



MARYLAND STATE TREASURER
Nancy K. Kopp

July 9, 2021

The Honorable Guy J. Guzzone
Chair, Senate Budget and Taxation Committee
3 West Miller Senate Office Building
11 Bladen Street
Annapolis, Maryland 21401

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

The Honorable Anne R. Kaiser
Chair, House Ways and Means Committee
131 House Office Building
6 Bladen Street
Annapolis, Maryland 21401

Victoria L. Gruber
Executive Director
Department of Legislative Services
90 State Circle
Annapolis, Maryland 21401

Dear Chair Guzzone, Chair McIntosh, Chair Kaiser, and Mrs. Gruber:

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 (“P3”) Agreement proposed by a unit of State government and submit its report to the Budget Committees and the Department of Legislative Services within 30 days of receiving a copy of the proposed agreement. The Board of Public Works (“BPW”) may not approve the proposed P3 agreement until the report has been submitted.

On June 10, 2021, my office received a P3 Agreement proposed to be entered into by the Maryland Department of Transportation (“MDOT”), the Maryland Transportation Authority (“MDTA”), and Accelerate Maryland Partners. In coordination with the Office of the Comptroller and with the cooperation of MDOT and MDTA, my staff has conducted an analysis of the P3 Agreement. The resulting report is included under this cover letter.

In addition to analyzing the proposed P3 Agreement, the report discusses our concern that my office was unable to fully engage the State’s Financial Advisor and Bond Counsel to assist with the review due to a lack of funding. The report therefore recommends updates to Maryland’s P3 statute, including the provision of a funding mechanism and a requirement that the Financial Advisor and Bond Counsel analyze the documents, which we believe would

facilitate a more robust review of future P3 Agreements. My office would be glad to assist with this process if the General Assembly decides it is appropriate.

If you have any questions, please do not hesitate to reach out to my Director of Debt Management, Christian Lund, who is the primary author of the report. He may be reached by phone at (410) 260-7920 or by email at clund@treasurer.state.md.us.

Sincerely,

Handwritten signature of Nancy K. Kopp in black ink.

Nancy Kopp
State Treasurer

cc: The Honorable Peter Franchot, Comptroller of Maryland
The Honorable Greg Slater, Secretary, Maryland Department of Transportation
Bernadette Benik, Chief Deputy Treasurer, State Treasurer's Office
Christian Lund, Director of Debt Management, State Treasurer's Office
Jaclyn Hartman, Chief Financial Officer, Maryland Department of Transportation



**OFFICE OF THE STATE TREASURER:
REVIEW OF PROPOSED PUBLIC-PRIVATE
PARTNERSHIP**

JULY 9, 2021

For further information or questions, contact:

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I. Introduction

Under Section 10A-203 of the State Finance and Procurement Article of the Annotated Code of Maryland (“SF&P 10A-203”) the State Treasurer’s Office (“STO”), in coordination with the Office of the Comptroller, is required to analyze the impact of a public-private partnership (“P3”) proposed by a unit of State government on the State’s capital debt affordability limits and submit that analysis to the Budget Committees and Department of Legislative Services within 30 days. The Board of Public Works (“BPW”), which is responsible for approving all P3s in the State, may not act on the proposed P3 until this report has been submitted. This report is the result of the submission of a proposed P3 by the Maryland Transportation Authority (“MDTA”) and the Maryland Department of Transportation (“MDOT”) to STO on June 10, 2021.

Note that this report is organized differently than the most recent report completed under SF&P 10A-203, which was for the Purple Line P3 Agreement approved by BPW in 2016. The Purple Line P3 Agreement had a financial plan that included clearly defined progress, milestone, and availability payments, which allowed STO to focus on whether the various payment streams should be considered tax-supported debt under the State’s capital debt affordability limits. This P3 Agreement instead uses a progressive delivery approach, which limits the defined costs to certain predevelopment work but also grants exclusive rights for the future construction and operation of the facility to the concessionaire. This leaves many of the costs and details of the P3 Agreement undefined (though it should be noted that MDOT’s stated goal is to complete the P3 at no direct cost to the State, only to tollpayers.)

The State’s experience with the Purple Line P3 has also shown that the narrow focus on payment streams in that report meant that some broader risks and potential costs went unrecognized. While one of the key objectives of using a P3 method of delivery to build the Purple Line was to minimize the State’s direct costs, unforeseen circumstances have delayed the project and led to the State paying hundreds of millions of dollars in own-source funds to ensure it can be completed.

