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September 27, 2004

Distribution to: RCC Members

Subject: Transmittal of Columbia River Crossing Project Review Draft Technical Memorandum 8.4 Use of Toll Credits as Local Match.

Attached for your review and comment is: **Review Draft – Technical Memorandum 8.4 Use of Toll Credits as Local Match.**

This Technical Memorandum has been prepared to inform project discussions about potential funding plan concepts that may be considered during formal environmental review. The Technical Memorandum documents information about the statutory and regulatory issues affecting the use of toll credits that may be earned by employing toll revenues to pay for the construction and operations of the Trade Corridor improvements, should tolling be incorporated in the finance plan.

The information in this working paper is part of our larger 2004-2005 efforts to answer planning level questions about potential project issues. If you have questions about how it fits with other technical analyses underway, please do not hesitate to contact us. We would appreciate receiving your comments on the draft document by October 6th.

Regards,

/s/ /s/
Doug Ficco, Project Director Rob DeGraff, Project Director
Washington State Department of Transportation
360-905-2023 Oregon State Department of Transportation
503-731-8461

Attachment(s)

DRAFT

I-5 Columbia River Crossing Partnership:
Traffic and Tolling Analysis

Use of Toll Credits as Local Match

Technical Memorandum 8.4

Prepared by

Siegel Consulting

Date
DRAFT – September 25, 2004

Technical Memorandum 8.4:
Use of Toll Credits as Local Match

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1. Introduction

First enacted in Section 1044 of the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA), and later modified and codified in Section 1111(c) of the Transportation Equity Act for the 21st Century (TEA-21), 23 USC 120(j) allows certain toll revenue expenditures to count as a credit toward the local matching share ("toll credit") of highway projects authorized by Title 23[1] and transit projects authorized by Chapter 53 of Title 49. Such toll credits operate as 'soft match;' they do not provide additional money for the project. But if there are sufficient federal funds and toll credits, the toll credits may permit eligible projects to be constructed with up to 100 percent federal funds.

If the Columbia River Crossing Project (the "Project") is tolled, toll credits offer important opportunities to the Project. For example, if applicable conditions are met and high capacity transit (HCT) is incorporated in the Project, the amount of toll-backed revenue bonds used to pay for highway bridge construction can serve as 'soft match' towards a federal HCT grant. If not needed to match a federal HCT grant for the project, the 'toll credits' can be divided between ODOT and WSDOT and used by the agencies as 'soft match' for other federally-funded road and transit projects within the metropolitan region, or the remainder of each state.

This Technical Memorandum describes (a) the statutory authority provided by 23 USC 120(j), and (b) issues that need to be resolved to optimize its use on the Project.

2. Earning Toll Credits

States can earn a dollar "toll credit" for each dollar of toll revenues it generates[2] and spends (actual cash outlays) for capital improvements to build, improve, or maintain of public highways, bridges, or tunnels that serve interstate commerce; provided that certain conditions are met.[3] Toll-credit-earning expenditures can include (a) preliminary engineering or right-of-way acquisition for upcoming construction projects and (b) initial

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[1] However, toll credits can not be applied to FHWA emergency relief program funds.

[2] The revenues may derive from toll receipts, concession sales, right-of-way leases, interest earnings, or bond or loan proceeds that are backed by these toll-relatd revenue streams. State grants to toll faclities cannot be used in calculating earned toll credits.

[3] 23 USC120(j)(1) Eligibility. A State may use as a credit toward the non-Federal share requirement for any funds made available to carry out this title (other than the emergency relief program authorized by section 125) or chapter 53 of title 49 toll revenues that are generated and used by public, quasi-public, and private agencies to build, improve, or maintain highways, bridges, or tunnels that serve the public purpose of interstate commerce. Such public, quasi-public, or private agencies shall have built, improved, or maintained such facilities without Federal funds.

construction of the toll facility, provided these costs are to be repaid with toll revenues. However, expenditures for such items as routine maintenance work (i.e., snow removal, mowing), debt service, and the costs of collecting tolls do not earn toll credits.

