Leasing the Ohio Turnpike: What we Know and What we Anticipate

An AMATS Staff Analysis
April 21, 2011

The Issue

- Governor Kasich has mentioned the possibility of leasing the Ohio Turnpike to a private company as part of his budget balancing proposal.

- In most similar cases, these leases are for a long period of time (75 to 99 years), with a large upfront lump-sum payment. In exchange for the one-time payment, the vendor will operate and maintain the toll road, and in return, receives the rights to all tolls collected.

- The Governor has said that he does not like that type of arrangement. He feels that 75 years is way too long, and would prefer multiple payments rather than one lump-sum, and has said that he would not settle for a lease less than $2.4 - $3.0 billion. State officials want any lease to include a cap on future tolls.

- Other than these general details, not many specifics are available at this time.

Benefits of Leasing the Turnpike

- The State may receive a very large sum of money to invest in infrastructure and transportation projects; particularly appealing for projects of prohibitively high cost.
    - Under a similar arrangement, Indiana was able to use lease proceeds to fund a large portion of its 10-year transportation plan, "Major Moves", including multiple complete interchange and bridge replacements.

- Money could be saved by instituting potential efficiencies, such as salary reductions through the hiring of private sector employees, enhanced automation of tolling, and efficiencies in maintenance (such as snow plowing and ice treatment), etc.

- Lump-sum would allow for immediate retirement of Turnpike debt, now at around $600 million.

Arguments Against the Leasing of the Turnpike

- Trading in a profitable, long-term revenue producing public asset to a private (and likely foreign) entity, for a one-time windfall.
    - Unlike the Indiana Turnpike and Chicago Skyway, which were unprofitable and inefficiently operated (and thus finally turned a profit once privatized), the Ohio Turnpike is very well managed, operated, and financially self-sustaining.

- A very long term solution to address a short term problem.

