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## TIFIA and private activity bonds: Additional financing sources for US PPP transportation projects

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As the market for transportation public private partnerships gathers pace in the United States, private sector concessionaires are increasingly tapping into supplemental forms of debt finance, facilitated by the US federal government, that provide the benefit of lower cost financing and potentially longer tenors than is typically available in the taxable bank or bond markets. This article focuses on the two principal sources of such supplemental financing: TIFIA and private activity bonds, or PABs.

### What is TIFIA?

In 1998, the US Congress passed the Transportation Infrastructure Finance and Innovation Act, or TIFIA, which established a US federal credit programme for eligible surface transportation projects of national or regional significance. Under this programme, the US Department of Transportation is authorised to provide three types of credit assistance—direct secured loans, loan guarantees and standby lines of credit. The objective of the TIFIA programme is to leverage US federal transportation funding by attracting private investment to the US surface transportation sector. Towards this end, TIFIA funding is available to state departments of transportation, transit operators, special transportation

authorities, local governments and private investors. As of August 2007, the US DOT had committed in excess of US\$3.6bn of funding under the TIFIA programme.

### What projects are eligible for TIFIA financing?

Projects seeking TIFIA financing must meet several threshold requirements, including:

- minimum anticipated project costs (generally no less than US\$50m);
- the TIFIA portion of the financing cannot exceed 33% of reasonably anticipated eligible project costs;
- the project's senior debt must receive an investment grade rating from a nationally recognized credit rating agency;
- the project must be included in the relevant state's transportation planning and programming cycle; and
- the project must have a dedicated revenue source, such as tolls or other user fees, that are pledged to secure debt service payments for both the TIFIA and senior debt financing.

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A pledge of federal funding, regardless of the source thereof, is not an acceptable dedicated source of revenue for this purpose. The US DOT may accept, however, on a case by case basis, general obligation pledges or corporate pledges.

Eligible project costs generally include project development (i.e., pre-construction) and right of way acquisition costs, procurement and construction costs and capitalized interest on the senior debt, reasonably required reserve funds and financing costs. Up-front concession payments made by a winning bidder to the state or local authority would also generally qualify. However, TIFIA financing costs and capitalized interest may not be included as an eligible project cost. With respect to real property acquisition, the property must be physically and functionally related to the transportation project to be an eligible cost; hence, land acquired for real estate development purposes would not qualify. In addition, with respect to development costs incurred prior to the making of the TIFIA application, US DOT will make an eligibility determination on a case by case basis, and will generally only consider costs incurred within three years prior to the application date.

It should be highlighted that projects receiving TIFIA financing must comply with certain federal laws that cover a wide range of activities. For example, highway projects must satisfy federally mandated minimum design standards and procurement procedures, including Buy America and disadvantaged business enterprise participation requirements, prevailing wage rates and compliance with anti-discrimination laws.

In addition, eligible projects must comply with the National Environmental Policy Act (NEPA), which necessitates an environmental evaluation and, if there is a significant impact on the environment, an environmental impact statement addressing alternative solutions and a record of decision that is issued by the relevant federal agency only following a public comment period.

### How is TIFIA financing obtained?

An applicant must submit a letter of interest in a prescribed format to the US DOT. If the US DOT

confirms the project's eligibility and readiness, the applicant may submit an application and, if it passes an initial screening, the applicant will be invited to make an oral presentation to US DOT staff. The staff then prepares an evaluation and recommendation to the DOT Credit Council, which consists of five representatives from the Office of the Secretary of Transportation and the Administrators of each of the Federal Highway Administration, the Federal Transit Administration, the Federal Railroad Administration and the Maritime Administration. The Credit Council in turn makes a recommendation to the Secretary of Transportation, who developed by private participants. Note that the US DOT will not obligate funding, however, until all basic requirements, such as obtaining environmental approvals, have been met. The issuance of a term sheet by the US DOT triggers the commitment of budget authority for the project.