For these reasons, this report has a broader focus. It examines other risks and considerations that BPW should be aware of before approving the project, in addition to a discussion of the costs and payment streams of the P3 itself. The report also recommends changes to SF&P 10A-203 to improve its utility in the future.

II. Background

MDTA, working in concert with MDOT, recently completed a procurement to initiate the first phase of a P3 on a project to upgrade certain transportation facilities, including portions of I-495, I-270 and the American Legion Bridge (the “Project”). The Project is proposed to be delivered using a progressive delivery approach with individual agreements covering different portions of the Project. The proposed P3 agreement (the “Phase P3 Agreement”) currently under evaluation will be focused on the predevelopment work necessary for a portion of the Project. Accelerate Maryland Partners (“AMP”) has been selected as a private partner for the predevelopment phase of the Project. Upon successful completion of the predevelopment work under the Phase P3

Agreement, AMP may become a “Section Developer” by entering into additional P3 agreements (“Section P3 Agreements”) with MDOT and MDTA for the responsibility of designing, constructing, financing, operating, and maintaining a portion of the Project for a term of 50 years. These activities will be supported primarily by future toll revenues associated with the Project facilities. MDTA would set the minimum and maximum toll rates, as well as a “soft rate” cap on tolls when the facility is operating within designated metrics¹. Section P3 Agreements may also include revenue sharing between the State and the developer of that section of the Project².

III. Lack of Funding Limits Scope of This Report

As STO began its analysis of the Phase P3 Agreement, it became clear that it would require outside assistance to adequately review the agreement within 30 days. STO is a small agency with only a handful of individuals with public finance experience. The P3 Agreement itself is 123 pages long and includes 1,168 pages of exhibits, in addition to several years’ worth of related studies, letters, presentations, and news articles that need to be understood for context. Additionally, the State’s experience with the Purple Line P3 has definitively shown that P3 Agreements are complex documents with many possible ways for unexpected roadblocks and/or costs to arise for the State.

Due to these factors, STO determined that in order to properly fulfill the oversight role required by SF&P 10A-203, it was necessary to engage the State’s Bond Counsel, Kutak Rock, and Financial Advisor, Public Resources Advisory Group (“PRAG”), to work with STO to examine the Phase P3 Agreement and produce their own independent assessments of the impact to the State, which would have informed and complemented this report. Doing so would have given the State the benefit of Kutak Rock and PRAG’s professional staff, who collectively possess decades of expertise in designing, analyzing, and negotiating P3s. Their assessments would have included:

- A thorough review of the Phase P3 Agreement by lawyers and financial advisors who specialize in P3s, which might have identified additional risks and considerations not described in this report (or alleviated concern over some of these risks and considerations)
- A comparison of the structure, contractual terms and conditions, and risks of the proposed P3 to similar P3s around the country, which could have helped policymakers understand the possible outcomes of the Phase P3 Agreement
- More formal, definitive guidance of the potential costs and risks associated with the Phase P3 Agreement

Based on cost estimates prepared by Kutak Rock and PRAG, STO made a request to the Department of Budget and Management (“DBM”) for \$100,000 for this purpose. However, DBM

¹ December 18, 2020 Letter from MDTA to AMP, I-495 and I-270 P3 Program Revised Preliminary Toll Rate Proposal.

² Exhibits to Phase P3 Agreement, Exhibit 8 – Section P3 Agreement Term Sheet, pp. 23-24.

denied STO's request for additional funding. With no other funds available in its budget to redirect towards this project, STO was unable to fully engage Kutak Rock and PRAG.

STO has analyzed the Phase P3 Agreement to the best of its ability and has received limited, informal assistance from PRAG and Kutak Rock with some aspects of the review. However, because STO could not fully engage Kutak Rock and PRAG and obtain formal assessments, we warn that this analysis is not fully complete; there could be key risks, costs, terms, and conditions not contemplated here. In a later section, this report will discuss the need for legislative and budgetary changes to ensure proper oversight of proposed P3 Agreements in the future.

IV. Phase P3 Agreement Costs

Since the Phase P3 Agreement only covers predevelopment work, the types of costs and risks allocated to the State are limited. The Phase P3 Agreement establishes caps on the anticipated costs; however, there are several situations in which the caps intended to contain costs could be exceeded, renegotiated, or are not yet defined.

