

MARYLAND STATE TREASURER
Nancy K. Kopp

April 3, 2016

The Honorable Edward J. Kasemeyer
Chairman
Senate Budget and Taxation Committee
3 West Miller Senate Office Building
11 Bladen Street
Annapolis, Maryland 21401

The Honorable Sheila E. Hixson
Chairman
House Ways and Means Committee
131 House Office Building
6 Bladen Street
Annapolis, Maryland 21401

The Honorable Maggie McIntosh
Chairman
House Appropriations Committee
121 House Office Building
6 Bladen Street
Annapolis, Maryland 21401

Warren G. Deschenaux
Executive Director
Department of Legislative Services
Legislative Services Building
90 State Circle
Annapolis, Maryland 21401

Dear Chairman Kasemeyer, Chairman McIntosh, Chairman Hixson and Mr. Deschenaux:

Section 10A-203 of the State Finance and Procurement Article of the Maryland Annotated Code requires the State Treasurer, in coordination with the Comptroller, to analyze the impact of a public-private partnership agreement (P3 Agreement) proposed by a unit of State government on the State's capital debt affordability limits and submit that analysis to the Budget Committees and the Department of Legislative Services within 30 days of receiving a copy of the proposed agreement.

On March 4, 2016, my office received an executed version of a P3 Agreement to be entered into by and between the Maryland Department of Transportation (MDOT) and Purple Line Transit Partners LLC (Concessionaire) in connection with the proposed 16-mile light rail line extending from Bethesda to New Carrollton known as the Purple Line. This Agreement is referred to in this letter as the Purple Line P3 Agreement.

In coordination with the Office of the Attorney General, the Office of the Comptroller, including the State's External Independent Auditor,¹ and with the cooperation of MDOT, my staff and I have conducted an analysis of the Purple Line P3 Agreement to determine the impact, if any, of that Agreement on the State's capital debt affordability limits.

¹ The State's External Independent Auditor advised the State that GASB 60 which covers public-private partnerships did not apply to the Purple Line P3 Agreement. The Auditor further advised that the State's financial statement would reflect a \$2 billion asset and a \$1 billion liability as a result of the Purple Line P3 Agreement. Since the \$1 billion liability is not synonymous with State debt, this liability was not factored in when reaching the conclusions of this Report.

Background

Under the Purple Line P3 Agreement, the responsibilities for designing, building, financing, operating and maintaining the publicly-owned Purple Line are bundled together and transferred to the Concessionaire. In consideration for providing these services, the Purple Line P3 Agreement sets forth three types of payments to be made by MDOT to the Concessionaire: *Progress Payments*, which would be made during the design-build phase and would reimburse the Concessionaire for eligible project expenditures; *Milestone Payments*, which would be paid when the Concessionaire reaches two critical points in the project (service availability and final completion); and *Availability Payments*, which would be paid to the Concessionaire after service has begun as long as certain benchmarks are met. I have analyzed each type of payment to determine if each payment type should be considered tax-supported debt and, if so, whether inclusion of such payments would result in the State exceeding its debt affordability guidelines.

Progress Payments

Under the P3 Agreement, MDOT would make Progress Payments to the Concessionaire during the five-year design and construction phase of the project from the Transportation Trust Fund (TTF). MDOT has represented that these payments will be made to the Concessionaire on a reimbursable basis, and no part of the Progress Payments will include any reimbursement to the Concessionaire for payment of principal or interest on its own debt. As the Concessionaire incurs expenses related to the design and construction of the Purple Line, invoices will be submitted for payment. Upon invoice review and approval, a Progress Payment to the Concessionaire for eligible expenses will be made.²

If, instead of a public-private partnership, the State were to undertake a design-build transportation project on its own, that project would be considered a straightforward pay-as-you-go (PAYGO) project with associated costs paid from the TTF on a reimbursable basis. In fact, MDOT routinely uses cash to pay for design-build contracts, and obligations under such contracts are not considered tax-supported debt.

Given that Progress Payments exclusively reimburse the Concessionaire for actual, eligible design and construction expenses and that State design-build transportation projects are routinely considered PAYGO projects, the Progress Payments under the Purple Line P3 Agreement do not constitute a State obligation that is tax-supported debt. Consequently, the Progress Payments would not impact the State's capital debt affordability limits.

Milestone Payments

The Milestone Payments include two one-time payments to the Concessionaire: a \$100 million Revenue Service Availability (RSA) payment; and a \$30 million Final Completion (FC) payment. The RSA payment will be made once the Purple Line is operating but certain work such as landscaping is still incomplete, while the FC payment will be made once all work is complete.

MDOT has represented that both Milestone Payments will likely be used by the Concessionaire to pay debt service on its own Purple Line debt. MDOT will utilize the services of a Trustee to establish a

² MDOT has represented that it ultimately intends to allocate only federal and local funds to the Progress Payments. The fact that MDOT intends to use all non-State funds for the Progress Payments bolsters the conclusion that these payments are not State obligations that constitute tax-supported debt.

