The Ohio Turnpike – Unlocking the Value of a Transportation Asset

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Background

In 2011, AMATS released an analysis of the benefits and challenges involved with the leasing of the Ohio Turnpike, which at the time had been proposed as a method of increasing revenue and closing Ohio’s major transportation funding gap. The analysis, titled “Leasing the Ohio Turnpike: What we Know and What we Anticipate”, looked at the Ohio Turnpike Commission’s (OTC) financial statements, as well as case studies of nearby states that had recently leased their own turnpikes to private firms in exchange for large upfront, lump-sum payments to be applied to those states’ major transportation projects. The findings raised concerns as to whether the costs of such an action would outweigh its potential benefits.

Approximately one year ago, partially in response to the aforementioned and similar concerns raised by stakeholders located across Ohio, the State of Ohio commissioned KPMG Corporate Finance to perform an analysis of three scenarios to unlock the potential value of the Ohio Turnpike. Although the issue has been controversial in nature, the state desperately needs revenue to close an ever increasing gap in the funding available for a number of necessary transportation infrastructure projects. With an increase in the state fuel tax considered off the table during these sluggish economic times, Governor John Kasich and the Ohio Department of Transportation (ODOT) viewed an “unlocking” of the intrinsic value of the Ohio Turnpike as the most effective and politically feasible method of closing the transportation funding gap.

This follow-up analysis will serve three functions: 1) A brief description of the independent KPMG financial analysis, 2) an outline of the stated policy directives of the Kasich Administration and ODOT, and 3) an AMATS staff analysis of some of the remaining issues and concerns related to the future of the Ohio Turnpike.

1) The KPMG Financial Analysis

The final draft of the KPMG analysis can be viewed at: [http://www.ohturnpikeanalysis.com/Ohio-Turnpike-Opportunity-Analysis-12-12-12-FINAL.pdf](http://www.ohturnpikeanalysis.com/Ohio-Turnpike-Opportunity-Analysis-12-12-12-FINAL.pdf). Three possible scenarios were analyzed in the KMPG study:

- **Status Quo** – the Ohio Turnpike would remain under the control of the Ohio Turnpike Commission (as it has been for its 60 year history), which would be newly authorized to issue bonds based on future toll revenues.

- **Public Option** – the Ohio Turnpike Commission and ODOT would be closely aligned, realizing savings through the elimination of redundant processes and streamlining of operations. Revenue would be generated by issuing bonds based on future toll revenues, as well as from future excess cash flows.

- **Public-Private Option (i.e. Turnpike Lease)** – in exchange for an up-front, lump sum payment, operations and maintenance of the Turnpike would be transferred to a private concessionaire. The concessionaire would be required to maintain the Turnpike according to predetermined standards.
The Public Option

Of the three options, the “public” option appears to be the one that the state has decided to pursue. However, there remain traces of the “status quo” option, particularly in regards to the relationship between ODOT and the OTC, which largely leaves the OTC’s functions and structure unchanged. The KPMG analysis indicates that selecting the “public” option would generate higher revenue than the “status quo”, and would avoid the political maelstrom of the leasing of a public asset to a private firm. In short, ODOT appears to be leaning towards a solid middle-ground option.

The KPMG analysis highlighted the following financial benefits associated with this particular option:

<table>
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<th>Public Option: Financial Benefits</th>
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<tr>
<td><strong>Savings Through Partnership Efficiencies</strong></td>
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<tr>
<td>- Reduced administrative costs by eliminating redundant functions</td>
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<td>- Streamlining of toll collection operations (i.e. EZ Pass adoption)</td>
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<td>- Closure of 2 maintenance facilities &amp; expansion of the remaining 6</td>
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<td>- Mirror ODOT's seasonal staffing procedures during winter months</td>
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<td>- Streamline operations of service plazas</td>
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<td><strong>In total, should achieve annual cost savings of 21% for 10 years</strong></td>
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<td><strong>Future Toll-Based Revenue</strong></td>
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<td>- Year 1 Bond Issue: $1.003 billion</td>
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<td>- Year 5 Bond Issue: $1.064 billion (NPV* of $833 million)</td>
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<td>Total Net Bond Proceeds: $2.067 billion (NPV* of $1.836 billion)</td>
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<td><strong>Excess Cash Flows: from $349 - $729 million over 50 years</strong></td>
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<td><strong>Total Aggregate Value: $2.185 - $2.564 billion over 50 year period</strong></td>
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<td>* NPV = Net Present Value</td>
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2) Stated Policy Directives

