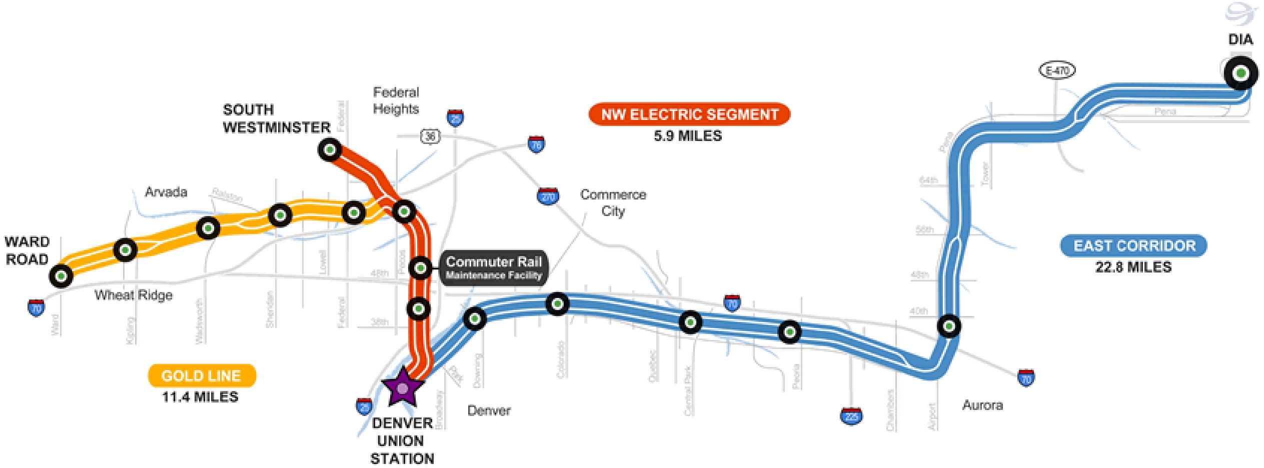
Finance: The Crucial Component of Multi-Faceted Rail Contracts

By Rich Sampson



The practice of combining the various aspects necessary to deliver a passenger rail project from planning to reality has become increasingly common over the past few decades, as public agencies and private entities have worked together on Design, Build, Operate and Maintain (DBOM) contracts. These multi-faceted agreements allow public investment to be more greatly leveraged by working with a single private firm or consortium, reducing overhead and administrative costs and utilizing an integrated stream of products, suppliers and sub-contractors. Such arrangements also reduce project timelines and speed-up rail service by eliminating time-intensive hand-offs between companies and realizing a holistic timeframe for all of the project's phases. The private sector also benefits, by guaranteeing a steady line of work across the firm or consortium's areas of expertise, allowing for stable employment and more predictable budgets.

Today, another element of combined project contracts through public-private partnerships is emerging: the integration of a financing component, expanding the concept to DBOM-F. The rationale for including private sector financing is easy to grasp. The economic downturn of recent years has led to a dearth of public investment – at all levels; federal, state and local – unparalleled since the beginning of the resurgence of passenger rail in the late '70s and early '80s. And where public investment does exist for a new or expanded passenger rail project, it often falls short of the full costs needed to move forward.

Although the public's interest in leveraging outside financing is intuitive, the motivation for private sector to support passenger rail projects is less obvious. After all, very few passenger rail operations generate profits through their operations alone; their ultimate value is in driving economic development, supporting commuting and travel for business and providing mobility for entire communities and regions, although certain high-speed rail corridors and automated heavy rail transit operations can achieve profitability. In this context, the private sector assumes significant risk in providing up-front capital investment for passenger rail projects. Their incentive therefore resides either in any

long-term operating profits the system may be able to produce, or realizing the interest returns when public sector bonds are repaid at or before maturity – thereby recouping their initial capital over many years and decades.