Trust Account to pay the Milestone Payments.³ MDOT will then direct federal and local funds, as well as MTA fare revenue, to be deposited directly into the Trust Account in an amount sufficient to make the Milestone Payments. The Milestone Payments will be paid entirely from this Trust Account, ensuring that only non-tax revenues are being used to make these payments.

Although these payments could be used by the Concessionaire to pay its debt obligations, MDOT will ensure that these payments are not supported by State tax revenues and do not constitute a State obligation that is tax-supported debt. Consequently, the Milestone Payments would not impact the State's capital debt affordability limits.

Availability Payments

The Availability Payment (AP) is a monthly payment intended, among other things, to pay for the operation, maintenance and renewal of the Purple Line. The obligation to pay Availability Payments begins once Purple Line service begins. There are three components of the AP which are intended to pay for different costs associated with the Purple Line: *General*, which is intended to pay Concessionaire debt service, among other things; *Operating and Maintenance* (O&M), which pays for regular O&M costs such as salaries and regular day-to-day maintenance of facilities, infrastructure, and equipment; and *Lifecycle*, which pays for vehicle and infrastructure rehabilitation and replacement. The different components of the AP are required under the terms of the Purple Line P3 Agreement to be clearly differentiated in each payment request submitted to MDOT.

General

Since the General portion of the AP is partially intended to cover payment of principal and interest on the Concessionaire's debt for the Purple Line, these payments could be considered debt. MDOT will again utilize the services of the Trustee to make these payments. MDOT will deposit MTA fare revenue, including but not limited to Purple Line fares, directly into the Trust Account, and the Trustee will pay the Concessionaire the General portion of the AP from such Trust Account. In this way, MDOT will ensure that the General portion of the AP is not supported by State tax revenues and does not constitute a State obligation that is tax-supported debt.

Operating and Maintenance

The O&M portion of the AP will pay for regular operating costs such as salaries and regular maintenance, such as janitorial services, routine repairs, and upkeep. These types of expenditures are routinely considered operating expenses, and, as such, would not be considered State debt. Therefore, the O&M portion of the Availability Payment does not constitute a State obligation that is tax-supported debt.

Lifecycle

There are three components of the *Lifecycle* portion of the AP: Light-Rail Vehicle (LRV); Non-LRV; and Special. The LRV and Non-LRV components of the Lifecycle portion of the AP are paid to the Concessionaire for rehabilitation or replacement of light-rail vehicles and infrastructure. Though these expenditures are capital in nature, MDOT would typically use TTF PAYGO funding for this type of system preservation in the absence of a P3 Agreement. As such, the LRV and Non-LRV Lifecycle portions of the AP do not constitute State obligations that are tax-supported debt.

³ In keeping with our delegated authority to procure financial services for the State, the State Treasurer's Office will procure the services of the Trustee approximately one year prior to the start of the Milestone Payments.

The Special component of the Lifecycle portion of the AP will be made over the first five years of the Purple Line P3 Agreement and will be used by the Concessionaire for start-up O&M, initial build up of an inventory of equipment and parts, and could be used for payment of debt service on its own debt related to these start-up costs.

Since the Special component of the Lifecycle portion of the AP is partially intended to cover debt service on the Concessionaire's Purple Line debt, these payments could be considered debt. MDOT will again utilize the services of the Trustee to make these payments. MDOT will deposit MTA fare revenue directly into the Trust Account, and the Trustee will make the Special component of the Lifecycle portion of the AP to the Concessionaire from such Trust Account. In this way MDOT will ensure that this portion is not supported by State tax revenues. Therefore, the Special component of the Lifecycle portion of the Availability Payment does not constitute a State obligation that is tax-supported debt.

Based upon the determination that the various portions of the AP do not constitute State obligations that are tax-supported debt, the Availability Payment would not impact the State's capital debt affordability limits.

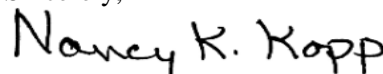
Conclusion

After reviewing the details of the Purple Line P3 Agreement and receiving representations from MDOT regarding the fund sources and methods of payment for the Progress Payments, Milestone Payments, and Availability Payments, it is my opinion that none of the payments included in the Agreement should count as State tax-supported debt that would impact the State's capital debt affordability limits.

I do note that the three rating agencies (Moody's, S&P, and Fitch) are looking at P3 Agreements nationally to determine if and how they will include these types of financing arrangements when calculating state debt metrics. My Office will be sharing this Report with the rating agencies. In addition, if the project is approved by the Board of Public Works, my Office will have conversations with the rating agencies to share the details of our analysis and the basis for our conclusions. I would expect that the Purple Line P3 Agreement would be a factor to be considered by the rating agencies in determining the State's credit ratings for our upcoming bond sale scheduled for June 8, 2016. We anticipate receiving the three ratings in late May.

I trust that my analysis will facilitate your review and comment on the Purple Line P3 Agreement.

Sincerely,



Nancy K. Kopp
State Treasurer

cc: The Honorable Lawrence J. Hogan, Jr., Governor of Maryland
The Honorable Thomas V. Mike Miller, Jr., President of the Senate
The Honorable Michael E. Busch, Speaker of the House
The Honorable Peter Franchot, Comptroller
The Honorable Pete K. Rahn, Secretary, Maryland Department of Transportation