Although the KPMG study provided a detailed analysis for three potential scenarios to unlock the intrinsic value of the Ohio Turnpike, it left plenty of leeway for variation within each of those scenarios. Shortly after the completion of the KPMG analysis, ODOT issued a press release (see Appendix A) detailing high-level policy direction and the anticipated benefits of pursuing its version of the “public” option:

- There would be no long-term leasing of a public asset to a private organization
- The state expects to generate $1.5 billion in new funds, and an additional $1.5 billion from matching local and federal funds, for a total of $3 billion in funding for major Ohio highway projects
- 90% of new bond money would go directly to projects in Northern Ohio (defined as the portion of the state along or north of US 30)
- Tolls for local trips (defined as 30 miles or less) would be frozen for 10 years for EZ Pass users
- All other tolls will be capped at inflation (i.e. the CPI), which is substantially less than historic toll increases rates
• The Ohio Turnpike Commission would be renamed “The Ohio Turnpike and Infrastructure Commission”, indicative of its partnership with ODOT and its expanded funding authority
• No Turnpike employee layoffs are expected; 65,000 construction jobs generated by new projects are expected to be funded from these revenues

3) Outstanding Questions/Concerns

The decision to pursue the “public” alternative has already received some bipartisan support, and led to sighs of relief from many Northern Ohioans who generally felt many reservations towards an outright leasing of the Ohio Turnpike. Although many fears have been alleviated, there are still a few key questions and concerns on the minds of residents, businesses and public officials with a vested interest in the Turnpike.

This analysis classifies these outstanding issues as either primary concerns (those potentially having a statewide or regionally significant impact) or secondary concerns (those anticipated as having a localized or minimal regional impact).

Primary Concerns

Turnpike Reconstruction – In addition to numerous major transportation needs throughout the state, the Turnpike itself is in need of a total replacement, with an estimated $3.3 billion price tag. The KPMG analysis lays out a long-term plan for the complete reconstruction of the 241 mile Ohio Turnpike and its crumbling, 60 year old concrete base. Initially, it was estimated that the Turnpike would be reconstructed in 5 mile segments over a period of 50 years. However, Governor Kasich was recently quoted in the Toledo Blade as saying that the proceeds from the bonding of the Turnpike could reduce the overall completion time by 50%, to 25 years.

Omitted from the discourse thus far is a significant looming question: with many costly transportation needs all throughout the state, how much of the $3 billion will be reinvested directly back into Turnpike reconstruction, and how much will remain for other pressing transportation projects? At this time, the answers to these questions are unknown.

Major Statewide Transportation Needs – Without a doubt, $3 billion in “unlocked” Turnpike revenues represents a significant transportation funding opportunity. However, at this point in time, it is unclear how much of this revenue will be reinvested into Turnpike reconstruction, and how much will remain for other key projects around the state. Even without allocating any of the $3 billion to Turnpike reconstruction, these proceeds only partially address the outstanding needs of the state - estimated at $6 to $7 billion. Some of the state’s most significant projects include:

• Brent Spence Bridge Project/Reconstruction in Cincinnati - $2.4 billion
• Cleveland Innerbelt Bridge - $1.5 billion
• I-75 Upgrade in Cincinnati - $940 million
• I-70/I-71 Upgrade in Downtown Columbus - $680 million
• I-76/77 Reconstruction (Akron’s Central Interchange) - $416.3 million
• I-75 Upgrade in Greater Toledo - $371 million
• I-270/315/SR 23 interchange in Columbus - $184 million
In the end, “unlocking” the value of the Ohio Turnpike is still unlikely to address all of the state’s transportation needs. A significant funding gap is likely to remain even after exhausting the potential of this particular funding solution. Other means of generating revenue capable of fully funding Ohio’s transportation needs could include increasing state or federal fuel taxes, tolling additional roads/bridges, or finding other innovative funding solutions.

**Reinvestment in Northern Ohio** - An ongoing concern of Northern Ohioans is that Turnpike proceeds could largely benefit projects outside of Northern Ohio. Conflicting viewpoints are at play: Northern Ohioans view the Turnpike as a transportation asset which historically has been used by, paid for and maintained by Northern Ohioans throughout its 60 year history, and therefore, the majority of future revenues should be reinvested in their region. State officials see it as a State of Ohio asset, arguing that the majority of toll revenues are collected from traffic passing through the state – not local traffic.