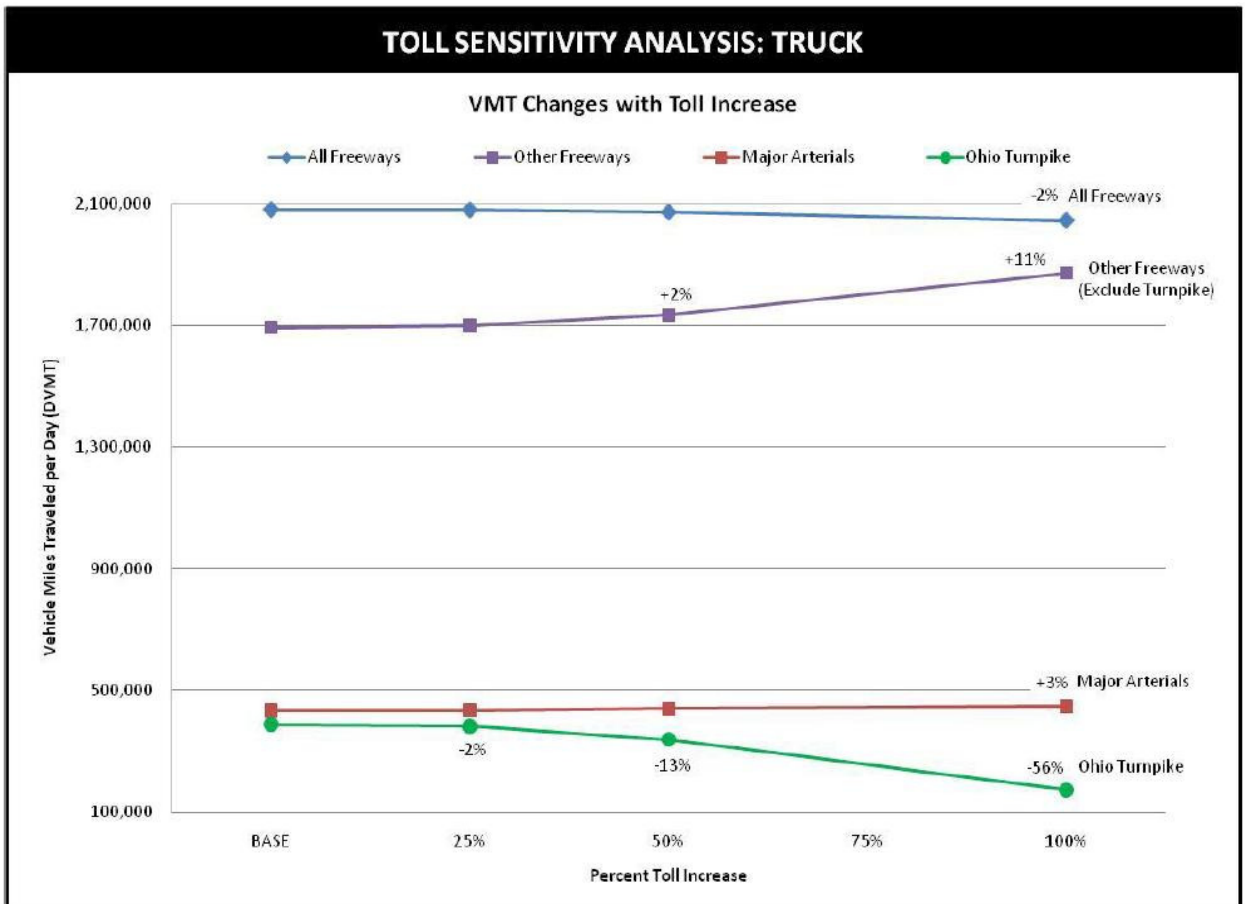
    - Was introduced as an option to address the current state budget deficit. One time lump-sum would only address a fraction of the *current* deficit, and in return, would forego a revenue generating asset for two generations or more.
    - A solution that has very little correlation to the causes of the current budget deficit.
    - Ohio Constitution (Section 12.05a) mandates that all funds collected from the operation of vehicles on public highways shall only be used for highway/transportation related purposes. Would appear to be unconstitutional to divert it to the state's General Fund
        - Most likely, would simply be used instead of any General Fund monies that would have gone to transportation in the first place. No net gain in transportation/infrastructure funding.
            - Exact situation occurred in lottery funding for schools. State could simply cut General Funds to schools, since lottery could fill the gap. No net increase.
            - Local governments are concerned that casino proceeds will lead to similar cuts in local government funds.
        - The Administration detailed a desire to shift some proceeds to an Ohio Job fund; a well intentioned idea, but likely to be found unconstitutional.

- Roads bought and paid for by Northern Ohioans (and those doing business here) will be sold for the benefit of those elsewhere in the state
    - Turnpike has never received federal funds, and the only state funds are from the receipt of a portion of the state gas tax collected at Turnpike service stations
        - These state gas tax proceeds are completely reinvested into bridges and overpasses of state highways that cross the Turnpike; no reinvestment into the Turnpike itself.
    - The Ohio Turnpike is fully funded by those who use it, the vast majority of whom are Northern Ohioans.
    - There is fear that the proceeds from this asset will be distributed to other parts of the state, as occurred in Indiana.
        - The Administration said projects from the proceeds of any lease would "focus on Northern Ohio", but stopped short of confirming their exclusive use in this portion of the state.

- Could harm the local logistics industry, driving it from Northern Ohio to Central or Southern portions of the state
    - Higher tolls resulting from a multi-decade lease could alter the locational preferences of transportation and logistics companies, causing them to favor I-70, a "free" highway.
    - Northern Ohio could lose large amounts of business to Columbus and Dayton.

- Toll increases would encourage trucks and other traffic to use parallel state highways rather than the Turnpike, causing greatly increased congestion and road wear-and-tear.
    - In essentially all examples of leased Turnpikes, tolls dramatically increased.
        - Tolls doubled in Indiana for non-EZ Pass users.
        - Chicago Skyway tolls went from $0.50 to $2.50 after privatization, and will be phased in to $5.00 by 2017.
    - The Administration's plan calls for caps on tolls, but this would likely reduce the amount of any lump-sum payment proportionally, making it difficult to reap the $2.4 - $3 billion target set by the Administration.