In several recent projects, for example in Texas, the state DOT has applied for TIFIA financing and a PABs allocation (see below) prior to seeking proposals from bidders in order to provide bidders with the opportunity to factor these sources of financing into their proposals.

### TIFIA financing terms

The direct secured loan is the most commonly sought form of TIFIA financing, and provides a maximum loan tenor of 35 years after a project's substantial completion with a fixed interest rate based on US treasuries with comparable maturities. Debt service can be deferred for up to five years following commencement of revenue operations and, in addition, flexible amortization schedules, utilizing a mandatory debt service/scheduled debt service model, may be available. Moreover, the TIFIA loan's lien on project cash flow can be subordinate to the lien of other project debt (e.g., bonds or bank debt), except that the lien is required by federal statute to become *pari passu* with the lien of other debt upon the occurrence of a bankruptcy or insolvency event. Non-payment of TIFIA debt service for 12 months also triggers a determination as to whether an insolvency event has occurred.

## Private activity bonds

In the US, states and municipalities have traditionally financed public transportation infrastructure using tax receipts (e.g., fuel taxes) and proceeds of tax-exempt municipal bonds. Until recently, however, private participants in transportation PPPs have not had the benefit of tax-exempt bond financing and have had to resort to taxable debt financing to support their bids for transportation concessions. This is the result of the US tax code, which limits tax-exempt status for bonds issued by state and local authorities if the proceeds are used for private business purposes. Certain categories of infrastructure, such as airports, waste to energy facilities, and water and sewage facilities, among others, historically have benefited from special exemptions permitting tax-exempt treatment even if projects were developed by private participants.

In 2005, pursuant to the SAFETEA-LU legislation, the US Congress amended the US Internal Revenue Code to establish a new category of “exempt facility”—qualified highway or surface freight transfer facilities—with respect to which up to US\$15bn of tax-exempt private activity bonds, or PABs, may be issued by state or local governmental entities for the benefit of private developers. Accordingly, private concessionaires receiving PAB allocations may now benefit from the lower cost of capital achievable in the US tax-exempt bond markets. As with other private activity bonds, a government conduit entity is required to issue the bonds.

Qualifying projects for PABs include surface transportation projects that are otherwise receiving federal assistance; an international bridge or tunnel project for which an international entity authorised under federal or state law is responsible and which is otherwise receiving federal assistance; and any facility for the transfer of freight from rail to truck or vice versa (including temporary storage facilities relating to such transfers, but excluding lodging, retail, industrial or manufacturing facilities). If 95% of net bond proceeds are not expended for the relevant project within five years of issuance, the remaining proceeds must be used to redeem bonds within 90 days of the five-year anniversary date.

What constitutes “federal assistance” for eligibility purposes is determined by the US DOT. In general, while the entire project does not need to be receiving federal funding, it will be necessary for some material element of a project, such as front-end engineering work, to be supported by federal funds. The receipt of TIFIA credit assistance constitutes federal assistance for purposes of PABs eligibility, and hence it may be possible to utilise both TIFIA and PABs financing for a project.

There are also limitations on the use of PABs proceeds. In general, proceeds must be used for new construction projects as opposed to projects that have already commenced revenue operations.

The US DOT is responsible for allocating the US\$15bn of PABs authorised under SAFETEA-LU. As of June 2007, US\$3.37bn of conditional allocations had been made—US\$600m for the Missouri bridges project, US\$900m for the Port of Miami Tunnel project and US\$1.866bn for the SH-121 project in Texas. For this latter project, the bond authority may be reallocated due to the award of the project to the North Texas Tollway Authority, a public entity, in an unusual series of events following the initial award of the project to a Cintra-led consortium. One factor the US DOT is particularly focused on in allocating PABs authority is the timing of project delivery—it wants to ensure that the authority is utilized in a timely manner, and may impose a long-stop date prior to which the bonds must be issued.

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