projects. The lease agreement shall include performance standards, including, but not limited to, levels of service. The agreement shall require facilities on the state highway system to meet all requirements for noise mitigation, landscaping, pollution control, and safety that otherwise would apply if the department were designing, building, and operating the facility. If a facility is on the state highway system, the facility leased pursuant to this section shall, during the term of the lease, be deemed to be a part of the state highway system for purposes of identification, maintenance, enforcement of traffic laws, and for the purposes of Division 3.6 (commencing with Section 810) of Title 1 of the Government Code.

(m) Failure to comply with the lease agreement in any significant manner shall constitute a default under the agreement and the department or the regional transportation agency, as appropriate, shall have the option to initiate processes to revert the facility to the public agency.

(n) The assignment authorized by subdivision (c) of Section 130240 of the Public Utilities Code is consistent with this section.

(o) A lease to a private entity pursuant to this section is deemed to be public property for a public purpose and exempt from leasehold, real property, and ad valorem taxation, except for the use, if any, of that property for ancillary commercial purposes.

(p) Nothing in this section is intended to infringe on the authority to develop high-occupancy toll lanes pursuant to Section 149.4, 149.5, or 149.6.

(q) Nothing in this section shall be construed to allow the conversion of any existing nontoll or nonuser-fee lanes into tolled or user fee lanes with the exception of a high-occupancy vehicle lane that may be operated as a high-occupancy toll lane for vehicles not otherwise meeting the requirements for use of that lane.

(r) The lease agreement shall require the contracting entity or lessee to provide any information or data requested by the California Transportation Commission or the Legislative Analyst. The commission, in cooperation with the Legislative Analyst, shall annually prepare a report on the progress of each project and ultimately on the operation of the resulting facility. The report shall include, but not be limited to, a review of the performance standards, a financial analysis, and any concerns or recommendations for changes in the program authorized by this section.

(s) Notwithstanding any other provision of this section, no lease agreement may be entered into pursuant to the section that affects, alters, or supersedes the Memorandum of Understanding (MOU), dated November 26, 2008, entered into by the Golden Gate Bridge Highway and Transportation District, the Metropolitan Transportation Commission, and the San Francisco County Transportation Authority, relating to the financing of the U.S. Highway 101/Doyle Drive reconstruction project located in the City and County of San Francisco.

(t) No lease agreements may be entered into under this section on or after January 1, 2017.