- Research has shown (notably, that conducted by our sister MPO in the Cleveland Area, NOACA) that a doubling of the toll rate will result in more than 50% of the Turnpike truck traffic shifting to non-tolled parallel routes.
  - Increased traffic on SR 303 would affect Richfield, Peninsula, Hudson, Streetsboro, Shalersville, Freedom, Windham, etc.
  - Increased traffic on SR 82/305 would affect Sagamore Hills, Macedonia, Twinsburg, Aurora, Hiram, Nelson, Garrettsville, etc.
  - Long haul traffic would likely divert to I-76/U.S. 224, causing increased congestion on these already busy highways.
- The wear-and-tear on these alternate routes would not be the responsibility of the Turnpike's vendor; rather, they would be paid for by federal and state taxpayers.
- However, the threat of loss of customers serves as a check-and-balance to limit any potential toll increases.



Analysis courtesy of the Northeast Ohio Areawide Coordinating Agency (NOACA).
http://media.cleveland.com/metro/other/Ohio%20Turnpike%20Lease.pdf

Valuation of the Ohio Turnpike

If the State is to proceed with the leasing of the Ohio Turnpike, it is imperative that a fair value for this key asset is determined. In 2006, J. Kenneth Blackwell, a candidate for Ohio Governor, stated that the leasing of the Ohio Turnpike to a private operator was one of his top priorities. At this time, David A. Ellis, Ph.D. (Senior Fellow and Director of Policy, Planning and Programs for The Center for Community Solutions) and Ned W. Hill, Ph.D. (Dean of the Maxine Goodman Levin College of Urban Affairs, Cleveland State University) authored a report titled *An Analysis of the Proposed Lease of the Ohio Turnpike* (www.csuohio.edu/offices/economicdevelopment/works/turnpike.pdf). This report used the Ohio Turnpike Commission's 2004 financial statements to calculate a range of present valuations for the Ohio Turnpike, and thus calculating a fair amount of the up-front lump-sum payment Ohio should expect for the leasing of this important asset.

Using this same valuation methodology, AMATS has calculated similar figures, using the Ohio Turnpike Commission's most recent (2009) financial statements, in order to estimate the current fair valuation of this asset under a number of different scenarios. According to our analysis, it would take a minimum of a 50 year lease to reach the $2.4 - $3 billion payment target desired by the Kasich Administration.

Ohio Turnpike Revenue Analysis

Operating Revenue	04 Report	09 Report	(Difference)
Tolls	$ 189,701,000	$ 187,278,000	
Special Toll Permits	$ 2,750,000	$ 2,964,000	
Concessions	$ 13,793,000	$ 13,616,000	
Other	$ 1,184,000	$ 2,058,000	
Total Operating Revenues	**$ 207,428,000**	**$ 205,916,000**	$ (1,512,000)
Operating Expenses	04 Report	09 Report	
Admin & Insurance	$ 7,982,000	$ 8,634,000	
Maint. Of Roadways & Structures	$ 30,957,000	$ 35,699,000	
Services & Toll Operations	$ 46,449,000	$ 53,817,000	
Traffic Control, Safety, etc.	$ 12,902,000	$ 15,529,000	
Major Repairs & Replacements	$ (277,000)	$ -	
Total Operating Expenses	**$ 98,013,000**	**$ 113,679,000**	$ 15,666,000
Total Profit (Loss)	**$ 109,415,000**	**$ 92,237,000**	$(17,178,000)

Methodology based upon that established by David A. Ellis, Ph.D. and Ned W. Hill, Ph.D. in their 2006 report *An Analysis of the Proposed Lease of the Ohio Turnpike*. www.csuohio.edu/offices/economicdevelopment/works/turnpike.pdf

Ohio Turnpike Cash Flow Summary: What is a Fair Price?

