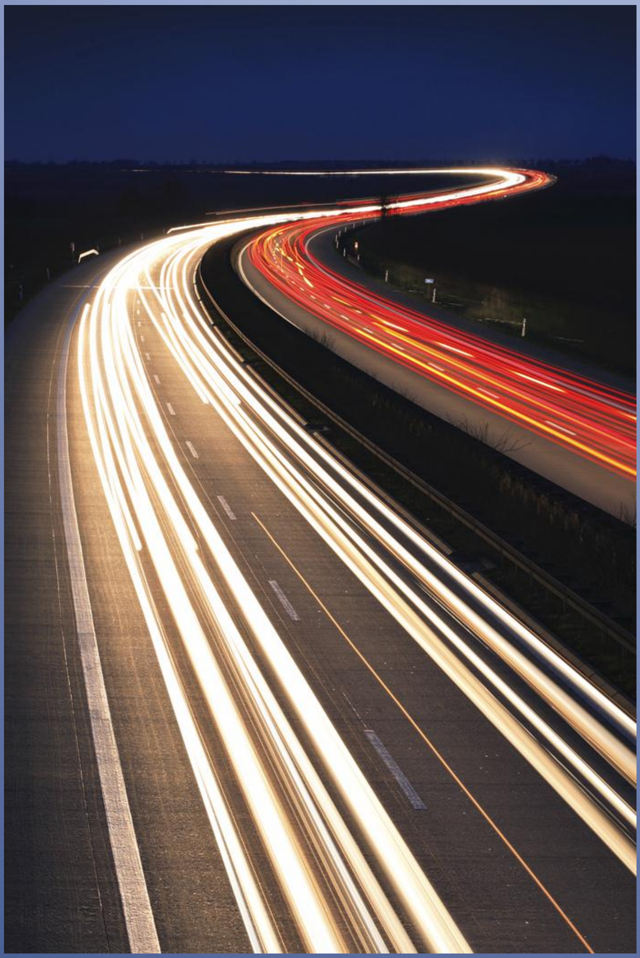

Eight Questions to Ask About the Future of the Ohio Turnpike

What the Public Needs to Know

The State of Ohio recently spent $2.85 million to commission KPMG to analyze different possibilities for borrowing against future toll revenue to the Ohio Turnpike, including privatization. Will the study fairly portray the state's options with the downsides and upsides? Here the Ohio PIRG Education Fund presents the eight questions Ohioans most need to ask.

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What the Public Needs to Know

Ohio PIRG Education Fund

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With public debate around important issues often dominated by special interests pursuing their own narrow agendas, Ohio PIRG Education Fund offers an independent voice that works on behalf of the public interest. Ohio PIRG Education Fund, a 501(c)(3) organization, works to protect consumers and promote good government. We investigate problems, craft solutions, educate the public, and offer Ohio residents meaningful opportunities for civic participation. For more information about Ohio PIRG Education Fund or for additional copies of this report, please visit www.ohiopirgedfund.org.

Executive Summary

On November 22, 2011, the Ohio Office of Budget Management and the Ohio Department of Transportation commissioned the consulting firm KPMG Corporate Finance to analyze financing options, including privatization, for the Ohio Turnpike. Privatization schemes would effectively raise money for current transportation funding by borrowing against decades of future tolls to be paid by drivers on the Turnpike. KPMG will be paid $2.85 million by the state to produce the report.

Ohio Governor John Kasich has touted privatization plans as a possible way to fund roadway projects around the state that have been stalled by deep budget cutbacks he signed to highway and bridge construction. Governor Kasich has said that decisions about potentially privatizing the Ohio Turnpike will depend on the results of the KPMG report.

Ohioans must make sure that eight basic questions have been fully addressed to ensure that fair comparisons are made and hidden costs are considered:

1. How much of the additional money that would be generated through privatization is the result of higher tolls, and how much from measures expected to result in more efficient operations? In other words, how much smaller would the payout likely be if tolls did not rise?

2. How would the value of an upfront cash payment from a lease compare to the value of revenue that would be forgone if the state charged *the same toll rates* as a private operator would be allowed to charge? In other words, could the state raise the same amount of money if it were willing to raise tolls as fast as the private operator?

