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# Transportation Project Finance – 3

## Additional Topics in Project Finance

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- ▶ Equity
- ▶ Debt
  - ▶ Senior
  - ▶ Junior (Subordinate)
  - ▶ Mezzanine

# Effects of subordination – 1

- ▶ Senior lien debt has a higher payment priority than subordinate debt
- ▶ Debt can be structured into **tranches** to take advantage of this
- ▶ Suppose \$100 is available for debt service, and debt service is \$90
- ▶ Debt service coverage ratio (DSCR) is  $100/90 = 1.11$   
– not very good

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## Effects of subordination – 2

- ▶ Divide \$90 debt into a \$75 senior tranche and \$15 junior tranche
- ▶ DSCR of senior lien debt is  $100/75 = 1.33$  – much better!
- ▶ DSCR of junior lien debt is  $100/(75+15) = 1.11$  – as before
- ▶ Overall coverage is still 1.11
- ▶ But senior lien debt is higher quality and can be sold at lower financing cost
- ▶ (We assume that the subordinate debt is marketable)

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# Debt financing – 1

- ▶ Grant anticipation notes (GANs) – general term for debt secured by anticipated grant money
- ▶ GARVEEs – already discussed, particular form of GAN secured by anticipated federal-aid highway funds (e.g. apportionments from the Highway Trust Fund)
- ▶ GARVEEs can be beneficial for a project if
  - ▶ Large enough that normal funding mechanisms (pay-go, apportionments, tolls, etc.) are insufficient
  - ▶ Cost of delaying project greater than cost of financing
  - ▶ State is willing to pledge future federal highway funds to the project

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# Debt financing – 2

## Private activity bonds (PABs)

- ▶ A PAB is a type of municipal bond
- ▶ Proceeds from the bond issuance are used by a private entity, not by the issuing government entity
- ▶ Under certain conditions, PABs qualify for income tax exemption on bond interest payments
- ▶ One form of PAB (**exempt facility bonds**) is intended to finance transportation facilities owned or operated by private entities
- ▶ Revenues from the facility are used to secure the bond payments
- ▶ With SAFETEA-LU, highway and surface freight transfer facilities are eligible for PAB financing

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## Transportation Infrastructure Finance and Innovation Act

- ▶ Offers three types of credit assistance to approved transportation projects
  - ▶ Direct loans from federal government
  - ▶ Loan guarantee – federal guarantee of debt service payment
  - ▶ Lines of credit – federal commitment to make loan if project revenues fall short
- ▶ Project sponsors can be public or private entities
- ▶ Senior project debt must be rated investment grade
- ▶ TIFIA assistance must be < 33% of project costs
- ▶ TIFIA assistance repaid from pledge of user charges or special state/local tax assessments (not other federal money)

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# State infrastructure banks (SIBs)

- ▶ SIBs are transportation infrastructure investment funds
- ▶ Established and administered by states with federal approval
- ▶ Capitalized with state funds and/or federal highway apportionments
- ▶ Can offer transportation projects loans or credit enhancement
- ▶ Public and private projects are eligible
- ▶ States have great flexibility to operate SIBs
- ▶ SIB can be repaid from project revenues or other sources

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# Section 129 loans

- ▶ Section 129 loans allow states to use regular federal-aid highway apportionments to fund direct loans to projects
- ▶ Eligible projects must have a dedicated revenue stream pledged to repay loan
- ▶ Revenue stream can come from project or other non-Federal source (not just tolls)
- ▶ Public and private projects are eligible
- ▶ States benefit by "recycling" federal highway apportionment
- ▶ Projects benefit by offering up-front capital at potentially below-market costs, and providing project finance structuring options

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**Flexible match** A wide variety of public and private contributions can counts towards the non-federal match for federal-aid projects

- ▶ Formerly only cash could be used for non-federal match
- ▶ Any other local contributions reduced project cost, but not matching requirements
- ▶ Now other types of match (land, materials, services) are allowed

## Other mechanisms – 2

**Toll credits** Toll revenues that states use to build or improve non-toll highways count towards state matching share (usually 20%) to federal highway or transit funds

- ▶ This can allow up to 100% federal funding of eligible projects
- ▶ Florida has an extensive toll road system and a policy of using toll revenues to fund non-toll highway improvements
- ▶ Almost all of Florida's federal-aid highway program is funded without requiring matching state funds

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