Annual Net Revenue as of 2009: $92,237,000 **(Source: OTC Financial Report 2009)**

Annual Net Revenue vs. Up-Front Lump Sum Payment [1]

Years in Lease	Sum of Annual Net Revenue (No Toll Increase)	Fair Lump Sum Amount (NPV) at 3% Discount Rate (No Toll Increase)	Fair Lump Sum Amount (NPV) at 5% Discount Rate (No Toll Increase)		Sum of Annual Net Revenue (3% Ann. Toll Increase)	Fair Lump Sum Amount (NPV) at 3% Discount Rate (3% Toll Increase)	Fair Lump Sum Amount (NPV) at 5% Discount Rate (3% Toll Increase)
10	$ 922,370,000	$ 786,800,319	$ 712,229,665		$ 1,057,393,836	$ 895,504,854	$ 806,852,026
25	$ 2,305,925,000	$ 1,606,136,504	$ 1,299,983,165		$ 3,362,893,163	$ 2,238,762,136	$ 1,760,350,404
50	$ 4,611,850,000	$ 2,373,236,243	$ 1,683,871,797		$ 10,404,044,648	$ 4,477,524,272	$ 2,848,772,288
75	$ 6,917,775,000	$ 2,739,607,350	$ 1,797,235,174		$ 25,146,652,227	$ 6,716,286,408	$ 3,521,741,826
99	$ 9,131,463,000	$ 2,909,788,879	$ 1,830,010,278		$ 54,293,360,777	$ 8,865,498,058	$ 3,924,750,217

[1] Methodology courtesy of David A. Ellis, Ph.D. and Edward W. (Ned) Hill, Ph.D., as used in their report *An Analysis of the Proposed Lease of the Ohio Turnpike*. Published June 25, 2006.

Conclusion

After thoroughly researching numerous articles, published analyses, and financial statements, AMATS staff concludes that the benefits to be gained from leasing the Ohio Turnpike to a private firm are far outweighed by the negatives.

The Administration has indicated that it wants to pursue an approach very different from that of previous states, ensuring the best possible deal for the residents of Ohio. A short term lease would be preferable to a long term one, caps on fare increases would be included, and rather than a one-time upfront cash infusion, the administration would prefer a stream of payments.

While the inclusion of these restrictions would seem to make any deal Ohio enters into superior to those of our sister states of Indiana and Illinois, they would each lead to reductions in the upfront, lump-sum payment, otherwise a mutually beneficial equilibrium could not be reached.

Unlike the Indiana Turnpike and the Chicago Skyway were prior to their privatization, the Ohio Turnpike is well managed and is consistently profitable. While it's true that the Ohio Turnpike carries a significant amount of debt, it should be noted that its debt was once paid off. Shortly afterward, the asset was borrowed against once again. Residents are rightfully skeptical about the long term elimination of debt. Previous administrations have reneged on promises to return the Turnpike to a traditional non-tolled highway upon its repayment, further adding to any skepticism. Financially, the Ohio Turnpike provides a reliable annual stream of revenue, reaching an all-time record of $236 million in toll receipts, during a recessionary year, in 2010.

The greatest potential benefit of a Turnpike lease would be an enormous up-front cash payment, allowing cost prohibitive projects a source of funding that they otherwise might never receive. However, once the up-front money is gone, it's gone for multiple generations.

There are three primary ways a private firm could profit from taking on a lease of the Ohio Turnpike: 1. a substantial increase in toll paying traffic, 2. raising toll rates, or 3. reducing operating and maintenance expenses. A large increase in traffic is probably not likely. Toll increases would simply cause people to take other routes, and all users of the Ohio Turnpike lose if maintenance of the highway is reduced.

The lease agreement could enforce minimum maintenance standards, toll ceilings, and periodic revenue streams, however, all of these will increase the rate of return used in their valuation of the highway, and as a result, reduce the funds that Ohio will receive for the lease. The consistent profit produced by the Ohio Turnpike renders anything other than a long term lease financially unbeneficial, and no one, including the Kasich administration, seems to support a long term lease.

In conclusion, we feel that the Ohio Turnpike is an efficiently run, revenue producing public asset that should remain under the control of those who purchased, built, maintained and are the primary users of it. We feel that this is a classic case of "If it isn't broken, don't fix it"; AAA polling and general discussion indicate that the majority of Northern Ohioans (2/3 of respondents in a recent AAA poll were opposed to a lease), regardless of political affiliation, feel the same way.