3. Are the same cost-saving measures included in each proposal, and if not, then why? In other words, what's stopping the state from introducing the cost-saving measures it anticipates a private operator would make?

4. Will there likely be language in a lease with a private toll road operator restricting improvements to parallel and competing roadways? The Indiana Toll Road included these kind of "non-compete" clauses.

5. How might the threat of paying compensation or other prohibitions in the contract constrain Ohio from pursuing policies it would otherwise advance for public benefit?

6. What downsides might result if higher tolls divert traffic onto secondary roads and local communities?

7. What additional costs would the state of Ohio likely incur to pay for professional services or in-house expertise to negotiate, monitor, enforce and litigate its privatization deal?

8. What information would be restricted from the public as a result of a private operator claiming proprietary privileges on information about its operation and finances for public structures?

Given the gravity of long-term decisions about the Turnpike, it would be foolhardy to move forward with a proposal simply because a consulting company was not required to examine the relevant questions, because short-term budget gaps needed filling, or because a number of listening meetings were already conducted. Ohioans should ensure that these eight questions are fully addressed before agreeing to privatize the Turnpike or borrowing against its future proceeds.

Ohio Turnpike Basics

The Ohio Turnpike is well-regarded as one of the best kept and most financially stable toll roads in the country. It is currently maintained by the Ohio Turnpike Commission, a government agency separate and independent from the Ohio Department of Transportation. Officially the James W. Shocknessy Ohio Turnpike, it connects the Indiana Turnpike and the Pennsylvania Turnpike and consists of I-76, I-80, and I-90. Its 241 miles of highway pass through cities such as Toledo, Elyria, Akron, Cleveland, Elyria, and Youngstown and provides passageway between Chicago and Pittsburgh. Per-mile toll rates on the Ohio Turnpike are some of the lowest in the Midwest and Northeast regions, a little more than half the rates of those in New Jersey. Nonetheless, the Turnpike earned $251.4 million in total revenue in 2011 and is projected to earn a record $270 million this year. The Turnpike's steady income is a primary reason for its strong credit rating. Under current Ohio law, revenue from the Turnpike may not finance projects more than one mile from the Turnpike's borders without special permissions.

Sources: Ohio Turnpike Commission Comprehensive Annual Financial Report for the Year Ending in December 31, 2011, page 18; Ohio Turnpike Commission, "The Ohio Turnpike Toll Rates –Midwest—Northeast Corridor," and "General Frequently Asked Questions, The Ohio Turnpike Commission, ohturnpikeanalysis.com; Tom Breckenridge, "Ohio Turnpike Director Favors Using Toll Revenues for Projects beyond the Toll Road," *Plain Dealer* (August 22, 2012).

Introduction

On November 22, 2011, the Ohio Office of Budget Management and the Ohio Department of Transportation commissioned the Texas-based consulting firm KPMG Corporate Finance to produce a report analyzing different options for the future of the Ohio Turnpike.[1] The report is expected to detail a number of possible financing methods that could be used to effectively borrow against decades of future tolls that will be paid by drivers. KPMG will be paid by the state $2.85 million to produce the report.[2] An additional $550,000 was approved for two law firms who are part of the advisory team led by KPMG, increasing the total cost of this report to $3.4 million.[3]

Governor Kasich has touted these plans as a possible way to fund roadway projects around the state that have been stalled by deep budget cutbacks to highway and bridge construction the Governor signed. The transportation budget for highway and bridge construction projects was cut from $317 million in 2011, to $60 million in 2012 and $123 million in 2013.[4]

The Governor has suggested that the KPMG-commissioned report should provide the basis for decision-making about the Turnpike moving forward. But will it provide a fair and complete consideration of alternatives? This white paper provides a list of some considerations that are necessary for a truly well-informed and fair assessment of those choices. If this information is excluded from the KPMG-commissioned analysis, then Ohioans should ensure that these questions are fully addressed before agreeing to privatize the Turnpike or borrowing against its future proceeds.

Are alternative proposals to privatization fully considered?

KPMG's latest update on the report's progress clarified three possible recommendations as the focal points of its report: leaving the Turnpike as-is under a newly established commission; putting the Ohio Department of Transportation in charge of the Turnpike; or privatizing the Turnpike by signing a long-term lease with a private company.[5] In making these comparisons, it must be clear whether new revenue leveraging or savings in one proposal could also be obtained in other proposals.