Types of Phase 1 South costs

Predevelopment costs. Predevelopment costs such as design, financial plan development, etc. would be reimbursed to AMP upon successful financial close of the first Section P3 Agreement for Phase 1 South. This reimbursement is capped at \$54.3 million³, but the cap could be increased if certain events occur (see next section).

Termination costs. If Phase 1 South is cancelled by MDOT for convenience, the NEPA process does not allow the project to move forward, a court order determines the contract to be void not for the fault of the Developer, or changes to key assumptions render the project not financially viable, MDOT will be responsible for paying AMP a termination fee of up to \$50.0 million⁴. MDOT would receive any work products developed by AMP.

Situations in which Phase 1 South cost caps could be exceeded

As noted above, the Phase P3 Agreement sets forth nominal caps on both predevelopment and termination costs. However, there are situations in which these caps can be exceeded. There are no limits on the amounts by which the caps can be exceeded in these cases.

“Relief events” which impact the predevelopment timeline⁵. Relief events include BPW declining to approve a Section P3 Agreement within 150 days; litigation, injunctions, or other legal challenges; and *force majeure* events, among other things. If a relief event occurs, AMP may claim an increase to the predevelopment cost cap, in addition to extensions to affected deadlines and relief from other obligations under the Phase P3 Agreement.

³ Exhibits to Phase P3 Agreement, Exhibit 1 – Definitions, p. 112.

⁴ Exhibits to Phase P3 Agreement, Exhibit 1 – Definitions, p. 111.

⁵ Phase P3 Agreement, Article 16 – Relief Events, pp. 33-35.

“Reasonable and proper” costs⁶. This would include costs such as the removal of hazardous materials, the discovery of archaeological sites, and change orders requested by MDOT.

Phase 1 North predevelopment costs not defined

No cost estimates or caps for Phase 1 North are established in the Phase P3 Agreement. MDOT and AMP would need to negotiate in good faith to establish the cost caps for Phase 1 North⁷. It is not clear if BPW approval of any agreement would be required, though MDOT has stated to STO that the agreement would be a contract modification subject to BPW review. Additionally, certain predevelopment work for Phase 1 North related to environmental and NEPA review would not be subject to any cap and would be paid even if NEPA approvals are not obtained for Phase 1 North⁸.

Costs and risks for Section P3 Agreements not contemplated

Because the Phase P3 Agreement’s scope only covers predevelopment work, the costs, terms, and conditions of the future Section P3 Agreements are not contemplated. These Section P3 Agreements would include the actual construction and operation of the facilities comprising the Project, which will make their cost, complexity, and risk far greater than anything included in the Phase P3 Agreement. However, information on those costs, complexities, and risks will not be available until the Phase P3 Agreement is already approved, the predevelopment work is completed, and the Section P3 Agreements are presented for review.

V. Key Risks Associated with Phase P3 Agreement

As part of STO’s review of the proposed Phase P3 Agreement, it has identified several major areas of risk associated with it. STO’s approach here is to simply identify these risks; it should be noted that MDOT is aware of these in many cases and has sought to mitigate them in various ways. The identified risks include:

Lack of funding limits the thoroughness of this review. As mentioned earlier in this report, STO’s request for funding to engage its Bond Counsel and Financial Advisor to assist with the review of this P3 Agreement was denied. While STO has analyzed the P3 Agreement to the best of its ability, there could be other risks, costs, terms, and conditions that were missed and are therefore not discussed in this report.

Phase 1 South cost caps may be exceeded or renegotiated under many circumstances. Events that could allow the cost caps to be exceeded or renegotiated include BPW declining to approve a Section P3 Agreement, *force majeure*, MDOT-directed change orders, discovery of

⁶ Phase P3 Agreement, Article 9 – Phase Site Access and Investigations, p. 16; Article 22 – Change Orders, pp. 55-56.

⁷ Phase P3 Agreement, Article 14 – Section Viability, pp. 31-33.

⁸ Phase P3 Agreement, Article 10 – Predevelopment Work, pp. 19-20.

hazardous materials, and delays caused by litigation⁹. There is no limit on the amount by which the caps can be increased or exceeded.

Phase 1 North costs are undefined¹⁰. Predevelopment and termination cost caps for Phase 1 North would be negotiated between MDOT and AMP at a later time. There are no parameters establishing limits or caps on what the total cost for Phase 1 North will be. Furthermore, the costs for Phase 1 North would be directly negotiated between AMP and MDOT. It is unclear if any resulting agreement would be subject to BPW approval; MDOT has asserted that BPW approval would be required as it would be considered a contract modification.

