July 17, 2007

Dear Doug,

OTIG appreciates the opportunity to respond to the Bear Stearns Review. OTIG welcomes such a review of the financial feasibility analysis of the Project and believes that such a review can provide additional validation and clarity to a complex subject.

In many areas of the review Bear Stearns is fundamentally in agreement with OTIG’s report. In particular Bear Stearns does agree with OTIG that Bypass-only tolling generates insufficient revenue to fund the Project under the current project scope.

There are however several areas in which Bear Stearns makes recommendations which are not consistent with the analysis in OTIG’s report.

The most disagreeable part of Bear Stearns review is their selection of the full “Corridor Tolling” option (tolling all trips made on both the Bypass and Highway 99W) as the “recommended” way forward for the project and their comparison of the OTIG model under this option with their “public sector comparator”

As was made clear in our meeting on May 10, full Corridor Tolling was not considered a viable option by ODOT, OTIG or local stakeholders. Bear Stearns have provided no supporting information on the viability of this option under a public sector funding model and appear to use it simply to try to discredit a concession model.

After our extensive involvement in and consultation with the stakeholder’s involved in this Project, we do not believe that selection of this option by Bear Stearns and presentation of potentially spurious results without detailed supporting evidence will do anything to enhance the quality of public debate on the Project.

Bear Stearns should provide more support for their assertion that the project could be 100% debt financed on the basis of full Corridor Tolling and detail how the large number of risks of the project on this basis would be addressed.

We provide our high level comments and rebuttal in the attachment to this letter. We also provide a marked up copy of Bear Stearns Review
proposing language which is more accurate, appropriate and better serves ODOT’s objectives.

We hope that ODOT will address and rectify these issues with Bear Stearns.

Yours sincerely,

**Oregon Transportation Improvement Group**

Nicholas Hann  
Project Manager
II. Tolling System

1. Bear Stearns states:

“Tolling technologies have made significant advances over the past decade, and revenue enhancement from innovative tolling applications such as time of day pricing may be important to bridging any feasibility gap for the Project.”

Time of day pricing would not materially impact the financial feasibility of Bypass-only tolling nor make it a financially feasible option. The results of OTIG’s time of day pricing analysis for the corridor tolling options were summarized in Section 3.4.11.5. OTIG reached the conclusion in consultation with ODOT that the peak tolls required to fund the project under corridor tolling would not be publicly acceptable and therefore were not pursued.

2. Bear Stearns states:

“For the Bypass Only tolling option, OTIG considered both distance tolling and point tolling. In Bear Stearns’ view, only point tolling makes practical sense for this proposed facility. In order to implement distance tolling, OTIG would be required to either have full video tolling capability or manned toll facilities at each point of access and egress to the road. This does not seem justified by the traffic volumes on the Project.”

OTIG was requested to examine a full range of options with respect to Bypass tolling, specifically point and distance tolling, and avoid providing a recommendation in favor of either option. OTIG agrees that the length of the Bypass and the relatively low traffic volumes do not justify the additional complexity and cost of distance tolling. However, OTIG believes that a transponder based system, which is more cost effective than video or manned tolling, would fulfill the technical requirements to implement a distance toll based system. Video tolling would only be utilized for enforcement purposes, and would be necessary for both point and distance tolling.

3. Bear Stearns states:

“For the Newberg-Dundee Bypass, Bear Stearns is of the opinion that it may be impractical for all users to have installed transponders. Unlike the SR 91 project, where few customers reside outside of the service area, the Newberg-Dundee Project will have a significant number of “visitor” trips, making the marketing of transponders to all users of the Project difficult.”

ODOT provided OTIG with guidance that their objective was free flow electronic tolling. OTIG agrees that fully electronic tolling is a worthy objective as it minimizes operating costs and improves the financial feasibility of the project. However, OTIG advised ODOT that it would be practically and politically difficult to require all users to have a transponder from day one and therefore assumed a phased introduction of electronic tolling with a cash collection alternative (see Section 3.4.11.6 and Section 3.5.8.2). OTIG included the cost of cash collection during the early years of the financial analysis.

Expected widespread use of transponders statewide and inter-operability agreements with neighboring states are expected to occur over the medium term and enhance the effectiveness and suitability of fully electronic tolling of the facility, allowing for the phasing out of cash collections. See Section 3.3.6 and 3.3.6.1 for OTIG’s advice with respect to inter-operability agreements.

