

CALIFORNIA LEGISLATURE

Senate

STATE CAPITOL
SACRAMENTO, CALIFORNIA
95814

December 22, 2010

Cindy McKim
Director
California Department of Transportation
P.O. Box 942873
Sacramento, CA 94273-0001

Dear Ms. McKim:

We write to share our concerns and questions about the public-private partnership (P3) agreement between the California Department of Transportation (Caltrans) and Golden Link Concessionaire LLC for the Presidio Parkway Project, which your office submitted to the Legislature for review and comment pursuant to Section 143 of the Streets and Highways Code. In reviewing the agreement, we asked the Legislative Analyst's Office (LAO) to comment on several issues, including the extent to which the agreement meets Caltrans' stated goals for the project, the features of the agreement that provide for a transfer of risk from the state to the concessionaire, and whether the P3 agreement is more or less cost-effective than using a traditional procurement method. We have enclosed a copy of the LAO's response for your convenience.

In general, the LAO concluded that the Presidio Parkway Project is not "a good fit for a P3 procurement approach because the project is already very far along in its schedule and it does not rely on a toll or user fee to fund the work." The LAO's analysis found that the agreement "does not provide the level of risk transfer that Caltrans initially implied it would" and further stated that "the state is not likely to achieve any significant benefits from procuring this project as a P3." Upon comparing costs to the state for completing this project using a P3 procurement method versus a traditional approach, the LAO concluded that "on a fiscal basis, it is likely that procuring the project with a more traditional procurement approach would result in lower total costs to the state," and it recommended that the state refrain from executing the agreement.

Based on the LAO's analysis, we have several concerns and questions about the P3 agreement, and ask that Caltrans not sign the agreement until the issues that the LAO raised can be resolved.

Fiscal sense? Our primary concern with this project relates to the higher costs the state will bear to complete this project as a P3 relative to the costs it would incur through a traditional procurement method. The LAO's analysis objected to the 8.5 percent annual discount rate Caltrans used to determine the net present value of the project's costs and instead recommended using a 5 percent discount rate. We note, the Administration itself used a 6.0 percent discount rate in valuing the sale-leaseback of state buildings, and the LAO used a 5.0 percent discount rate for that project. Using a 5 percent discount rate, the net present value of the project procured through a P3 is, at best, comparable to that obtained through a traditional procurement approach. Moreover, if Phase 2 projects experienced the same 40 percent bid savings achieved for the Phase 1 projects, the P3 could cost the state as much as \$141 million more in net present value terms than a project completed through a traditional procurement.

Furthermore, based on documents that Caltrans provided to our staff, construction costs for the Phase 2 projects are expected to be about \$358 million. Considering that the full bid for the concession is \$1.1 billion over the term of the lease, approximately \$740 million of the total cost will be used to pay the financing costs, profit to the concessionaire, and operations and maintenance over 30 years. This is a very expensive proposition. In an era of year-after-year budget deficits and declining revenues for transportation, this experimental financing deal appears too costly for the state.

Before proceeding with this procurement, we ask that Caltrans re-examine the costs of the Presidio Parkway Project to ensure that it does in fact represent a good deal for the state, comparing the costs of four different procurement and financing approaches: design-bid-build with pay-as-you-go financing; design-bid-build using Grant Anticipation Revenue Vehicles (GARVEE) financing; design-build with pay-as-you-go financing; and the proposed P3 - all using a 5 percent discount rate.

Risks to the state and cost certainty. Two of the potential benefits of a P3 procurement are the transfer of risk from the state to the private partner and cost certainty. As the LAO pointed out in its analysis, under this concession agreement the "state would retain some potentially significant construction risks such as costs or other problems that could result from the discovery of hazardous materials, endangered species, and archeological or cultural artifacts." This risk also creates some uncertainty with regard to how much the state may be required to pay the concessionaire for the project. We understand that due to construction work on the Phase 1 projects, Caltrans was unable to allow P3 bidders access to the construction site for evaluation and the state only retained the high level of risk for this reason. Because construction on the Phase 2 projects is not expected to commence until next fall, it seems that Caltrans could provide the bidder access to the job site as the Phase 1 projects come to a close. This could allow the state to shift additional risk to the concessionaire as originally planned.

Another risk borne by the state in this agreement is the risk that financing costs will increase from the time the concessionaire submitted its bid and financial close, which we understand is expected to occur late summer or early fall of next year. Executing the agreement closer to financial close provides more certainty as to what costs the state will bear in actuality.

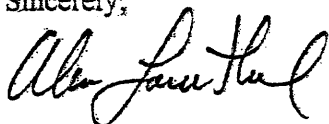
Pending litigation. The agreement provides for relief to the concessionaire in the event of delay attributable to litigation challenging the validity of the P3. A lawsuit has in fact been filed challenging this P3, and while Caltrans may be confident that the state will prevail, our Legislative Counsel has issued an opinion that also questions the validity of the P3. We have two concerns about proceeding in light of this litigation. First, the state could owe the concessionaire compensation for any delays the litigation may cause, thereby increasing the cost of the project. Second, the Presidio Parkway Project is an important seismic safety project. The public interest is not served by delay. Litigation, and any delay it causes, could be avoided by not signing the agreement and proceeding using a traditional procurement method. In fact, the LAO concluded that "if the P3 agreement were not signed, the state could still complete the Presidio project on schedule using traditional pay-as-you-go funding."

Additionally, we note that the written contract material provided to the Legislature for 60-day review was not all-inclusive of the lease agreement. Staff learned on November 23, 2010 that other contract documents existed, such as mitigation and monitoring plans, that were not submitted, but rather posted on a Caltrans website.

For all of these reasons, signing the agreement is premature and ill-advised at this time. We reiterate that the Presidio Parkway Project is an important project that should proceed expeditiously. Based on the LAO's analysis, however, we are not convinced that this P3 agreement does in fact provide the benefits that Caltrans has purported it would and it appears that it will cost the state more than if the project were done using a traditional procurement method with pay-as-you-go funding.

We welcome the opportunity to discuss this matter further. If you have any questions, please do not hesitate to contact us or Jennifer Gress on the Senate Transportation and Housing Committee staff at (916)651-4121.

Sincerely,



Alan Lowenthal



S. Joseph Simitian

Enclosure

cc Dale Bonner, Secretary, Business, Transportation & Housing Agency
José Luis Moscovich, Executive Director, San Francisco County Transportation Authority
James Earp, Chair, California Transportation Commission
Bimla Rhinehart, Executive Director, California Transportation Commission