AMP's financial plan for Phase 1 South could depend on sources of funding not currently available. Phase 1 South is expected to be funded by a combination of a Transportation Infrastructure Finance and Innovation Act (“TIFIA”) loan, Private Activity Bonds (“PABs”), and equity investments; availability of these funding sources is listed as two “Key Assumptions” for Phase 1 South¹¹. However, to be eligible for a TIFIA loan, Phase 1 South will need to complete the NEPA process, including the Air Quality Conforming Analysis from which it was removed by the National Capital Region Transportation Planning Board in June 2021. Furthermore, there is no PABs allocation currently available from the federal government; a new PABs allocation would need to be included in federal legislation such as the proposed infrastructure bill for PABs to be a viable option for funding. In the absence of TIFIA and/or PABs, more expensive sources of funding might be needed, with the cost possibly passed on to tollpayers and/or negatively impacting future revenue sharing with the State. If the absence of TIFIA and/or PABs led AMP to conclude that that Phase 1 South was no longer financially viable, AMP would have the right to terminate the Phase P3 Agreement and MDOT would be required to reimburse all eligible costs up to the termination cap¹².

Unclear if P3 Model is best method of delivery. Though a confidential, preliminary value for money analysis examining managed lanes throughout the entirety of I-495 and I-270 was completed in 2020, no public value for money analysis examining Phase 1 South and Phase 1 North has been completed. Without an analysis directly comparing the costs and risks associated with P3 delivery to a comparable project using public sector delivery, there is no way for the State to make an informed choice between the two alternatives. MDOT and AMP intend to perform their own separate value for money analyses as part of the predevelopment phase, but only after the Phase P3 Agreement would have already been approved. In the past, MDOT has dismissed the possibility of public sector delivery based on legislative debt caps, bond ratings, and coverage ratios, though these are all issues that STO believes could be solved through discussion and reexamination. It is unclear if MDOT will continue to dismiss public sector delivery out of hand, or if the planned value for money analyses will be a legitimate comparison of P3 versus public delivery.

⁹ Phase P3 Agreement, Article 9 – Phase Site Access and Investigations, p. 16; Article 22, Change Orders, pp. 55-56; Exhibits to Phase P3 Agreement, Exhibit 1 – Definitions, pp. 114-116.

¹⁰ Phase P3 Agreement, Article 14 – Section Viability, pp. 31-33.

¹¹ Exhibits to Phase P3 Agreement, Exhibit 18 – Key Assumptions for Phase South A, p. 141.

¹² Phase P3 Agreement, Article 26 – Termination, p. 72.

May be difficult to contain costs using progressive delivery model. While there are advantages to the progressive delivery model, the approach could make it challenging to keep costs competitive. Once the State approves the Phase P3 Agreement, future phases of the Project will not be subject to the typical competitive procurement process which helps to ensure costs are kept at market levels¹³. Though MDOT would not be required to move forward with the Section P3 Agreements, inertia could lead it to move forward with future steps even if best execution is not attained. Higher costs could be borne by tollpayers and/or impact potential revenue sharing with the State.

VI. Other Considerations for the Phase P3 Agreement

STO also noted several other considerations regarding the proposed Phase P3 Agreement that policymakers should be aware of. These considerations include:

Cost of equity is very high compared to traditional capital funding. The rate of return for AMP's equity is confidential under the terms of MDOT's RFP, but a typical annual rate of return on equity for this type of P3 is in the low to mid-teens. Compare this to the current rate of less than 2% for a 30-Year Treasury Bond. This cost could be borne by the tollpayers and/or impact potential revenue sharing with the State.

MDTA notes may be purchased by AMP using equity. The Phase P3 Agreement contemplates MDTA selling \$100.0 million or less in notes directly to AMP to fund MDTA's costs related to the project¹⁴. The expectation is that AMP will use equity to purchase these notes. This could lead to a situation in which the stated rate of return on the notes is quite low, but AMP earns a very high return on the equity it uses to purchase the notes. The equity repayment cost could be recovered from tollpayers and/or impact future revenue sharing with the State. MDTA might be able to reduce costs for tollpayers by instead selling the notes via a public process or with alternative funding.