Toll credit-eligible expenditures are based on when the actual expenditures are made regardless of when the toll revenue is generated. For example, when capital construction funds are raised through toll revenue-backed bonds, the actual expenditure of bond proceeds represents the amount used in determining the amount of earned toll credits. [4]

3. Eligibility Requirements

3.1 No Use of Federal Funds

To count as an earned toll credit, an expenditure of toll revenues must be for improvements paid entirely without Federal funds. The improvements can be on facilities which have had prior Federal funding. This requirement may have great significance in structuring an overall funding plan for the Project; as discussed in Section 7 of this Technical Memorandum.

3.2 Maintenance of Effort (MOE)

Toll credits can only be earned in years that the State satisfies the "maintenance of effort" (MOE) requirement.[5, 6] The MOE requirement seeks to ensure that the State does not use the toll credits to lower the amount of non-Federal funds it spends on transportation programs; including projects wholly funded by the State plus the State's shares of all federally funded highway projects. At the State's option, the calculation can also include expenditures by tolling entities or local governments for highways, or expenditures by the State or local governments for transit systems. However, if the State wishes to employ these options, it must do so in the first and all subsequent MOE determinations.

To be eligible for toll credits, the non-Federal transportation expenditures by a State in the last year of the 4-year period must exceed the annual average of such expenditures in the preceding three years of the 4-year period.[7] States are offered several options on how

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[4] Toll Credit for Non-Federal Share Section 1111(c) of TEA21 Implementing Guidance; August 7, 1998

[5] 23 USC 120(j)(2)(A) In general. The credit for any non-Federal share provided under this subsection shall not reduce nor replace State funds required to match Federal funds for any program under this title.

[6] Toll Credit for Non-Federal Share Section 1111(c) of TEA21 Implementing Guidance; August 7, 1998

[7] 23 USC 120(j)(2)(B) Condition on receipt of credit. - To receive a credit under paragraph (1) for a fiscal year, a State shall enter into such agreement as the Secretary may require to ensure that the State will maintain its non-Federal transportation capital expenditures in such fiscal year at or above the average level of such expenditures for the preceding 3 fiscal years; except that if, for any 1 of the preceding 3 fiscal years, the non-Federal transportation capital expenditures of the State were at a level that was greater than 130 percent of the average level of such expenditures for the other 2 of the preceding 3 fiscal years, the

to make this calculation. However, once a State selects an Option, it must continue to use this same Option in all subsequent MOE determinations. Options include:

- Option 1: uses the 4 years prior to the year for which a toll credit is being determined. For example, if a toll credit is to be earned for FY 2005, Option 1 would compare FY 2004 expenditures with the annual average expenditures for FYs 2003, 2002 and 2001.

- Option 2: uses the 4-year period beginning three years prior to the year for which a toll credit is being determined with the fourth year being the year the credit is earned. For example, if a toll credit is to be earned for FFY 2005, Option 2 would compare FY 2005 expenditures with the annual average expenditures for FYs 2002, 2003 and 2004.

- Option 3: uses the 4-year period beginning 2 years prior to the year for which a toll credit is being determined and extending through the year after the year of toll credit determination. For example, if a toll credit is to be earned for FY 2005, Option 3 would compare FY 2006 expenditures with the annual average expenditures for FYs 2003, 2004 and 2005.

Option 1 uses only historic data on the use of non-Federal dollars to determine the eligibility of earning toll credits. However, Options 2 and 3 depend on expenditures of non-Federal dollars in the current year and/or future year. Thus, Options 2 and 3 are inherently riskier than Option 1, since with Options 2 and 3 the project budget depends on a determination made after the toll credits are budgeted. Should a State not meet the current or future expenditure levels required under Options 2 or 3 and, thereby, fail to certify that MOE has been met; the use of toll credits would be lost for that year and the State would have to plug the unanticipated gap with actual State revenues.

23 USC 120(j)(2)(B) offers states a variation that can be applied with any of the Options described above -- the "*Two-year rule.*" Normally, MOE compares the fourth year of a 4-year period against the average of the three previous years. Under the *Two-year rule*, if any one of the three previous years exceeds the average of the other two years by 130 percent, then the higher year can be dropped from the 3-year average computation and instead the average is based on only two years. This eliminates the possibility of not earning toll credits due to a one-year spike in State transportation expenditures.