4. Bear Stearns states:
“The relatively small size and modest traffic volumes for the Project suggest the use of point tolling. OTIG proposes that a point tolling scenario collect tolls only at one location; between Hwy 219 and the Dundee Interchange. SDG’s traffic forecast reflects significant traffic diversion around this single toll plaza. Bear Stearns recommends that further analysis is appropriate regarding utilization of point tolling at two locations-Rex Hill and west of the Dundee Interchange. An unmanned coin and transponder reader should be a consideration for ramp toll collection.”

Steer Davies Gleave (SDG), OTIG’s traffic forecaster, is of the opinion that any reconfiguration of the toll locations will not materially increase toll revenues for the Bypass-only tolling options and will not materially change the financial feasibility of the Bypass-only tolling option.

III. Operations and Maintenance

5. Bear Stearns states:

“The assumed cost of $6.5 million for operations and maintenance in the first year of operations seems somewhat conservative based upon the experience of recent start-up toll facilities of similar size, and is a reasonable estimate in our opinion. The operating and maintenance expenses for the Pocahontas Parkway (Richmond, Va.) in its first full year of operations was approximately $1.9 million and the first full year of operations budget for the Northwest Parkway (Broomfield, CO) was approximately $5.9 million... The Project, which has State sponsorship, is likely to be somewhere in between.”

OTIG cannot comment on the start-up costs of the Pocahontas Parkway, whose first full year of operations was in 2003, or the Northwest Parkway, whose first full year of operations was in 2004, without more information provided by Bear Stearns, including the effect of inflation on these costs. The initial operating and maintenance costs of $6.532 million decline over the first years due to the elimination of several start up costs the elimination of construction-related staff as well as reductions in marketing, media and public relations. In practice, several of these costs may be incurred in the period leading up to the opening of the Project and through the first full year of operations. The long term operating and maintenance cost structure is reduced to $5.069 million (2006 dollars) following the elimination of tolling and cash handling staff after 10 years.

6. Bear Stearns states:

“The configuration of the toll system for Bypass Only is not discussed in the OTIG report other than stating that the Point Tolling scenario assumes the toll is collected between Hwy 219 and the Dundee Interchange.”

The Bypass and Distance Toll locations are indicated in Section 3.4.7.4.

7. Bear Stearns states:

“OTIG has assumed $.14 cost per electronic toll transaction in year one. This is higher than the industry average of $.09-$1.1, but may be reasonable for the first year of operation. Bear Stearns would anticipate that this cost per transaction would go down over time, both as it converges on the industry norm and also as the industry norm continues to decline, as it has over the past decade.”

OTIG has projected that initial operating and maintenance costs will decline over the first years due to the elimination of several start-up costs, specifically elimination of construction-related staff as well as marketing, media, and public relations costs. Operating and maintenance costs are reduced over the long term due to the elimination of tolling and cash handling staff.
Electronic toll collection costs are variable costs and as such vary with traffic volumes in the OTIG financial feasibility analysis. The unit cost to process electronic toll transactions is also assumed to increase with inflation which OTIG understands to be common practice in toll road forecasts. In the larger picture, electronic toll collection costs represent less than 10% of total operating costs in the initial 8-10 years, increasing to about 20%-25% over the remainder of the concession. While minimizing these costs is important to financial feasibility, they should be considered in the larger picture. Finally, OTIG notes that while cents per transaction is a useful metric to compare toll collection efficiency across various toll road projects, care must be taken to ensure that such comparisons include the same cost base so as not to distort the comparison. This is especially true for Newberg-Dundee, which would be the first tolled facility in the State and is not expected to carry high levels of traffic.

8. Bear Stearns states:

“The Report sets out the assumption that OTIG would be given the right to impose tolls on existing 99W, but would not be responsible for the costs of maintaining this existing road. This assumption may prove problematic as any financial stress on the concession project may result in disputes related to the State’s level of maintenance of 99W. There is no precedent we are aware of for a private company to toll an existing roadway but not be responsible for roadway maintenance.”

The assumption that OTIG would maintain the Bypass only was the result of consultation and discussion with ODOT. ODOT already has a routine operations and maintenance team managing roads in the area. OTIG has suggested that lifecycle maintenance of the new Bypass should be the responsibility of the Concessionaire for risk transfer reasons. In our experience, it is both contractually challenging and potentially expensive for a Concessionaire to take on full lifecycle responsibility for an asset, such as the existing 99W, for which it has had not input into the design or construction. In general, it is unlikely that the State’s level of maintenance on 99W would negatively affect traffic utilizing the Bypass; substandard levels of maintenance on 99W could potentially serve to increase the attractiveness of the Bypass as an alternate route. Final allocation of this risk will be subject to detailed technical analysis of the existing road surface and ultimately the concession agreement negotiations between ODOT, its advisors and OTIG.

