GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2015

Legislative Fiscal Note

BILL NUMBER: House Bill 954 (Third Edition)

SHORT TITLE: Terminate Agreement for Tolling of I-77.

SPONSOR(S): Representatives Jeter, Hager, and Bradford

FISCAL IMPACT

($ in millions)

☑ **Yes** ☐ **No** ☐ **No Estimate Available**

State Impact	**FY 2016-17**	**FY 2017-18**	**FY 2018-19**	**FY 2019-20**	**FY 2020-21**
HF/HTF Revenues:	$0.0	$0.0	$0.0	$0.0	$0.0
HF Expenditures: (Clean Up)	$4.4	$0.0	$0.0	$0.0	$0.0
HF/HTF Expenditures: (Termination And External Expertise)	No estimate available. Please see Assumptions and Methodology section for additional details.				
State Positions:	0.0	0.0	0.0	0.0	0.0
NET STATE IMPACT	**($4.4)**	**$0.0**	**$0.0**	**$0.0**	**$0.0**

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Transportation

EFFECTIVE DATE: Varies

TECHNICAL CONSIDERATIONS:
Yes - See Technical Considerations Section

BILL SUMMARY:

Sec. 1 requires the Department of Transportation (DOT) to terminate the Comprehensive Agreement for the I-77 HOT Lanes Project in Mecklenburg and Iredell counties. It specifies that "Comprehensive Agreement" means the Comprehensive Agreement dated as of June 26, 2014, including any amendments made to the Agreement as of the effective date of this act. It directs DOT to terminate the Comprehensive Agreement (Agreement) for the I-77 HOT Lanes project (Project) in Mecklenburg and Iredell counties pursuant to Section 17.1.1.7 of the Agreement, and in a manner consistent with its terms. Section 1 also includes language stating that the State is not relieved from paying damages owed from the early termination of the agreement.

Sec. 2 creates a reserve account within the Highway Trust Fund to be used to pay any damages or other monetary penalties resulting from the termination of the Agreement. It requires that, upon resolution of any litigation resulting from the cancellation of the Agreement, or 10 years, whichever is sooner, the funds remaining in the reserve account are to be used by the Department of Transportation to fund the projects suspended by the act, in their Strategic Transportation Investments Act Prioritization 3.0 order. It provides that, if those remaining funds are insufficient to fund any of those suspended projects, those unfunded projects may be resubmitted for prioritization under the Strategic Transportation Investments Act as new projects without prejudice. In the event these funds are deemed unappropriated, the funds are appropriated for the purposes as stated in this section of the act.

Sec. 3 specifies the eight projects to be suspended in Mecklenburg County, notwithstanding Article 14B of G.S. Chapter 136 (Strategic Prioritization Funding Plan for Transportation Investments): I-77/Gilead Road Interchange, I-77/NC-73 Interchange, five projects to widen NC-73, project widening US-21 (two projects), US-21/Gilead Road Interchange, project widening NC-115, Hambright Road Improvements, and Lakeview Road Improvements.

Sec. 4 directs that any State funds resulting from the suspension of the projects in Sec. 3 are to be credited to the reserve account established by the act.

Sec. 5 prohibits a project on I-77 in Mecklenburg or Iredell Counties to be constructed as a toll-managed lanes public-private partnership project by DOT or Turnpike Authority, notwithstanding the provisions of G.S. 136-18(39), G.S. 136-18(39a), and G.S. 136-89.183(a)(2).

Sec. 6 provides that the act is to have no effect on the provisions or implementation of the Strategic Transportation Investments Act, Article 14B of G.S. Chapter 136, except as provided in the act.

Sec. 7 appropriates $25,000 from the Highway Fund to DOT in nonrecurring funds for FY 2016-17 to be used for legal fees incurred in determining the amount of damages that may be owed and other effects resulting from the cancellation of the Agreement.

Sec. 8 states that all provisions of the act are effective September 1, 2016, except the provisions for appropriation and effective date, which are effective July 1, 2016.