It should be noted that the MOE determination only needs to be satisfied for the year in which the State earns the credit amount. Once a credit amount is established, it can be applied whether or not the State satisfies the MOE determination in later years.

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agreement shall ensure that the State will maintain its non-Federal transportation capital expenditures in the fiscal year of the credit at or above the average level of such expenditures for the other 2 fiscal years.
23 USC 120(j)(2)(C) Transportation capital expenditures defined. In subparagraph (B), the term "non-Federal transportation capital expenditures" includes any payments made by the State for issuance of transportation-related bonds.

Additionally, toll credits remain available until used by the State, they do not lapse after a period of time.

4. Steps in Earning Toll Credits

There are essentially five steps in earning toll credits:

1. State spends toll funds (and no Federal funds) on capital roadway improvements serving interstate travel.

2. State submits to FHWA Division office a request to count toll expenditures (from Step 1) as toll credits and the certification and documentation that MOE requirements have been met. The Division reviews the request for conformance with the credit provision requirements and then forwards it to Headquarters for approval action.

3. FHWA determines whether the State meets requirements [8] and, if appropriate, approves MOE and toll credits for later use.

4. State establishes a special account to track toll credits.

5. Credit remains available until used by state.

5. Steps in Using Toll Credits

In general, a State may begin use of toll credits once a credit amount has been approved by the FHWA. However, it is possible to receive conditional authorization to use anticipated toll credit, subject to a State providing appropriate credit and MOE certifications and their subsequent acceptance by the FHWA.

The use of toll credits is initiated at the time Federal funds are authorized for a project. Toll credits cannot be applied to projects after project authorization. A request to use toll credits on a specific project must be submitted to the Federal agency (i.e. FHWA, FTA) administering the project. A State has the option of using amounts of toll credit to cover all or a portion of the non-Federal share of a project. The effective Federal share established at the time of project authorization must be used throughout the life of the project.

There are essentially five steps in using toll credits:

1. State identifies candidate project(s) for application of toll credits.

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[8] If a State decides to use Options 2 or 3, expenditure data may not be available at time of the request. In this case, the State's submission will not include a "certification" covering the MOE but instead merely be a request to use either Option 2 or 3. The MOE certification will subsequently be made by the State once the time period involved has transpired and the actual expenditures are known.

2. State determines the amount of credit applied to project(s).

3. Credit is debited from state's account when project agreement is executed.

4. State submits billings for progress payments and toll credits applied as non-Federal share.

5. FHWA reimburses Federal share according to project agreement.

6. Application of Toll Credits: Case Examples

Toll credits are being used extensively by states with toll facilities. At the end of FY 2001, 20 states had accumulated $9.2 billion in toll credits. The credits are being applied in a variety of ways, depending on the state's needs.

For example, Missouri reserves its toll credits for situations where project matching funds are unavailable in order to increase Federal funding to 100 percent of project costs. Ohio uses toll credits as a match on GARVEE projects and also shares its toll credits with local government agencies for highway and transit projects. The Florida DOT uses toll credits on almost every new Federal-aid project, so that most of its Federal highway program funds are 100 percent Federally-funded.

Washington has a toll credit program that is fueled by revenues from its ferry system. Among other uses, the Highway and Local Program division of WSDOT is using about $85 million in toll credits over ten years to match Federal funds for bridge projects, and an additional $85 million to match Federal funds on other local projects.

7. Issues and Opportunities for the Columbia River Crossing Project

Tolling the Columbia River bridges (I-5 and I-205) is an option that may be considered in the environmental impact statement for the project. To date, there have not been any decisions to incorporate tolling, or, if one or both bridges are to be tolled, the amount of tolls. But if tolling is incorporated in the Project and applicable requirements are met, [9] the use of toll credits may become an essential element of the financial plan for the Project.

If federal funds are not used to pay a portion of the construction costs for a new bridge or rehabilitation of the existing bridge, toll credits will be earned upon issuance and, initially, in the amount of the toll revenue-backed construction bonds. This would be a sizable asset. But its availability depends, in part, on ensuring that the prohibition for using Federal funds on the project earning toll credits is met.

This raises several issues, which need to be worked-out with FHWA and FTA:

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[9] This section will assume that MOE requirements can be met.