Initial ODOT press releases indicate that 90% of proceeds from the Turnpike will be reinvested in Northern Ohio. Some local officials have referred to this declaration as a “shell game”, and that this new dedicated funding source will only cause fuel taxes collected in Northern Ohio to be shifted to projects elsewhere in the state. Governor Kasich responded in a 12/20/12 Toledo Blade article, stating that “I can only tell you that projects that would not occur [without this funding], will occur”.

Regardless of how the state decides to allocate its transportation funding, one item of concern remains for the AMATS region. To date, none of the discourse has referred to the primary transportation issue in the Greater Akron region: the Akron Central Interchange project. Although needs are substantial all around the state, AMATS hopes that the “unlocking” of Turnpike revenues will ultimately lead to the construction of the Central Interchange improvement project.

**Legislation to Spend Funds Beyond Turnpike** – Ohio law currently prohibits the OTC from spending Turnpike generated funds beyond one mile of the Turnpike. Legislation would need to be passed to permit all future Turnpike generated revenues (bond proceeds, excess cash flow payments, etc.) to be spent anywhere within the state. Presently, the timeline for passage of this legislation remains unclear.

**Secondary Concerns**

**Outstanding Debt** – The Ohio Turnpike currently carries approximately $566 million in outstanding debt. A benefit of the “public” option is that, unlike with an outright lease, this outstanding debt does not need to be deducted from the bond proceeds. However, if future toll revenues do not reach levels capable of servicing old and new debt, excess cash flows would be reduced or eliminated, and higher than expected toll increases may be required. Higher toll revenues would increase the traffic diverted to local streets, transforming a secondary issue into a primary issue.

**Employee Layoffs** – Initial news releases have touted the fact that Turnpike employees would not face layoffs. However, the KPMG report details that the savings from operational efficiencies presume large-scale adoption of electronic toll collection (ETC). The ETC adoption rate varies according to vehicle class. As of 2012, 30% of Class 1 vehicles (standard passenger cars, light trucks and motorcycles) pay their tolls via ETC. The rate is expected to increase to 43% by 2065. Approximately 40-90% of large trucks currently pay tolls electronically. The report predicts a 90-99% EZ Pass adoption rate, depending on truck class, by
2062. If such market penetration comes to pass, toll collectors may find their jobs subject to gradual reductions, albeit over a lengthy period of time. However, it could be argued that these gradual reductions would occur in any of the three potential scenarios. In today’s lean, technology-driven business environment, it’s not uncommon for workers to be automated out of their jobs, regardless of the industry.

Traffic Diversion – Communities located along the Ohio Turnpike have expressed concern that in the event of toll increases, truck traffic will be diverted from the Turnpike and onto local, parallel roads in an effort to evade high tolls. According to the KPMG report, truck traffic diversion is not expected to be an issue. The report states that 45% of all Turnpike traffic passes through the state with no local origin or destination. 69% of truck traffic passes completely through the state. Although there is some probability of diversion onto other interstates (I-76 or I-70), it is highly unlikely that long haul trucks would realize any financial benefit running along slow moving local parallel roads (SR 303, SR 82, etc.). Additional benefits to remaining on the Turnpike, despite higher tolls, are the 70 mph speed limit (the highest in the state), the generally lower traffic volumes and the permitting of long, triple-trailer vehicles.

The KPMG study reports that under the existing toll structure, approximately 33% of truck traffic is diverted from the Turnpike. Under the toll structure proposed for the selected “public” Turnpike option, the truck diversion rate would see a slight dip for the first ten years, with tolls capped at the inflation rate. Beyond the first ten years, tolls are scheduled to increase 10% every 10 years. An uptick in diversion is anticipated immediately following each increase, followed by a prolonged dip, due to the attractiveness of tolls which increasingly fall below the inflation rate. Historically, Turnpike tolls have risen 7% annually over the past two decades (Ohio.com 12/14/12). Towards the end of the 50 year KPMG analysis period, tolls are expected to be so underpriced (relative to the inflation rate) that the diversion rate will be well below its current rate.