Improvements to public transit in Frederick and Montgomery County could be limited if they threaten the financial viability of the managed lanes¹⁵. Though public transit improvements are contemplated as a potential component of future Section P3 Agreements, the P3 Agreement restricts these improvements to public transit projects for which the cost and scope "are not of an amount that prevents the Section from being financially viable." This language could exclude otherwise worthy public transit projects from inclusion in the Section P3 Agreements. Note that it should not prevent the State from pursuing public transit projects separately from the Project, as Section 10A-401 of the State Finance and Procurement Article of the Annotated Code of Maryland prohibits P3 agreements from including noncompete clauses that inhibit the planning, construction, or implementation of State-funded transit projects.

¹³ Phase P3 Agreement, Article 4 – Exclusive Rights and Obligations, p. 6.

¹⁴ Exhibits to Phase P3 Agreement, Exhibit 8 – Section P3 Agreement Term Sheet, p. 24.

¹⁵ Phase P3 Agreement, Article 11 – Section P3 Agreements and Committed Section Proposals, pp. 24-25.

The State might not be permitted to build new general purpose lanes on I-270 unless it compensated AMP for any loss of cash flow¹⁶. The compensation would be negotiated between MDOT and AMP. It would not necessarily be a monetary payment from the State to AMP; it could take the form of other changes to the Section P3 Agreements.

Phase 1 North may be divided into two or more Section Agreements. Though Phase 1 South is expected to be completed as a single Section Agreement, MDOT believes Phase 1 North could ultimately be divided into multiple Section Agreements. This could significantly extend the timeline and complexity of Phase 1 North.

VII. Impact on State's Capital Debt Affordability Limits

The impact of the Phase P3 Agreement on the State's capital debt affordability limits cannot be determined due to the uncertainties around its full costs. These uncertainties include:

- The actual cost of predevelopment and termination fees for Phase 1 South cannot be determined due to provisions allowing cost caps to be exceeded or re-negotiated.
- All costs for Phase 1 North are left undefined in the agreement.
- STO was denied funding for external assessments of the Phase P3 Agreement, which it views as necessary for a complete analysis.

Note that even if the costs of the Phase P3 Agreement could be quantified, they might or might not be considered tax-supported debt and impact the State's capital debt affordability limits depending on how any payments are structured. For example, a reimbursement from future toll revenues generated from the Project likely would not be considered tax-supported debt, while a termination fee for predevelopment design work funded by Consolidated Transportation Bond proceeds would be considered tax-supported debt. MDOT should ensure that any payments made under the Phase P3 Agreement are structured to avoid being considered tax-supported debt.

VIII. Recommended Updates to SF&P 10A-203

Given the State's experience with the Purple Line P3, STO determined early on that the report required under SF&P 10A-203 for this proposed P3 Agreement should have a broad focus on the various costs and risks involved, rather than the narrow focus on payment structures that STO used for its 2016 report on the Purple Line P3. However, STO was stymied by funding and time limitations that prevented this broader analysis from being adequately conducted.

STO is therefore recommending updates to SF&P 10A-203. These recommended changes are primarily focused on improving the utility of this report by making it a more in-depth, substantive tool for decision making and oversight of proposed P3s in the State. At a minimum, STO believes the changes to the statute should include:

¹⁶ Exhibits to Phase P3 Agreement, Exhibit 8 – Section P3 Agreement Term Sheet, pp. 16-17.

- A focus on the broader set of the costs and risks involved with any proposed P3 Agreement, rather than a narrow focus on the impact on the State's debt affordability limits
- Additional time for review before this report is due
- A requirement to engage STO's financial advisor and bond counsel to perform outside review of proposed P3 documentation and risk allocations
- A requirement for the agency proposing the P3 Agreement to reimburse STO for the cost of outside review

If the General Assembly would like to consider these updates to the P3 law, STO suggests it might be prudent to convene a taskforce similar to the one created to design the P3 law. STO would gladly assist with this process.

IX. Conclusion

While STO is unable to draw a firm conclusion regarding the impact on the State's capital debt affordability limits, it is STO's view that there are significant uncertainties around the costs, risks, and ultimate benefits of the Phase P3 Agreement. Members of the BPW should recognize these uncertainties and view them as acceptable before approving the agreement. Additionally, given the possibility that there could be multiple Section P3 Agreements in the State's future as part of the Project, STO believes the State should quickly act to amend its P3 law to allow for a more thorough, workable oversight process moving forward.