ASSUMPTIONS AND METHODOLOGY:

The I-77 Managed Lanes Project, located in Mecklenburg and Iredell Counties, spans 26 miles from Brookshire Freeway (Exit 11) to NC-50 (Exit 36). The project converts existing HOV lanes to managed lanes and adds a new managed lane along both I-77 North and I-77 South. DOT signed the Comprehensive Agreement with I-77 Mobility Partners on May 20, 2015.

The proposed bill would trigger a fiscal impact in three key areas: 1) the cost to cancel the Comprehensive Agreement, 2) the cost for external legal fees, consultant fees and other expert fees, and 3) the cost to stabilize the road to a safe and environmentally stable condition.

Cost to Terminate the Comprehensive Agreement

The proposed bill requires DOT in Section 1 to terminate the Agreement consistent with the terms of the Agreement and pursuant to Section 17.1.1.7 of the Agreement. Article 17 of the Agreement includes provisions for default, remediation, and dispute resolution. Sec. 17.1 of Article 17 describes the types of occurrences of specified events or conditions that can be used to show the Developer is in breach of the Agreement. Sec. 17.1.1.7 states "Any representation or warranty in the CA Documents made by Developer, or any certificate, schedule, report, instrument or other document delivered by or on behalf of Developer to NCDOT pursuant to the CA Documents is false or materially misleading or materially inaccurate when made or omits any required material information when made." According to Section 17.1.3 of the Agreement, the Developer has a cure period of 0-180 days to remedy the developer default. Under the Agreement, termination of the Agreement falls under two contractual provisions within Article 19, which sets forth the types of termination proceedings. The two types are in Section 19.1 of the Agreement - Termination for Convenience and in Sec. 19.3 of the Agreement - Termination for Developer Default.

Under the Agreement, DOT may terminate the Agreement for convenience. The Termination for Convenience provision entitles the Developer to compensation based on the greater of Fair Market Value (FMV) or the senior debt termination amount, plus demobilization costs. A report issued in January 2016 by the State Auditor, discussed later in this paragraph, states that FMV "is exactly what it sounds like in that it represents the value of the asset, being the rights and interests available to and obligations of the private partner under the Comprehensive Agreement, as defined if these rights and obligations were to be marketed for sale to a third party or evaluated as an asset of the private partner." Also, as project construction advances, the risk of project delays, or other risk related factors, such as bankruptcy, declines. Therefore, the project's value increases as the level of risk declines. Demobilization costs are paid for shutting down the project work site and for other out of pocket costs. The Office of State Auditor issued a report in January 2016 that calculated the potential cost to cancel the Agreement through the Termination for Convenience provision. The Auditor's report found that the FMV and the debt termination amounts are not static, and constantly change over time. The Auditor's report estimated the FMV to be $300.2 million, the senior debt determination amount to be $82.1 million, and the demobilization cost factors were "conservatively estimated" to be $4.6 million. Each estimate is based on a cancellation date of October 31, 2015. Therefore, since the FMV is the greater of FMV and the senior debt termination amount, the Auditor's report estimates the cost will be $300.2 million for FMV plus $4.6 million for demobilization costs based on a cancellation date of October 31, 2015.

DOT states that the Developer may default on the terms of the Agreement through bankruptcy or "other Developer defaults" in which the Developer fails to perform its contractual obligations. Under a Termination for Developer Default provision, DOT states that it "must compensate lenders for 80% of outstanding debt" if cancelled "before substantial completion" of the project.
The project is financed with $100 million in private activity bonds (PABs) and $215 million in federal TIFIA loans. The project is funded with $17.7 million in expected interest accrued on the PABs and TIFIA loan. The amount of interest drawn down on the PABs and TIFIA loans will be included when calculating the 80% of outstanding debt. The remaining project funds, which do not count as debt, come from DOT ($88.2 million) and from private equity ($234.2 million). DOT stated that all of the $100 million from PABs has been used and approximately $7 million to $10 million of the TIFIA loan has been used as of June 2, 2016. Therefore, if the Agreement was terminated today, DOT, under the terms of the Agreement, would compensate 80%, or a minimum of approximately $88 million, if a qualifying default termination event is found.