As mentioned in the “Outstanding Debt” section, if future toll revenues do not meet the levels specified in the KPMG analysis, tolls will necessarily increase to levels capable of servicing both new and old Turnpike debts. These higher toll rates could lead to higher than expected traffic divergence levels, clogging local parallel roads with traffic opting to avoid high tolls. That being said, AMATS has no immediate reason to doubt the assumptions used in the KPMG analysis, which appear reasonable and sound.

The chart on the following page, produced by KPMG in its analysis, illustrates anticipated traffic divergence rates over an approximately 50 year period. Rates are based on the toll increase methodology proposed in the study, as described above.
Conclusion

In summary, AMATS appreciates the efforts of the State of Ohio in commissioning the detailed KPMG financial analysis. The analysis is thorough, the assumptions seem sound and the anticipated outcomes appear reasonable.

Of the three options presented in the KPMG analysis, the AMATS staff feels that the State of Ohio chose the best of them. If the process is executed successfully, we feel that there could be a significant benefit to our region and the state as a whole.

As the old saying goes, however, “the devil is in the details”. Will there be ample transportation dollars remaining after reinvesting a portion of the bond proceeds back into the Ohio Turnpike? Will there be a net gain in transportation funding to Northern Ohio communities, or will it simply shift the fuel taxes collected in our portion of the state to others? Will the AMATS region receive the funding it needs to complete major new projects, such as the Central Interchange reconstruction? Only time will tell.
AMATS appreciates the State of Ohio’s willingness to bring communities to the table for open dialogue during the early stages of this proposal. We hope that as the process moves forward, state officials will continue this productive dialogue by partnering with local elected officials across Northern Ohio through their respective metropolitan planning organizations. We appreciate the fact that fleshing out some of the details (especially with regards to funding) and answering some of the other questions posed in this analysis will take time. AMATS is committed to helping foster the necessary dialogue between state and local officials on the Ohio Turnpike, so that the state’s residents may continue to enjoy a world-class transportation system.
Ohio Launches ‘Jobs and Transportation Plan’ to Fuel Critical Highway Projects

Ohio Turnpike will not be leased; Commission remains public, independent; Tolls remain low

COLUMBUS (Thursday, December 13, 2012) – Governor John R. Kasich embarked on a two-day state tour as he, Ohio Department of Transportation (ODOT) Director Jerry Wray, Ohio Turnpike Director Rick Hodges and others unveil a first-of-its-kind plan to generate approximately $3 billion for highway road construction without leasing the Ohio Turnpike and without Turnpike employee layoffs.

The Ohio Jobs and Transportation Plan would generate $1.5 billion in new funds for Ohio highways from bonds issued by the Ohio Turnpike Commission and backed by future toll revenues. Up to an additional $1.5 billion could be generated from matching local and federal funds coming to a combined total of approximately $3 billion for Ohio’s major highway construction projects.

“This plan just makes sense as we continue Ohio’s economic resurgence, grow jobs and make our state prosperous once again,” Kasich said. “Billions of dollars in new highway funds further strengthens Ohio’s jobs-friendly climate and keeps our state moving by delivering more projects faster.”

“Bonding against future Turnpike revenue generates enough money to erase our highway budget deficit,” Wray said. “Combined with ODOT’s work to reduce our cost of doing business and improve service to the state’s motoring public, this plan puts the resources we need into our major construction budget.”
Details of the Ohio Jobs and Transportation Plan include:

- No long-term, private lease;
- A continued public, independent Turnpike with expanded authority and renamed the “Ohio Turnpike and Infrastructure Commission”;
- More than 90 percent of new bond money will go directly to northern Ohio highway projects, including the Turnpike itself;
- Rebuilding the Ohio Turnpike will occur decades sooner than planned;
- Tolls for local trips paid with an EZ Pass are frozen for 10 years;
- All other toll rates are capped at inflation, which is significantly less than historic toll increases;
- No Turnpike employee lay-offs are anticipated.

“Maintaining public control and an independent Turnpike Commission helps keep tolls low and workers on the job,” Hodges said. “Plus, with this new plan we can get to work rebuilding the entire Turnpike decades sooner than we once had planned.”

ODOT has cut the agency’s $1.6 billion highway budget deficit by $400 million thanks to new savings and operational efficiencies, but more money and more innovation is needed. Money generated from the Ohio Jobs and Transportation Plan will help fill budget deficit without raising taxes that would kill jobs. The launch of the new plan concludes a year-long study of options for better using the revenue generated by the Ohio Turnpike.

A copy of the complete study is available here.

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