IV. Traffic and Revenue Forecasts

9. Bear Stearns states:

“While the survey samples were too small to be considered reliable, we anticipate that this would be rectified in the more detailed analysis yet to be undertaken.”

SDG, the traffic and revenue forecaster for OTIG, has provided a draft response to the issues raised by WSA (memo dated December 14, 2007) which addressed this issue. SDG reinforces that the sample rates also took into account traffic at other count sites where sample rates were closer to 10%. Additionally, SDG undertook OD surveys on the weekend which are hardly ever considered for other traffic and revenue studies. As per the Pre-Development Agreement between ODOT and OTIG, OTIG will undertake an investment grade traffic and revenue study as part of any next milestone.

10. Bear Stearns states:

“The Report states that projected 2006 usage of the Bypass (if it existed) is approximately 5,000 vehicles per day at a $1 toll, with demand dropping to fewer than 1,000 vehicles per day at a $1.50
toll. While this level of price sensitivity is not consistent with other recently opened toll facilities this does not make the forecast incorrect.”

OTIG has noted that potential users of the Bypass are very sensitive to price as:

- There is a relatively small time differential between the Bypass and the 99W travel times (particularly in the early years of the concession).
- The opening of the Bypass reduces traffic flows and travel times on the 99W, therefore making the differential between both roads lesser and leading to less traffic willing to pay for the toll (see Section 3.4.7.2).
- There is no history of tolling or toll increases in the region.

OTIG disagrees with the implied statement by Bear Stearns that the traffic diversion for Newberg-Dundee is too high given changes in toll rates.

11. Bear Stearns states:

“The further statement that this revenue scenario is incapable of covering the costs of operating the Project in some cases, however, is not a conclusion with which Bear Stearns agrees. Using Bear Stearns’ financial model, the Project under a Bypass Only tolling assumption is capable of covering operating expenses and making a contribution towards capital costs. Work undertaken by WSA at the direction of Bear Stearns supports the premise that alternative tolling scenarios are likely to increase the revenue potential of tolling only the Bypass”

DG is of the opinion that further testing may increase the revenue potential of tolling only the Bypass, however these increases are immaterial in relation to the funding gap under Bypass Only tolling and will not result in a financeable project, a conclusion with which Bear Stearns appears to agree elsewhere in the Review.

12. Bear Stearns states:

“Under the “Bypass Point Tolling Revitalization High Delay” scenario, revenues increase to $9.5 MM in 2010, to $18.8 MM in 2020 and to $38.5 million in 2030 (when the CPI escalator is assumed to be 2.5 percent). Partly based upon OTIG’s own analysis, Bear Stearns believes that the Bypass Only scenario should not be eliminated from further analysis at this stage of Project development.”

While the revitalization high delay scenario developed by OTIG in the Report does substantially increase toll revenues, when analyzed in context of the required revenues to support the Project, the revenues under the Bypass Point Tolling Revitalization High Delay are still just over half of the required revenues in a best case scenario and remain grossly insufficient to make the Project financially feasible when tolling only the Bypass.

<table>
<thead>
<tr>
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<th>2010</th>
<th>2020</th>
<th>2030</th>
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</thead>
<tbody>
<tr>
<td>Revenue without ‘High Delay’</td>
<td>$2.7</td>
<td>$7.3</td>
<td>$18.6</td>
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<tr>
<td>Revenue under ‘High Delay’</td>
<td>$9.5</td>
<td>$18.8</td>
<td>$38.5</td>
</tr>
<tr>
<td>Required Revenue to Support Capital Payments</td>
<td>$22.4</td>
<td>$43.1</td>
<td>$70.2</td>
</tr>
<tr>
<td>‘High Delay’ Revenue as % of Required Revenue</td>
<td>42%</td>
<td>44%</td>
<td>55%</td>
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“Bear Stearns anticipates that a Point Tolling scenario with Revitalization High Delay and two toll plazas will result in higher annual revenue.”

Notwithstanding the size of any additional capital costs necessary, the Bear Stearns suggestion is unlikely to result in a fundable project. The toll locations and toll levels presented in the OTIG Report were configured to maximize revenue; OTIG does not believe choice of alternate toll locations will materially increase toll revenue.

14. Bear Stearns states:

“The Report appears to assume that delays on the existing 99W will only be achieved with additional capital expenditures. This is logically not the case, as there would be virtually no cost to lowering the speed limit on 99W and imposing longer signal delays at urban intersections. Slower travel speeds on 99W have a significant impact within the traffic forecasting methodology on the feasibility of the Bypass. Noting that the SDG travel speeds on existing 99W are largely in excess of 40 mph, with several sections in excess of 50 mph, lowering the speed limit on 99W within the Urban Growth Corridor to 25 mph would add significantly to the travel time savings accruing to the Bypass.”