Under the provisions of Section 1 of the proposed bill, it is unknown whether the Agreement would be cancelled under the Termination for Developer Default provision or the Termination for Convenience provision. The cost to terminate the Agreement under the Termination for Convenience provision will likely increase as the FMV increases as more of the project is constructed. KPMG, the DOT consultant hired to negotiate the I-77 contract, believes the cost to terminate the Agreement under the Termination for Developer Default provision will, with a high degree of confidence, likely increase as more TIFIA funds are used to construct the project. The calculations provided by DOT and the Office of State Auditor estimate a minimum cost of $88 million under the Termination for Developer Default provision or a minimum cost of $304.8 million under the Termination for Convenience provision.

Costs for External Professional Services

Additional external professional services fees under either termination provision cannot be determined. DOT may need to employ external attorneys, advisors, and experts. KPMG stated that “a successful termination for cause claim could result in a much shorter dispute period while a termination for convenience would likely result in significant disagreement over the fair market value. This dispute could easily result in the need for additional expert and adviser services.”

DOT provided the following costs to hire external expertise that were used in recent lawsuits. DOT hired outside legal staff to work on the Map Act lawsuit in April 2015 and has spent $1.15 million to date. DOT paid $189,199 for outside legal staff for the Monroe Bypass lawsuit from October 2014 through January 2016. The costs stated above were provided by DOT as a general proxy for these types of professional services costs, but DOT notes the nature of the work performed may not be equivalent to the requirements for a termination authorized under the proposed bill.

According to KPMG, while contracts for public-private partnership toll/managed lane projects have been renegotiated, no contracts are known to have been cancelled for cause or convenience at this stage in the construction process in the United States to date. According to a research paper from the George Mason University School of Policy, Government, and International Affairs, of the 45 public-private partnership highway project contracts entered into in the US, 18 have been renegotiated.

DOT does not know if it will require attorneys outside of the Attorney General’s Office. DOT will retain consultants, who may hire attorneys and other experts, if the contract is terminated. DOT estimates hiring private counsel for litigation could cost $600-$1,500 per hour, commercial advisors could cost $300-$1,000 per hour, and experts hired for traffic and revenue estimates could cost $150-$350 per hour. The Agreement requires an expert advisor to evaluate the FMV upon termination, which will cost approximately $300-$1,000 per hour. A fiscal estimate of the cost to hire external expertise is not available but it will exceed the $25,000 appropriated in FY 2016-17 in Sec. 7 of this bill.

Cost to Stabilize Project Work Site

Work on the 26 mile I-77 managed lanes project has progressed quickly since construction began in November 2015. Construction is expected to be completed in 2018. According to DOT, surveying, geotechnical activities and other preconstruction activities are ongoing from the I-277/I-77 Interchange past Exit 18, the road is being graded between Exits 23 and 28, and construction is occurring between Exits 23 and 36. Traffic barriers have been installed to shift traffic between Exits 28 and 36. By cancelling the Agreement, DOT will need to restore the road to a safe and environmentally stable condition. Based on Figure 1, DOT estimates it will incur $4.37 million in FY 2016-17 to stabilize the project's work site.