The result is a financing strategy that has found only limited applications in the North American arena to date. The first such endeavor was the Hudson-Bergen Light-Rail system in Jersey City and Hoboken, N.J. The 21st Century Rail Corporation was formed as a consortium between URS' Washington Division, Itochu Rail Car and Kinkisharo USA to deliver a DBOM-F contract. Parsons Brinckerhoff, Booz Allen Hamilton and Nossaman, Guthner, Knox & Elliott, LLP, also had advisory and consulting roles in the effort. The DBOM-F structure provided for a drastically reduced project timeframe: eight years shorter than initial estimates, made possible through upfront capital financing through 21st Century Rail, which then realized millions of dollars in savings over the course of the project. Today, the Hudson-Bergen Light-Rail network carries more than 43,000 daily riders over a 20.6-mile system, and is poised to expand further north in coming years on the Northern Branch Corridor Project. *(For full details on Hudson-Bergen Light Rail, see our feature article in RAIL #3 – ed)*

"This approach is one of those rare times where you see a complete shift in how things are done," says Gary Schulman, Vice President of Booz Allen Hamilton. "Through our work on the Hudson-Bergen project, we helped transform the norm to create a more streamlined, accelerated approach. This was essential in helping New Jersey Transit meet changing expectations."

The most substantial DBOM-F effort currently underway in passenger rail is the Eagle P-3 Project in the Denver, Colo., metropolitan region. With an ambitious agenda to construct two new, electrified commuter rail lines connecting downtown Denver with Denver International Airport and suburbs to the west of Denver – along with a maintenance facility – as part of the region's FasTracks capital infrastructure program, the Regional Transit District(RTD) selected Denver Transit Partners (DTP) to execute its Eagle P-3 DBOM–F project in 2010. DTP is providing a total of $1.3 billion in financing to support the $2.1 billion project through the 40-year contract period. While DTP assumes more than a billion dollars in initial risk, it also will receive a total of $7.1 billion in payments from the RTD throughout the contract to operate and maintain the system once completed, which benefits the consortium as capital costs end once construction is completed and operating and maintenance costs become predictable and consistent. The two lines are expected to open for service in 2015 and 2016, respectively. *(For more information on Denver's FasTracks and Eagle P-3 projects, see our feature article in RAIL #28 – ed)*

"We had a ballot measure in 2004 which authorized a sales tax sales increase," Eagle P3 Project Director Brian Middleton told Daily Finance Magazine. "And we have got $450 million of private debt and equity to support the project as well. It's a combined funding and financing model -- not unusual elsewhere in the world, but this is unique in the transit environment here in the U.S. In capital cost savings, we've saved about $300 million. So we're actually taking advantage of a very good bidding environment, because lots of people are hungry for work. We're able to get better prices than we would have, if we waited a couple of years."

While large passenger rail transit projects offer opportunities for more DBOM-F structured contracts, the concept's most promising application is likely in high-speed rail corridors. After capital costs are assumed, most high-speed rail corridors – and even many frequent and reliable conventional intercity routes – can realize profits in their operations. Already, Amtrak's *Acela* high-speed service on the Northeast Corridor operates in the black in terms of revenue, despite lacking true high-speed rail amenities. But these corridors require massive capital expenditures necessary to construct their infrastructure, often reaching tens or hundreds of billon dollar figures. With significant constraints on public investment for high-speed rail infrastructure, the private sector may find an important role in providing some of that capital investment in exchange for the ability to collect revenues from high-speed operations over a long-term timeframe.

Although Florida Governor Rick Scott ultimately cancelled the high-speed rail project that would have linked Orlando and Tampa due to what he explained would be unsustainable operating deficits in its early years, many fiscal analysts believed the state would have had no trouble attracting private-sector financing to assume those initial deficit risks if they could have collected some or all of the network's operating revenues over several decades after. This model for private financing of high-speed rail infrastructure in exchange for access to future revenue streams may serve as a viable approach to other such projects in North America, in corridors including California, the Northeast Corridor, Quebec-Ontario and elsewhere.

"I met recently with one of the leading Japanese entrepreneurs in passenger rail service," said U.S. Representative John Mica when Florida's high-speed rail project was still under consideration. Mica represents Florida's seventh congressional district and is the Chairman of the House Transportation and Infrastructure Committee. "They're willing to put up huge amount of investment. They're there to gain a return on their investment. That's a great motivator."

While the inclusion of financing elements into the more established DBOM framework is only recently emerging as an option, it is one that more communities and regions may explore in coming years, especially if public investment streams remain scarce. The concept is one whereby the interests of the public – initiation of new or expanded passenger rail service on a shorter timeframe at lower costs – complement the motivations of private firms and consortiums to realize profits and guarantee future work in exchange for some assumption of risk. This produces more mobile communities, responsible and efficient project delivery and healthy prospects for returns in an important sector of our national and regional economies.