OTIG suggests that there are a number of issues that need to be addressed regarding the reduction of the speed limit to 25mph and imposing longer signal delays at urban intersections to achieve higher delays:

- Sections in the more urbanized area have already speeds of around 25mph (see Appendix D for observed travel times and associated speeds i.e. between Brutcher St N Main St in Newberg);
- To maintain and enforce a 25mph speed limit in the non-urbanized sections will be difficult;
- We strongly believe that to achieve the level of delays assumed under the High Delay scenario (6.5 minutes on a 15 to 20 minute trip) requires ‘real’ physical measures to be put in place;
- We refer to previous comments on the bankability of these measures which are acknowledged by Bear Sterns as “legitimate concerns”

OTIG believes that Bear Stearns has over-simplified the ability to create slower speeds on the 99W and overstates its ability to make Bypass only tolling a viable project.

15. Bear Stearns states:

“The potential for peak hour congestion on 99W is critical to the financial viability of the Bypass as a stand-alone project. While the conclusion that the full Project scope cannot be fully funded by tolls on the Bypass alone appears sound, the revenue potential of the Bypass only approach is not fully explored. If there are significant delays on 99W at peak hour, the Project appears to be a good candidate for variable pricing. … This suggests an opportunity to raise tolls when these long distance trips are most prevalent (late Friday and Sunday afternoons). If additional sources of Project funding can be identified, or if significant changes to Project scope to lower initial financing requirements were to be considered, additional analysis of the Bypass Tolling may be called for.”

OTIG is of the opinion that variable pricing that takes into account peak periods on Friday and Sunday afternoons will not be sufficient in itself to make the Project financially feasible. OTIG concluded that variable pricing is a refinement to be considered in subsequent phases of the project but is unlikely to fundamentally alter the financial feasibility of the Project.

16. Bear Stearns states:
“A more useful options analysis for officials charged with advancing the Newberg-Dundee Bypass would have offered alternative funding models in the Milestone 1 Report with the traffic and revenue analysis of resulting tolling scenarios to achieve financial viability.”

OTIG was not required to provide a financial feasibility assessment under an alternative financing scheme such as revenue bonds. Furthermore, OTIG is of the opinion that the financing structure proposed by Bear Stearns as the public sector comparator is fundamentally flawed and incapable of reaching financial close.

17. Bear Stearns states:

“The OTIG report does not make clear that the toll rates presented are at levels necessary to achieve returns on a given level (i.e., $124 million) of equity funding, and imply that lower toll rates cannot achieve financial viability.”

Section 3.6.1.3 clearly states that a 13.5% equity IRR has been selected for the financial analysis presented in the Report.

V. Project Definition

18. Bear Stearns states:

“At this early development stage, the cost of the Project is often presented as a range of potential project cost. OTIG has provided such a range, and has reflected the high end of the range in their financial model. This establishes a degree of conservatism to the financial projections, which is appropriate at this stage. “

OTIG provided a Baseline Project Cost of $493.2 million including $100 million related to acquisition of Right of Way. OTIG also provided a minimum construction cost of $373.7 million including $84 million related to acquisition of Right of Way. For the purposes of the financial model, OTIG included a construction cost estimate of $379.6 million, excluding Right of Way costs as these were assumed to be funded by ODOT after discussions with ODOT (since the publication of the Report, estimated Right of Way costs have increased substantially). OTIG actively sought out measures to reduce costs and final construction cost estimate used in the financial analysis was agreed upon with ODOT.

19. Bear Stearns states:

“We also note that OTIG assumes the State will pay for the costs of the electronic tolling infrastructure. We believe this is in addition to the $100 million ODOT contribution set out in section 3.6.1.1”

OTIG has assumed the cost of the electronic tolling infrastructure and will bear all risk associated with the procurement and installation of this infrastructure. Under the assumptions contained in the Report, ODOT would not be responsible for the cost of the electronic tolling infrastructure which is estimated at $14 million.

20. Bear Stearns states:
“It would benefit the OTIG proposal if an analysis of the potential savings accruing to a fixed-price, Design-Build contract as an alternative to traditional state contracting procedures had been included in the cost analysis.”

It was not possible for OTIG to provide a comparison with the costs of state contracting as ODOT had not undertaken any cost estimate at the time. However, a proxy for this was considered in OTIG’s minimum capital cost scenario which represents a 23% saving over the full costs based on ODOT’s design. This “bottom up” cost estimate based on the features of the Project is also generally consistent with empirical evidence of P3 delivery which achieves average costs savings of 20% compared to conventional state procurement.