Figure 1: DOT Estimate of I-77 Clean Up and Restoration Cost as of June 1, 2016

Item Description	UOM	Quantity	Unit Price	Subtotal	Comments
UNCLASSIFIED EXCAVATION	CY	30,000	$12.00	$ 360,000	Fill in silt basins, build median shoulders where removed for widening
GRADING	LS	1	$80,000.00	$ 80,000	Walk In Slopes, shaping median, grading shoulders, ditch work
FRAME W/2GRTS STD 840.20	EA	22	$125.00	$ 2,750	Grates for Drainage Structures installed w/ no grate
MILLING ASPHALT PAVEMENT	SY	133,700	$2.00	$ 267,400	Assumed worst case removal of 3' wide - old pavement marking lines
ASPHALT SURFACE COURSE	TON	11,500	$60.00	$ 690,000	Pavement repair to fill milled areas
ASPHALT BINDER FOR PLANT MIX	TON	700	$500.00	$ 350,000	Pavement repair to fill milled areas
RIP RAP, CLASS B	TON	500	$40.00	$ 20,000	Median ditches as needed
STL BM GUARDRAIL	LF	28,000	$15.00	$ 420,000	Installation of new guardrail, assuming existing was disposed of
GR ANCHOR TYPE 350	EA	16	$2,000.00	$ 32,000	Installation of new units
GR ANCHOR TYPE B77	EA	8	$1,500.00	$ 12,000	Installation of new units
GR ANCHOR TYPE (CAT)	EA	8	$500.00	$ 4,000	Installation of new units
REMOVE PORT CONC BARRIER	LF	100,000	$6.00	$ 600,000	Estimated removal and trucking costs
THERMO PVT MKG LINES 6 " 120 MILS	LF	43,000	$1.15	$ 49,450	Reestablish existing I-77 traffic pattern, long life markings
THERMO PVT MKG LINES 6" 90 MILS	LF	338,000	$0.90	$ 304,200	Reestablish existing I-77 traffic pattern, long life markings
THERMO PVT MKG LINES 12" 120 MILS	LF	20,000	$3.30	$ 66,000	Reestablish existing I-77 traffic pattern, long life markings
RUMBLE STRIPS	LF	63,000	$0.13	$ 8,190	Reestablish along outside shoulders in areas where removed
SNOWPLOWABLE PAVEMENT MARKERS	EA	4,300	$5.00	$ 21,500	Installation of new lenses in existing markers
SEEDING AND MULCHING	ACR	100	$1,900.00	$ 190,000	Permanent vegetation establishment in the median
MATTING FOR EROSION CONTROL	SY	60,000	$2.00	$ 120,000	As needed
LANE CLOSURE	EA	75	$1,600.00	$ 120,000	Barrier removal, pavement marking removal, pavement repair, restriping
TOTAL				**$ 3,717,490**	
Additional Overage				$ 400,000	Work that may surface in a more detailed estimate or during reconstruction
Engineering & Inspection				$ 250,000	Estimated contract administration costs
GRAND TOTAL				**$ 4,367,490**	

Notes: Does not include the cost of any completed work to date (design or construction) and does not incude demobilization costs for subcontractors

UOM Definitions: CY: Cubic Yard; LS: Lump Sum; EA: Each ; SY: Square Yard; TON: Tons; LF: Linear Foot ; ACR: Acres

The $25,000 appropriated from the Highway Fund in Sec. 7 of the bill is insufficient to cover these costs. Sec. 6 additionally prohibits the use of Highway Trust Fund monies in the Strategic Transportation Investments account as coverage. (See Technical Consideration #2)

SOURCES OF DATA: Department of Transportation, Office of State Auditor, KPMG, George Mason University

TECHNICAL CONSIDERATIONS:

1. The proposed bill does not indicate how DOT should proceed forward with the I-77 project. If the intent is to continue the project as a non-public-private partnership managed

lane project under DOT's "Transition Project" status, DOT may need additional legislative direction that enables it to fund approximately $235 million needed to finance the project. The Agreement's financing plan used $234.2 million in private equity. The $235 million assumes DOT negotiates a similar debt package for the bond and the TIFIA loan.

2. Sec. 7 appropriates $25,000 in FY 2016-17 for legal or other costs from the Highway Fund but does not indicate which account within the Highway Fund to use or how to fund costs in excess of $25,000. Sec. 6 prohibits the use of Highway Trust Fund monies in the Strategic Transportation Investments account to fund these costs.