If elected leaders determine that the state should not finance current transportation investment with current tax revenues and federal aid, then Ohio has a variety of options available. States use a variety of methods to finance long-term transportation infrastructure. States traditionally raise long-term capital at low interest rates by issuing bonds. Bond buyers are willing to accept very low interest rates to purchase state bonds because states can't declare bankruptcy and the interest that states pay to bond holders is tax-free income. When the Ohio Turnpike Commission has raised capital for major repairs and new investments, it has similarly issued bonds. States have other ways to cheaply finance long-term infrastructure projects, such as federal programs to issue long-interest bonds by borrowing against future federal gas tax revenue that will be received by the state.[6]

Privatizing a toll road does not unlock new value.[7] In Chicago and Indiana, turnpike privatization was accompanied by increased toll rates and legal commitments to continue increasing the toll rates that drivers will pay for decades into the future. This represents a redistribution of income from drivers on the Turnpike to the state with the private toll operator as the middleman. If a toll road concession includes an upfront balloon payment to the state, then money is generated by borrowing from future revenue. Like taking out a second mortgage on a house, it may make sense but it should not be confused with creating new value.

Governor Kasich's administration has suggested some other changes to the Turnpike that might reduce costs or be more efficient in collecting additional revenue for the state. For instance, the administration has discussed converting some or all toll booths currently staffed by public employees to electronic tolling booths. The administration has also discussed increasing tolls, shutting down some maintenance facilities, and allowing greater commercial use in rest areas.[8] These measures could be taken by the current Turnpike Commission, or a new commission. They could also be completed by the Turnpike under the control of the Ohio Department of Transportation, or under a privatized long-term lease of the Turnpike. It would be misleading to compare the benefits that one Turnpike option could reap from these options without also considering the benefits the other options could gain from the same measures.

Thus, the KPMG-commissioned study should be crystal clear about how new capital would be generated or savings obtained. Specifically:

1. How much of the additional money that would be generated is the result of higher tolls, and how much is from projected saving from enactment of more efficient operations? In other words, how much smaller would the payout be if tolls did not rise?

2. How would the value of an upfront cash payment from a lease compare to the value of the revenue that would be forgone over time if the state charged *the same toll rates* as a private operator would? In other words, could the state raise the same amount of money if it were willing to raise tolls as fast as the private operator? If

there are benefits to borrowing against future tolls in order to finance immediate spending or to create dedicated funds for specialized purposes, then those options should be explored under each option for reorganizing the Turnpike, not just one.

3. Are the cost-saving measure in one proposal also included in other measures, and if not, then why?

Are the hidden downsides of privatization considered?

Privatization of toll roads in other states has created downsides that were not fully anticipated beforehand. Private toll road contracts typically protect their returns by guaranteeing that the public will compensate the private operator if policies end up indirectly reducing its profits. Pressure to avoid these "compensation events" as well as outright prohibition of certain policies in private toll road contracts can reduce public control over transportation policy. Loss of public control can be particularly painful if privatization deals lock in toll hikes that divert traffic in ways that harm local communities. Privatization will also create additional state costs to negotiate, monitor, enforce and litigate these ongoing agreements. Private companies typically refuse to publicly disclose the same information about their finances that public entities do, claiming that information is a "proprietary business secret." The KPMG-commissioned report should explore these risks and additional costs in the context of Ohio.

It's no mystery why private investors in toll road concessions want their contracts to include special measures protecting their revenue or requiring the state to compensate them if policies end up reducing the volume of toll-paying traffic or requiring new investments in road safety.[9] For instance, the state of Indiana had to reimburse the private operator $447,000 for waiving toll collections to assist in evacuations from flooding in September 2008.[10] The Indiana Toll Road contract also forbids construction or improvement of new transportation infrastructure within ten miles of the toll road. These kinds of prohibitions and compensation will become a bigger issue as economic development proceeds during the decades that private toll road leases typically last. Chicago's parking privatization, which contains similar clauses, recently led the private operator to file for $200 million in compensation from the city because city planners had approved parking in a new high-rise apartment building. The state of Texas recently agreed to increase its speed limit to 85 mph on a leased toll road and it decreased the speed limit on competing public roads because failure to do so would have meant reduced funds from the private toll road operator. The KMPG-commissioned report should identify the kinds of provisions and additional costs that investors are likely to request in a privatization contract.