21. Bear Stearns states:

“OTIG does set out the possibility of phasing the project by deferring the construction of the intermediate interchanges. This seems a reasonable approach to potentially lowering the capital costs for the Project and might be further explored in development and refinement of the financial model.”

Cost reduction options did include the deferral of intermediate interchanges. However, ODOT felt that this would jeopardize the NEPA process and the defined purpose and need statement and therefore opposed this cost reduction as a viable option to be considered as part of the Project’s financial feasibility.

22. Bear Stearns states:

“A significant portion of the current capital cost estimate for the Project derives from roadway improvements south of Dundee. Phasing the Project to initially provide for a bypass around the communities of Newberg and Dundee and providing a limited access alternative to 99W as a second phase might permit the Project to proceed without tolling the existing roadway.”

OTIG worked closely with ODOT to reduce the scope where possible to ensure the greatest chance of financial feasibility for the Project. OTIG has separately provided ODOT with suggestions for scope reduction, including consideration of reducing the length of the project and connecting back to 99W just west/south of Dundee. The additional cost for ROW and an additional interchange that may need to be removed at a later date together with the improvements that would still be required at the 99W/Highway 18 interchange made this option much less attractive. There were also concerns that this option would also require additional frontage roads along the section of 99W between this new South Dundee interchange and Highway 18 to maintain the limited access requirement which would further increase the costs for this option. The overall cost savings were not seen as significant enough for serious consideration. ODOT were also concerned with the implications for the NEPA process and were not supportive of this option being considered as part of the Project’s financial feasibility.

VI. Concession Model

23. Bear Stearns states:

“In the tables below, we have illustrated a cost of capital comparison where 95 percent of the equity is replaced with 9 percent subordinated loan. This has the effect of reducing the cost of capital by over 100 basis points.”
For the purposes of the analysis, OTIG did not substantially vary the financing structure used to evaluate the different options. This was to reduce the number of variables and allow for a side by side comparison of the various options. In practice the financing structure (mix of debt and equity) and cost of financing will vary with different options and this refinement would be considered in any future milestone.

Bear Stearns is broadly correct that Corridor Tolling would support a higher level of debt and require less equity at a lower rate of return than other more complex tolling options. However, we find Bear Stearns’ assertion that it would allow for 95% to 100% debt financing to be questionable. Equity is required to address traffic, construction and operating risk.

**Equity required to address traffic risk**

Firstly, even with comprehensive Corridor Tolling there is a level of traffic risk from diversion into other corridors, suppression of discretionary trips, volume discounts and toll collection risks. It is difficult to quantify these effects in terms of impact on revenue, however indications from the work undertaken by SDG are that an ‘uncertainty envelope’ of +/- 25 cents on toll levels (or, a 7% fluctuation in revenue on the Sample Case) is reasonable (see Section 3.4.1.1 and Section 3.4.11.5).

It should also be noted that the traffic forecast provided by SDG is commonly referred to as an ‘equity traffic forecast’ whereas lenders typically require a more conservative traffic and revenue base case. This requirement is based upon their experience that toll road traffic forecasts usually overestimate traffic. S&P notes that toll road traffic forecasts overestimate traffic by 20-30% on average. Revenue from tolls on the Northwest Parkway, which Bear Stearns refers to as a similar project to Newberg-Dundee, were 37% lower than forecasted in the first year and 44% lower in the second year. Bonds issued to support the project were downgraded to junk bond status. 2005 traffic volumes on the Pocahontas Parkway were approximately 50% of what was projected in the original 1998 study, leading to what one journalist called a ‘financial flop’.

**Equity required to address construction and operating risk**

Secondly Bear Stearns have not given sufficient consideration to the significant risks of Design-Build, tolling implementation and lifecycle asset management.

OTIG is proposing to accept the risks of Design-Build, including the risks of the Design-Build Contract satisfying ODOT’s performance specifications, completion on-time and on-budget and on the long term suitability of the design and the quality of construction. As ODOT has correctly pointed out, the public-private partnership approach transfers the risk of on-time and on-budget completion to the private sector partner as well as the impacts that a good or bad design will have on the road for the next 30 to 40 years. The private sector partner takes on this risk and ensures that the Design-Build contract and the lifecycle maintenance and rehabilitation plan are sufficiently integrated to allow for the best whole-of-life costing approach.

Empirical evidence suggests that cost savings of between 20-30% can be achieved under P3 delivery compared to conventional state procurement. There is some evidence of this in the work conducted by OTIG in the Feasibility Assessment. However, this would be analyzed in a thorough and professional public sector comparator prior to the final negotiation of the Concession Agreement.

