

Review of 91 Toll Road Funding

1. Summary

The Orange County Grand Jury became interested in studying the financial feasibility of the 91 Toll Road because of newspaper articles and public interest. Our findings indicate that:

- OCTA created a substantial long-term debt.
- The revenue and the operating expense projections appear to be optimistic.
- Unpaid vehicle violations represent \$18 million in outstanding citations.

However, after analysis, the grand jury believes:

- The 91 Toll Road is financially viable and self-supporting.
- Its purchase enabled OCTA to provide and fund much-needed improvements to the 91 Freeway.

Some Acronyms and Abbreviations in this Report

CPTC	California Private Transportation Company, L.P.
OCTA	Orange County Transportation Authority
RFP	Request for Proposal

2. Introduction

The 91 Express Lanes Toll Road (91 Toll Road) is located in the former median of Southern California's State Route 91 (91 Freeway). The toll road is 10 miles in length and links Orange County to the Riverside County line.

The California Private Transportation Company, L.P. (CPTC), opened the 91 Toll Road to traffic in December 1995. The original agreement establishing the 91 Toll Road prohibited improvements or planning for improvements for the 91 Freeway. Increasing congestion on the 91 Freeway led Orange County Transportation Authority (OCTA) to consider purchasing the toll road in order to be able to make improvements and reduce traffic congestion.

In 2002, after completing a financial analysis of the project, OCTA purchased the toll road for \$207.5 million. They assumed the \$135 million bond debt from CPTC and borrowed the remainder from other operations. OCTA began managing the toll road in January 2003. OCTA has restructured the bond financing, has implemented traffic-sensitive pricing, and has completed several improvements to the 91 Freeway. At the end of 2030, the 91 Toll Road will revert back to the State of California.

3. Purpose of the 91 Toll Road Study

The purpose of the study was to determine the financial viability of the 91 Toll Road.

4. Method of Study

Grand jurors met with OCTA management and staff, reviewed financial projections used by OCTA for the acquisition and for future operations, and observed the actual operations of the toll road. The study did not include a comparison with other toll roads because the 91 Toll Road is unique:

- It is constructed in the median of a public freeway.
- It has completely automated toll collections.
- It was constructed as a profit-making enterprise by a private company.
- It uses congestion management pricing which varies the tolls to manage the traffic.

5. Background

In September 2001, the OCTA Board of Directors instructed staff to explore solutions to improve traffic congestion on the 91 Freeway, such as widening entrances and exits and adding extra lanes. This study led to the decision by OCTA to purchase the 91 Toll Road from CPTC in 2002.

OCTA obtained estimates of the value of the toll road operations from two financial firms. The estimates ranged from \$202 million to \$220 million, using the income approach, with a discounted cash flow methodology. As a result, OCTA paid CPTC \$207.5 million for the 91 Toll Road assets and franchise rights, which expire December 31, 2030. OCTA assumed \$135 million in CPTC taxable bonds and paid CPTC \$72.5 million in cash. The cash amount was financed through temporary borrowing from OCTA's commuter rail fund and the bus operations fund.

OCTA began the operation of the 91 Toll Road in January 2003. In November 2003, OCTA refinanced the \$135 million of taxable bonds, which had an interest rate of 7.62%. They replaced them with tax-exempt bonds bearing an interest rate of 4.42%. The net present value of the savings was approximately \$24 million in debt service over the life of the loan.

The refinancing included repayment of \$23.5 million that OCTA borrowed internally from the bus operating fund. The commuter rail fund will be repaid over several years with interest.

Other expenses incurred for the refinancing were a prepayment penalty of \$26.4 million and financing costs of \$4 million. In addition, debt reserves of \$18.6 million were established as a conservative measure. The 91 Toll Road currently has \$191.6 million in outstanding senior debt (February 2005), plus \$56.4 million in subordinated debt.

5.1 Purchase Price Analysis

OCTA management and their consultants considered several different estimating approaches. They began with the historical experience of CPTC. The cost/unit in place approach, sales comparison and income approach—all were considered as methods to arrive at a purchase price. Only the income approach was found to be viable.

5.1.1 Cost/Unit in Place Approach

The cost/unit in place approach is the cost to reproduce the asset or business operation, which consists of the acquisition cost less depreciation. The acquisition cost of the right-of-way for the road is a necessary factor in this approach. However, such cost could not be determined because no comparable ten-mile toll road could be found. An estimate to construct a non-toll four-lane road came in at over \$200 million. The depreciation would be subjective and unsupported with actual market evidence. The approach did not provide a reasonable estimate of value but did serve as a reality check.