3. As stated in the Assumptions and Methodology section, it is assumed the estimates provided by DOT and the Office of State Auditor can reasonably be used to estimate a minimum cost of $88 million under the Termination for Developer Default provision or a minimum cost of $304.8 million under the Termination for Convenience provision.

   The proposed bill establishes a reserve within the Highway Trust Fund to fund the costs incurred by terminating the Agreement. . The Strategic Transportation Investments law does not provide an avenue for payment of funds from lawsuit settlements or court judgments. Sec. 6 also prohibits the use of Highway Trust Fund monies in the Strategic Transportation Investments account to fund these costs. If potential termination costs incurred exceed funds deposited to the reserve established by the proposed bill, then other legally authorized budgetary appropriations may be required.

4. Figure 2 includes a list of the projects covered under Sec. 3 and the 10 year schedule used in the STIP. Funds would be deposited into the account based on the fiscal year(s) in which DOT anticipates funding the project. Thus, funds from these accounts to be deposited to the reserve established under the proposed bill would accumulate year-by-year at different amount rates. It is unknown if the timing of deposits to the reserve would match the cash flow needs required for a possible termination of agreement scenario.

Figure 2: Schedule of Maximum Funding Availability to be Deposited Annually in Reserve Fund

	Funding Programmed in STIP (in $M)									
Project	FY 16	FY 17	FY 18	FY 19	FY 20	FY 21	FY 22	FY 23	FY 24	FY 25
I-5714 - I-77 Gilead Rd Interchange		0.1	10.5							
I-5715 - I-77/NC 73 Interchange				1.6		16				
R-2632 AB - NC 73 Widening						1.2		18.2		
U-5114 - US 21/Gilead Road Intersection		3.5								
U-5765 - NC 73 Widening						1.3		26.8		
U-5767 - US 21 Widening					23.2					
U-5771 - US 21 Widening					19.5					
U-5772 - NC 115 Widening							6.6		18.3	
U-5904 - US 21 Widening	1									
I-5405 A & B - I-77 Hambright & I-77/Lakeview Interchanges	29.7	23.7	23.7							
R-5721 AB - NC 73 Widening						3.6	4	4.1	20.2	4.1
TOTAL	30.7	27.3	34.2	1.6	42.7	22.1	10.6	49.1	38.5	4.1
CUMULATIVE TOTAL	30.7	58	92.2	93.8	136.5	158.6	169.2	218.3	256.8	260.9

5. Figure 2 includes the maximum funding available to be deposited in the reserve established by Sec. 2. Sec. 4 states that "State" funds on the listed projects shall be credited to the reserve. DOT chooses which projects will receive federal funds based on project eligibility parameters established by the US Department of Transportation. DOT may choose to swap federal funds for State funds and move the federal funds to other eligible projects. Reallocating funds between projects in future years has no fiscal impact.

   G.S. 143C-1-1(d)(25) defines both federal and State funds as State funds within the Highway Trust Fund. To provide further clarity to DOT, Sec. 4 of the bill could be amended to add federal funds.

   The eligible projects under Sec. 3 include $136.2 million in State funds used in Mecklenburg County and $124.6 million in federal funds, including State matching funds, used in Mecklenburg County.

6. One of the projects listed in Sec. 3(4) (STIP ID: R-5706B) is wholly in Cabarrus County. Another project in Sec. 3(4) (STIP ID: R-5721AB) is partially located in Lincoln County. Only the Mecklenburg County costs are included in Figure 2. It is unclear what will happen to the portions of the project located in Lincoln County.

FISCAL RESEARCH DIVISION: (919) 733-4910

PREPARED BY: Amna Cameron

APPROVED BY:

Mark Trogdon, Director
Fiscal Research Division

DATE: June 7, 2016

Official Fiscal Research Division Publication

Signed Copy Located in the NCGA Principal Clerk's Offices