OTIG is also proposing to accept long term lifecycle asset management responsibility for the Bypass to ensure ODOT’s performance specifications are met each year of the concession period.
As a private sector partner, annual budgeting decisions are made in the context of a long term plan and are not subject to the vagaries of local or regional planning departments or processes. The creation of a toll authority attempts to recreate this unbiased approach however is still subject to local and regional political motivations and often has a short term view.

OTIG has assumed a debt structure that takes into account the above-mentioned risks, rating agency guidelines and experience in operating toll roads. OTIG believes that Bear Stearns’ proposed replacement of 95% - 100% of the equity with subordinated debt will result in debt service coverage ratios too tight to sustain any downside risks due to lower traffic volumes than forecasted, unexpected delays in opening, higher than budgeted operating costs and even technical difficulties in electronic toll collection or other risks. OTIG further believes that some level of equity will be required to provide coverage for these risks, with the final risk allocation between ODOT and OTIG decided in the next milestones.

24. Bear Stearns states:

“An alternative option to a subordinated loan would be to refinance or retire a percentage of the equity by increasing debt after construction is completed. In certain project scenarios, project risk perceived pre-construction may preclude sourcing subordinated debt. If equity were required for the project at construction, realization of the revenues assumed by the Corridor Tolling OTIG equity model would permit additional debt financing in the first five years of operations.”

OTIG has structured the debt financing component based upon the cash flows of the Project during operations, rating agency guidelines and toll road development experience. It is unusual to consider a refinancing at the outset of a project when there is significant uncertainty whether the traffic volumes will be achieved. Additional debt financing in the first five years of operations would only be possible if the actual traffic volume realized were to be higher than that currently projected, assuming the Project was able to meet construction and operating cost budgets. Conversely, should the actual traffic volumes be lower than projected, the Concessionaire would be at risk of default as less cash flow is available to service debt obligations.

25. Bear Stearns states:

“As an alternative to equity financing, we analyzed two scenarios: first, equity funding is replaced by a TIFIA subordinated loan, and second, the public comparator model in which tax exempt municipal debt and TIFIA make up the capital structure. The first scenario reduces the base case cost of capital from 6.48 percent to 4.26 percent. The last option, the public comparator scenario, further reduces the cost of capital to 3.72 percent. This demonstrates that most of the financial strain imposed by the OTIG financial model is not a result of using a concession approach, but rather because OTIG assumes a large amount of equity which remains invested for the full term.”

As discussed above, for the purposes of the analysis, OTIG did not vary the financing structure used to evaluate the different options substantially. This was to reduce the number of variables and allow for a side by side comparison of the various options. In practice the financing structure (mix of debt and equity) and cost of financing will vary with different options and this refinement would be considered in any future milestone.

Macquarie Infrastructure Group (“MIG”) is the equity provider for OTIG and is intimately familiar with TIFIA. MIG utilized TIFIA for construction of the South Bay Expressway, the first time a private sector partner accessed the TIFIA program, and recently arranged TIFIA financing for another potential toll road project. OTIG has also analyzed utilizing TIFIA for the Newberg-Dundee Project. However, the restrictions regarding distributing free cash flow to shareholders when TIFIA interest
payments were deferred mitigated the majority of the financing benefit TIFIA provided. Distributions to equity are allowed if TIFIA interest payments are current, however in this analysis Private Activity Bonds are structured in a similar manner and were deemed to be more efficient.

OTIG, as part of the Pre-Development Agreement with ODOT (ref. PDA Section 10.2), will solicit competitive term sheets from various debt providers together with ODOT to determine the most competitive financing structure for the Project. OTIG suggests that both OTIG and ODOT further contemplate the use of TIFIA at that time.

26. Bear Stearns states:

“OTIG has undertaken their financial analysis of the concession approach utilizing the revenue scenario where local residents and other users of 99W were allowed to use the existing roadway on a toll-free basis. Subsequent discussions with State officials, however, have determined that there is not sufficient comfort that such an arrangement would be allowable under the limitations imposed by the Interstate Commerce Clause of the U.S. Constitution.”

OTIG believes that allowing local residents to travel on the existing 99W for fee, as is currently the case, is crucial to gaining the public support necessary to build the bypass. OTIG believes that a workable solution to address legal challenges could be found should the Project move forward. Bear Stearns suggests such a solution in their Review where they state:

“The accepted manner to reduce the burden of tolls on those users most reliant on the toll facility is to provide volume discounts, where a lower toll is charged to vehicles which use a transponder, make a certain number of trips during a given period or prepay for a given number of trips. This is a potential solution to the issue of local trips in Newberg-Dundee.”