5.1.2 Sales Comparison/Guideline Company Approach

In the sales comparison/guideline company approach, an appraiser estimates the value of the property by comparing it with similar, recently sold properties in surrounding or competing areas. Due to the lack of comparable sales of any other ten-mile toll road, this method could not be used in the analysis.

5.1.3 Income Approach

In the income approach, projected income is converted to a value estimate through the capitalization of the income. This technique is commonly referred to as the discounted cash flow analysis. The projected income is adjusted with a discount rate from future dollars to current dollars. The riskier the future cash flows are, the higher the discount rate will be, and the less the projected income is worth today.

The toll road revenues are considered variable due to risk factors; therefore, a relatively high discount rate of 13-14% was used. The OCTA consultants pointed out the following risk factors that could materially impact revenues of the 91 Toll Road operation:

- expansion of alternate highways that could compete with the 91 Toll Road
- earthquake disrupting or destroying parts of the road
- availability and pricing of auto fuel
- technological advances
- changes in business trends
- users switching to other modes of travel

The revenues generated by CPTC were used as a basis in creating the income stream.

Operating expense projections were based on CPTC's historical statements for the years ending December 1998 through December 2001. The 2002 budget projection was also analyzed for expenses. All expenses were inflated at 2.5% per year in the estimate.

The expense categories included salaries and benefits, general and administrative, repair and maintenance, Caltrans services, California Highway Patrol services, contracted services, electronic toll collection system, finance related expenses, advertising and promotions, rent, professional fees and services, insurance, equipment rental, and miscellaneous expenses.

The income approach yielded an estimate of value for the 91 Toll Road between \$202 million and \$220 million. OCTA accepted this estimate as a basis for its negotiation with CPTC.

5.2 Grand Jury Analysis

The grand jury examined the assumptions underlying the revenue, expense and debt service projections. It is the opinion of the grand jury that the revenue and expense estimates prepared by the consultants for OCTA appeared to be optimistic when all of the risk factors were taken into consideration. In addition to the risk factors identified by the consultants, the development of an industrial/commercial base in Riverside and San Bernardino Counties could reduce the need to commute to Orange and Los Angeles Counties, which would slow the increase in traffic on the 91 Freeway.

Alternative financial projections were formulated by the grand jury with more conservative assumptions to test the fiscal soundness of the consultant projections.

5.2.1 Revenue Analysis

The grand jury believes OCTA's revenue projections are optimistic. Their projections are in line with respect to the current operations experience of January 2003-November 2004; however, the revenue projections continue to grow aggressively through 2029 to a high of \$77.5 million. The projection does not have a leveling off period after 2013 when OCTA will have two additional "free" lanes completed as part of their 91 Freeway Improvement Program. The revenue was inflated by 6% per year for the first nine years, 3.5-4% for the next nine years, and approximately 1.6-2.4% per year thereafter. A subsequent study included the effect of improvement projects and confirmed the essential viability of the purchase.

5.2.2 Expense Analysis

Each 10 years, \$10 million are set aside for capital improvements. Also, excess dollars are put in an account for unexpected capital projects. It is assumed the electronic toll collection system would require replacement every seven years at a cost of \$3 million.

5.2.3 Debt Service Analysis

Debt service consists of payments on fixed and variable bonds (4.42% interest fixed and 4.06% variable) and in-house subordinated debt to the commuter rail fund. The projections appear to be on target. The refinancing transaction to replace the original bond with tax-free bonds closed in November 2003. From 2005 through 2031, OCTA will pay \$417.9 million in principal and interest for the debt of \$207.5 million in bond borrowing and \$56.4 million in subordinated debt.

Under the provisions of Assembly Bill 1010 (2002), which authorized OCTA to purchase the toll road, if the debt is paid off early, the toll lanes will revert to the state as free lanes.

5.2.4 Grand Jury Model

The grand jury created a model using a more conservative 2% growth factor for the revenue but continued to use the same 2.5% growth factor for operating costs. In this model, some years reflect a negative net income between revenue, operating costs and the debt repayment schedule. OCTA would have to draw on reserves to make these payments in those years. However, even with the more conservative revenue projection, the toll road appears to be self-funding.