- Issue 1: The DOT's should work with FHWA and FTA to ensure that the use of Federal funds for environmental impact statement (EIS) activities and preliminary engineering (PE) do not make toll revenue bond proceeds used for Project construction ineligible for earning toll credits. This raises the following sub-issues:

  1.1 Due to the potential importance of toll credits to an overall finance plan for the Project, the use of Federal funds may only make sense if there is a high likelihood of very significant amounts of Federal discretionary highway funds; such that the anticipated amount of Federal grants justifies the loss of the toll credits. Thus, if the use of Federal funds for EIS and PE activities impairs the ability to earn toll credits for the toll revenue-backed construction bonds, there may be a need to (a) determine an alternative funding strategy for PE and EIS, and (b) modify the DOT's approach to reauthorization bill requests.

  1.2 If Issue 1.1 proves to be a problem, the use of a borrowing strategy should be reviewed with FHWA and FTA. In lieu of discretionary Federal grants expressly for Project EIS and PE activities, it may be worthwhile to seek discretionary highway funds for the State Infrastructure Bank (SIB) or a similar financing mechanism. Such funds could be loaned to the Project to be repaid with toll revenues if and when tolling is instituted for the Project. It appears that this approach avoids the prohibition of earning tax credits, yet permits Federal funds to indirectly cover PE and EIS costs.

- Issue 2: If Federal funds can be made available for highway improvements in the Project corridor, it may be possible to define the overall highway improvement program in terms of multiple projects with 'independent utility' and 'logical termini' rather than one single project. By doing so, some projects can be solely funded with toll revenues and retain their ability to earn toll credits, while the remaining projects can be wholly or partially Federally-funded. For example:

  - Under Option A, there is one project consisting of a $100 million highway segment and a $50 million interchange. The funding plan for Option A consists of a $100 million toll revenue-backed bond and a $50 million Federal grant. Because the project is formulated as one project and includes Federal funds; no toll credits would accrue to the State.

  - Under Option B, the exact same project elements are to be constructed at the same costs shown for Option A, but it is demonstrated that the two project elements have independent utility and logical termini of their own. Therefore the project elements can be developed as two separate projects; rather than as one integrated project. Given the same funding as in Option A, the $100 million highway segment can be paid entirely with toll revenue-backed bonds, allowing $100 million in toll credits to accrue to the State. Assuming an 80/20 match ratio on the Federal funds, $12.5

million of the toll credits can be used to match the $50 million Federal grant to pay for the interchange. Thus both project elements could be built – but, in addition, $77.5 million of toll credits would remain to match other projects in Oregon and Washington. Thus, Option B would be a far superior approach than Option A.

This raises the following sub-issues:

2.1 The DOTs should work with FHWA to determine if and to what extent the Project alternatives can be divided into separate projects for the purpose of retaining toll credit flexibility.

2.2 The DOTs should work with FHWA to determine if addressing the entire Project in a single EIS impairs the ability to later divide the Project into multiple independent projects for toll credit purposes, and, if so, determine if and how that affects EIS and project development activities.

- Issue 3: If (i) HCT and tolling are incorporated in the Project and (ii) tolls cannot be used directly to pay the construction cost of the HCT component, toll credits may be required to cover the local match requirements. For example, if (i) the HCT component costs $500 million and (ii) a 50/50 match ratio is employed[10], $500 million in toll credits (earned when toll-backed construction bonds are issued for the highway/bridge component of the Project) can match $500 million in Section 5309 'New Start' funds [11] to pay for the construction of the HCT component. This raises the following sub-issues:

  3.1 Issues regarding dividing the HCT component and highway/bridge component of the Project need to be addressed as discussed in Issue 2.

  3.2 The timing impacts of the HCT component relative to the highway/bridge component needs to be resolved with FHWA and FTA. In particular, the DOT's need to determine if there is a need to stagger the construction of the two components in order to first earn sufficient toll credits to use on the trailing HCT component.

[10] The 50/50 match ratio would allow for a medium-high financial rating under FTA's fixed guideway project assessment methodology.

[11] Section 5309 funds are FTA discretionary funds authorized for use on fixed guideway projects.