VI. Public Sector Comparator

27. Bear Stearns states:

“Bear Stearns has developed a financial model that establishes a base case for capital funding of the Project entirely from the proceeds of debt issuance. The financial structure consists of 65 percent tax-exempt municipal debt, 25% TIFIA subordinated debt, and 10 percent State contribution ($285 million tax-exempt, senior toll revenue bond issue, $112 million subordinated loan from USDOT under the TIFIA loan program, and $50 million in State contribution). Significantly, the revenues required to support the Public Sector Comparator of capital funding are approximately 32 percent lower than the Target Revenues for the OTIG plan. In addition, over the 50 year concession period, approximately $1.3 billion of future operating income would accrue to the State as owner of the Project.”

OTIG has not been provided the public sector comparator model and therefore cannot substantiate the claim by Bear Stearns that the target revenues can be approximately 32% lower.

28. Bear Stearns states:

“For the Public Sector Comparator, minimum senior debt service coverage of 1.5 times from net cash flow was assumed. While this is somewhat aggressive for a start-up toll road, the monopolistic aspect of the Corridor Tolling proposal supports this assumption as tolling of the existing through road facility reduces traffic generation risk. We believe that the OTIG assumption that a 1.4 coverage ratio is sufficient for an investment grade rating is overly aggressive. The senior revenue
bonds are assumed to be further supported by a municipal bond insurance policy. The TIFIA loan is paid on a subordinate basis and is assumed to meet all of the constraints of this loan program.”

“The public sector comparator model assumes debt is constrained to maintain aggregate minimum debt service coverage level of 1.25 times, although the TIFIA loan program guidelines allow debt service coverage to be as low as 1.1 times”

OTIG is comfortable assuming an aggregate debt service coverage level of 1.4 times in the opening year due to the use of a traffic ramp up reserve which releases funds to lenders should traffic projections fail to materialize as is often the case in the first 1 to 3 years. By year three the debt service coverage ratio is 1.9 times. This mechanism provides substantial comfort to lenders that the required debt service will be repaid.

Bear Stearns has assumed a senior debt service coverage ratio of 1.5 times, presumably without the benefit of ramp up reserves. Moody’s suggests that an investment grade rating requires a minimum debt service coverage ratio of 1.8 times. OTIG questions whether or not this type of structure will be able to attain the required investment grade rating necessary for the utilization of TIFIA given published rating agency guidelines such as those published by Moody’s.

Bear Stearns has assumed an aggregate debt service coverage level (senior debt and TIFIA) of 1.25 times which OTIG believes is quite aggressive. OTIG notes that, based upon recent experience, TIFIA is likely to require a 1.1 times aggregate cover ratio under a 30% revenue downside scenario. This would imply a required base case aggregate debt service coverage ratio of 1.57 times1, which is substantially higher than that proposed by Bear Stearns. Under Bear Stearns’ financial structure and a 1.25 times aggregate debt service coverage ratio, a 30% reduction in traffic revenues from that projected would result in default. Traffic on Pocahontas was 37% below that projected in the first year while the Northwest Parkway traffic was 50% below that projected 7 years into the Project. Both Northwest Parkway and Pocahontas were organized as tolling authorities, both of which are now operated by the private sector under a concession model following their financial difficulty. Bear Stearns underwrote the initial bond offering for Northwest Parkway and the Pocahontas Parkway.

OTIG questions the viability of the Bear Stearns proposed debt structure given (1) the lack of equity commitment to absorb downside risks such as traffic risk prevalent in greenfield toll road projects and the tight aggregate coverage ratios, (2) the ability of the financing structure to attain an investment grade rating, (3) the lack of a public sector comparator model that substantiates Bear Stearns’ claims.

VII. Preliminary Conclusions

In their preliminary analysis Bear Stearns makes several conclusions, summarized as:

- Bear Stearns agrees with OTIG that revenue raised from tolling the Bypass-only would be inadequate for funding the Project in its current form, but suggests that it would contribute to the capital costs of the project;
- Exemptions to tolls for local residents have not been determined to be clearly permitted under state and federal law and therefore the idea of exemptions for local residents should not be carried forward as part of any tolling strategy;
- Corridor tolling, whereby everyone pays a toll including local residents, is not viewed by Bear Stearns as providing adequate risk transfer to OTIG under a public private partnership concession model; and

1 1.57 times when multiplied by 70% equates to a debt service coverage ratio of 1.1 times.
• Bear Stearns suggests that under a corridor tolling approach, whereby everyone pays a toll including local residents, the project could be funded using 100% debt at a lower cost of finance.

