



The Orange County Toll Roads: Largely Successful

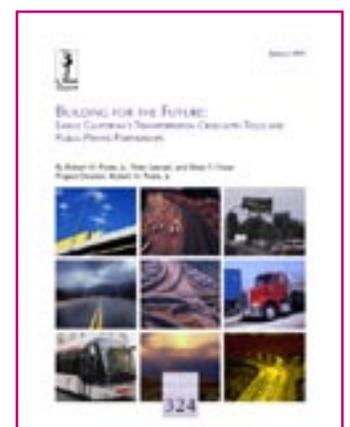
By Robert W. Poole, Jr.



The difficulties of the San Joaquin Hills Toll Road (SR 73) in Orange County have been well-publicized. In brief, it's not attracting as much traffic as projected, so its toll revenue is only 77 percent of what was forecast. Consequently, the 73 Toll Road, though operating in the black, does not have the planned level of reserve funds, and could theoretically default on its bonds in 2014 if things don't improve. But somehow the financial difficulties of this one toll road are often generalized into a negative judgment on all three toll roads developed by the County's Transportation Corridor Agency (TCA) during the 1990s. That perception is incorrect. The Foothill (SR 241) and Eastern (SR 241, 262, and 133) Toll Roads are doing better than forecast, in both traffic and revenue.

How did the quintessential land of the freeways come to build toll roads in the 1990s? What happened was that transportation funding failed to keep pace with Orange County's growth. From 1967 to 2000, the county's population doubled, from 1.4 million to 2.8 million. But the freeway system, though widened somewhat, was not expanded into the areas where much of the county's growth was occurring, due to lack of funding. Special legislation in 1986 allowed for creation of TCA; it was permitted to use tolls (as well as developer fees) to finance the construction of 67 miles of new toll road, in fast-growing eastern and southern Orange County. So far, 51 miles of the planned system have been financed, built, and opened to traffic. Investors have provided \$2 billion in bonds to build the

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Foothill and Eastern toll roads, and \$1.9 billion for the San Joaquin Hills. These bonds are backed by future toll revenues, not by Orange County. Thus, taxpayers have not been put at risk.

Start-up toll roads are inherently risky propositions, financially, especially in an area like Orange County with no previous familiarity or experience with toll paying. Detailed and sophisticated studies are made, to estimate the traffic that will use the new toll road at various possible toll rates. Using industry rules of thumb, the resulting traffic and revenue forecast is used to determine how large of a toll revenue bond issue can be offered. Bond buyers demand that projected revenue be some multiple of what is needed to make the scheduled debt-service payments (which pay interest and principal, similar to that of a home mortgage); multiples of 1.5 or 1.6 or higher may be required, depend-

ing on the specifics of a project, with the excess revenue set aside in reserve funds.

Some kinds of toll projects are easier to finance: adding lanes to an existing toll road, extending the length of an existing toll road, or developing a new toll road as part of a system of established toll roads in an urban area. In each of these cases, much more is known about people's willingness to pay tolls in that area. And in addition, the revenue base that supports the new bonds can include all the toll payments being made for the existing toll roads. By contrast, a stand-alone start-up project must be financed solely on the basis of the best prediction of how many people will use this one new project.

Because of these factors, the track record of stand-alone, start-up toll projects is not wonderful. There are more than 50 urban toll roads in the United States today, mostly



developed during the past 30 years. Only a few have actually defaulted on their bonds, but a number of others have experienced financial difficulties in their early years. The Dulles Greenway in northern Virginia defaulted a few years after it opened in 1996, primarily because the projected development near Dulles Airport had not yet materialized. But after a financial restructuring gave the project a new financial base (at considerable cost to the initial private investors), the surrounding area boomed, and today the Dulles Greenway has not only been able to increase toll rates, it has begun to add lanes to handle the increased traffic.

Seen in this context, the fact that two of the three TCA toll roads are exceeding their projections is actually a very good track record for start-up, stand-alone toll roads. For the 73 Toll Road, alternatives to default include extending the term of the debt and refinancing all three toll roads as a system. But even if default were to occur in 2014, it must be remembered that taxpayers will not be at risk. It is only the bond-buyers – sophisticated investors who knew what they were getting into – who stand to lose some of their investment. The toll road will still be there, after a financial restructuring, and with lower debt service requirements after the restructuring, it should be well-positioned to continue meeting Orange County's need for good transportation.

Public opinion in Orange County supports the toll roads. The 2002 Public Policy Institute of California/U.C.

Irvine survey asked residents whether the toll roads have been good, bad, or made no difference for transportation in the county. A strong majority (65 percent) said they were a good thing, versus only 16 percent who thought they were a bad thing. Asked specifically if the toll roads have been helpful in relieving traffic congestion, 77 percent either strongly or somewhat agreed. A 2003 survey by Decision Research for TCA asked South County residents whether they favor or oppose toll roads, and found 66 percent in favor. And 69 percent supported the construction of the planned Foothill South project.

Overall, then, the three toll roads have made a positive difference, taking nearly 300,000 cars per day off Orange County's freeways. The 73 Toll Road is nearly at capacity during some rush hours, even though its overall traffic is less than forecast.

Can we learn any lessons for future transportation policy from Orange County's initial experience with toll roads? Aside from continued improvements in toll road traffic and revenue studies, there is a known way to reduce the risk of default in start-up toll roads. Few businesses would finance themselves solely with debt if they had a choice. The problem with debt (bonds) is that it requires payments on a fixed schedule, regardless of temporary ups and downs in the business. It is considered much wiser for a business to employ a mixed capital structure, consisting of both debt and equity.

When a toll road is developed and operated by the private sector, under a long-term public-private partnership, this kind of capital structure becomes possible. For example, the new SR 125 toll road, under construction in San Diego County, is being funded approximately one-third with equity investment by its developer, and two-thirds with debt. Hence, if its early-years traffic and revenue are below projections, only two thirds of what would be required for debt service in an all-debt-financed toll road must be available in those critical early years. The equity providers tend to be "patient capital," willing to wait till later years for their return on investment.

This kind of capital structure reduces the risk of default in a stand-alone, start-up toll project. And that is a good reason for any new California enabling legislation to permit toll roads to be developed under long-term public-private partnership agreements as well as by joint powers authorities such as the TCA. ■

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RELATED STUDIES

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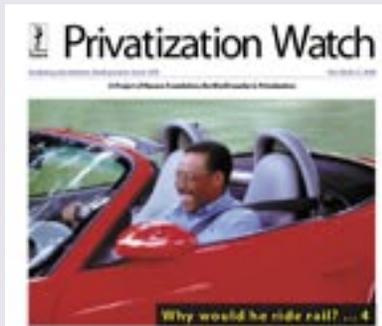
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