According to their contract with the state, KMPG's report must discuss one form of hidden costs: the impact upon parallel routes. This is important because what happens on a crucial transportation artery such as the Turnpike greatly influences traffic on other routes. The introduction of higher tolls is likely to divert truck traffic and other cars onto secondary roads as drivers seek to avoid those steeper levies. An academic study by researchers at

Penn State and Wayne State universities studied earlier toll and traffic patterns in Ohio and found toll increases on the Turnpike led to significant diversion of trucks into local towns where they clog local traffic and deteriorate local roads.[11] When toll road rate hikes create problems on publicly operated highways, public officials can then choose to reduce the toll rates, if necessary. On private toll roads, by contrast, the schedule of future toll hikes is locked in for many decades into the future. The authors of the study suggest that additional safety problems would likely result from a private toll concession and criticized privatized tolling for not considering the indirect public problems created by toll hikes.

Provisions in privatization contracts require careful negotiation and subsequent monitoring enforcement and litigation. The state of Ohio has already started down this road by paying $3.4 million to KPMG and other consultants. If they proceed, they will need to hire lawyers, accountants and analysts to conduct asset valuation, performance monitoring, and contract enforcement. Goldman Sachs was paid $20 million for financial advice on the Indiana privatization deal and $9 million for the Chicago Skyway deal.[12] Information is not available on what additional public costs have been incurred since the privatization leases began.

Lack of public information can be its own hidden cost of privatizing the Turnpike. Private toll road operators and their lawyers typically argue that their own analysis, information about operations, and financial outcomes are “proprietary” business secrets. Proprietary rules prevent full public review of the process and undermine both transparency and the opportunity for full public participation.[13]

Thus, in order to take consideration of the indirect effects of privatizing the Turnpike, the KPMG-commissioned report should provide analysis on five additional questions:

4. Will there likely be language in a lease with a private toll road operator restricting improvements to parallel and competing roadways? The Indiana Toll Road privatization includes these kinds of “non-compete” clauses.

5. Will potential contractual prohibitions or the threat of paying compensation constrain Ohio from pursuing policies it would otherwise advance for public benefit?

6. What downsides might result from locking in decades of future toll increases if higher tolls divert traffic onto secondary roads and local communities? These downsides are likely to include local traffic congestion, harm to local roads, additional accidents, and potential air-quality problems.

7. What additional costs would Ohio incur to pay for professional services or in-house capacity to negotiate, monitor, enforce and litigate its privatization deal?

8. What information would be restricted from the public as a result of a private operator claiming proprietary privileges on information about its operation and finances for public structures?

Final Considerations

The KPMG-commissioned report will be just one step toward a full consideration of choices for whether or not to reorganize the Ohio Turnpike and its finances. A long-term deal lasting several decades that would govern the most crucial infrastructure in the state would be a monumental decision that requires full consideration of these and other questions. Our grandchildren would find themselves governed by the contract that the state would now decide, perhaps with budget problems compounded because we already borrowed against the higher tolls that they will be forced to pay.

Given the gravity of these choices, it would be foolhardy to move forward with a proposal to privatize the Ohio Turnpike simply because a consulting company was not asked to examine the relevant questions, because money was needed for a short term budget, or because a number of listening meetings were already conducted. The answers to the eight questions in this report must be absolutely clear before any long-term decisions are taken.

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[13] James L. Oberstar and Peter A. DeFazio, *Public Interest Concerns of Public- Private Partnerships*, Position Paper by the Chairmen of the House Committee on Transportation and Infrastructure and the Subcommittee on Highways and Transit, 4 June 2007, Transportation. house.gov/Media/File/press/ppp%20guidelines%20veritas.pdf, 7. See also In the Public Interest, *Floodlights Instead of Flashlights: Sunshine Laws Out of Step with Government Contracting Leaves Public and Lawmakers in the Dark*, (March 2012) available at http://www.inthepublicinterest.org/article/floodlights-instead-flashlights-sunshine-laws-out-step-government-contracting-leaves-public-