OTIG and Bear Stearns agree that revenue generated from tolling the Bypass-only, and leaving the 99W untolled, would be insufficient to cover the capital costs of the Project. OTIG has suggested that the primary measure to increase the financial feasibility of the Project is to reduce its scope. Discussions with ODOT have indicated that altering the project scope may jeopardize the environmental approval process and could result in significant delays. OTIG would support any reductions in project scope that would improve the chances of building the project while still meeting environmental regulations.

Bear Stearns states that providing free passes for local residents is likely impermissible under federal and state laws. Bear Stearns has not sufficiently summarized the reasons why they conclude that corridor tolling is unworkable to the State of Oregon as described in the Report; such a summary would have added clarity to the Review.

OTIG suggests that there is no barrier to locality-based tolls under Oregon State or federal substantive law. However, the possibility of a constitutional challenge to such a tolling mechanism based on the Commerce Clause of the United States Constitution which prohibits discriminating against interstate commerce cannot be ruled out. Accordingly if the decision is made to proceed with the project on the basis of locality based toll discounts, further investigation should be undertaken of the legal position and the potential effect of legal uncertainty on the competitiveness of debt and equity for the Project.

OTIG believes that allowing local residents to travel on the existing 99W for fee, as is currently the case, is crucial to gaining the public support necessary to build the bypass. OTIG believes that a workable solution to address legal challenges could be found should the Project move forward. In fact, Bear Stearns suggests elsewhere in their review that a potential solution to the issue of providing local residents free trips is through volume discounts. OTIG does not believe there is sufficient public and political support to undertake a tolling system that requires local residents to pay a toll for each trip they make on their local road network.

Bear Stearns suggests that corridor tolling does not provide adequate risk transfer to OTIG to justify a concession model. OTIG disagrees with Bear Stearns and asserts that there is sufficient risk transfer including the private sector partner taking all cost and schedule risk relating to design and construction of the facility, traffic risk including collecting lower toll revenue than projected, cost risk on operating and maintaining the Bypass and risk relating to implementing the State’s first electronic toll system.

OTIG is proposing to accept the risks of Design-Build, including the risks of the Design-Build Contract satisfying ODOT’s performance specifications; completion on-time and on-budget and on the long term suitability of the design and the quality of construction. Empirical evidence suggests that cost savings of between 20-30% can be achieved under P3 delivery compared to conventional state procurement. There is some evidence of this in the work conducted by OTIG in the Feasibility Assessment. However, this would be analyzed in a thorough and professional public sector comparator prior to the final negotiation of the Concession Agreement.

Even with comprehensive Corridor Tolling there is a level of traffic risk from diversion into other corridors, suppression of discretionary trips, volume discounts and toll collection risks. It is difficult to quantify these effects, however indications from the SDG work are that significant trip suppression and diversion occurs at higher toll levels. OTIG believes that Bear Stearns proposed debt service
coverage ratios which we estimate to be 1.10x are too tight to support these risks and that some level of equity will be required to provide coverage for these risks.

OTIG is also proposing to accept long term lifecycle asset management responsibility for the Bypass to ensure ODOT’s performance specifications are met each year of the concession period. This will ensure that the Bypass is maintained to a high level of service and maintenance budgets are not subject to political decisions.

OTIG also faces considerable risk in implementing the State’s first electronic toll system, including the take up of transponders by the traveling public, the most cost effective method of collecting tolls. Risks of implementing a toll system are often manifested through lower collection rates or higher collection costs that strongly affect the financial position of the Concessionaire and the ability to make scheduled payments to debtholders.

Bear Stearns is broadly correct that Corridor Tolling would support a higher level of debt and require less equity at a lower rate of return than other more complex tolling options. However, we find Bear Stearns assertion that it would allow for 100% debt financing to be questionable. OTIG questions the viability of the Bear Stearns proposed debt structure given (1) the lack of an equity commitment to absorb downside risks such as traffic risk prevalent in greenfield toll road projects, (2) the potential inability of the financing structure to attain an investment grade rating, and (3) the lack of a public sector comparator model that substantiates Bear Stearns’ claims.

OTIG further notes that similar projects such as the Pocahontas Parkway and the Northwest Parkway, both underwritten using a public sector approach, experienced difficulties in meeting traffic projections and debt payment obligations. Both of these projects have since been restructured as concession projects with the private sector partner contributing equity to absorb downside traffic risk, among other risks. OTIG believes funding the Project using 100% debt is financially suspect and exposes taxpayers to a potential future debt burden.