**Consultant Estimate (millions of dollars)
(Revenue, Operations Cost, and Debt Repayment)**

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Revenue	26.4	28.1	29.8	31.6	33.6	35.7	38.0	40.4	43.0	44.6
Operations Costs	8.3	8.5	8.7	9.0	9.2	9.4	9.6	9.9	10.1	10.4
Operations Income	18.1	19.6	21.1	22.6	24.4	26.3	28.4	30.5	32.9	34.2
Debt Repayment				11.9	20.2	19.3	20.2	21.2	12.3	26.3
Net Income	18.1	19.6	21.1	10.7	4.2	7.0	8.2	9.3	20.6	7.9

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	46.3	48.0	49.9	51.7	53.7	55.7	57.9	60.1	62.3	63.9	65.4
Operations Costs	10.6	10.9	11.2	11.5	11.7	12.0	12.3	12.7	13.0	13.3	13.6
Operations Income	35.7	37.1	38.7	40.2	42.0	43.7	45.6	47.4	49.3	50.6	51.8
Debt Repayment	31.2	20.2	22.2	14.7	12.3	12.3	12.3	12.3	12.3	12.3	12.3
Net Income	4.5	16.9	16.5	25.5	29.7	31.4	33.3	35.1	37.0	38.3	39.5

	2023	2024	2025	2026	2027	2028	2029	2030	2031*	Total
Revenue	67.0	68.7	70.4	72.1	73.9	75.7	77.5	79.1	40.3	1,590.3
Operations Costs	14.0	14.3	14.6	15.0	15.4	15.8	16.2	14.4	7.3	352.5
Operations Income	53.0	54.4	55.8	57.1	58.5	59.9	61.3	64.7	33.0	1,237.8
Debt Repayment	12.3	12.3	12.4	12.4	12.5	12.5	12.5	12.6	12.6	417.9
Net Income	40.7	42.1	43.4	44.7	46.0	47.4	48.8	52.1	10.4	819.9

* two quarters, 2030-2031

5.3 Automatic Toll Collection

From the beginning, the 91 Toll Road has used an automatic, transponder-based toll collection system, eliminating the need for manual toll collection. Drivers sign up to receive FasTrak transponders from OCTA, and their accounts are automatically debited when they use the toll lanes. The transponder can be used for FasTrak lanes throughout California. OCTA has expanded the ways to sign up for FasTrak accounts: They can now be obtained in person at the Corona and Orange OCTA offices, by mail or online.

When OCTA bought the 91 Toll Road, they were required to retain (for two years) the contract for FasTrak toll collection with the current contractor. The contract is currently up and a request for proposal (RFP) to obtain bids has been circulated. There are approximately 65 contractor personnel who are dedicated to the task of daily operation, repairs, towing and billing services. Last fiscal year, the expense for these services was in excess of \$5 million. In order to lower contract expenses, the RFP has been opened to other bidders.

5.4 Toll Violations

As of November 2004, there was a total of 292,424 outstanding citations with a value of \$18,366,542, which includes late charges and interest. When OCTA took over, there was a two-year backlog of citations. They have instituted an aggressive collection policy.

The system processes most of the vehicles automatically. However, attempts by drivers to elude tolls create the need for human intervention. Vehicles that do not trigger the transponder automatically are reviewed for matches within the system. If no account can be found, a courtesy violation notice is sent out, along with an offer to sign up for a transponder account. If there is no response to the violation notice, or if an owner cannot be readily identified from the license number, collection efforts are undertaken.

6. Findings

Under California Penal Code sections 933 and 933.05, responses are required to all findings. The 2004-2005 Orange County Grand Jury has arrived at the following findings:

- 6.1 ***Primary goal accomplished:*** OCTA's purchase of the 91 Toll Road has accomplished their primary goal of being able to make improvements on the 91 Freeway.
- 6.2 ***Revenue and expense projections:*** OCTA used optimistic revenue and expense projections to calculate the purchase price and assumed a large debt to do so. Even so, their experience to date has been in line with, or exceeded, projections.

- 6.3** Payment Violators: The 91 Toll Road has repeated violators who use the toll road without paying.

Responses to Findings 6.1, 6.2, and 6.3 are required from the OCTA Board of Directors.

7. Recommendations

In accordance with California Penal Code sections 933 and 933.05, each recommendation will be responded to by the government entity to which it is addressed. The responses are to be submitted to the Presiding Officer of the Superior Court. Based on the findings, the 2004-2005 Orange County Grand Jury makes the following recommendations:

- 7.1** Implement improvements: Continue to implement proposed improvements to the 91 Freeway, including working with Riverside County to eliminate bottlenecks. (See Finding 6.1.)
- 7.2** Revenue surplus: If a surplus occurs, OCTA should consider accelerating the bond payoff, allowing the toll road to revert to free lanes as soon as possible. Surplus revenues could also be used for other transportation improvements in the 91 corridor. (See Finding 6.2.)
- 7.3** Payment Violators: Continue using aggressive efforts to collect unpaid tolls. (See Finding 6.3.)

Responses to Recommendations 7.1, 7.2, and 7.3 are required from the OCTA Board of Directors.

8. Sources

1. 2004-2005 OCTA Approved Budget
2. 2004 OCTA Executive Summary
3. 2004-2030 OCTA Long-Range Strategic Plan
4. 91 Express Lanes Brochure – 2003
5. Assembly Bill 1010 (2002)