

The Commonwealth of Massachusetts

Office of the Inspector General

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Massachusetts Turnpike Authority
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Commissioner Luisa Paiewonsky
Massachusetts Highway Department
10 Park Plaza, Suite 3170
Boston, MA 02116

RE: Proposal to remove Western Turnpike tolls

Dear Secretary Cogliano and Commissioner Paiewonsky,

I am writing to inform you of this Office's serious legal and financial concerns relative to the Massachusetts Turnpike Authority's plan to transfer the Western Turnpike to the Massachusetts Highway Department, and to lay out a series of action steps that I believe are essential before the transfer can take place.

LEGAL CONCERN No. 1: A Lack of Clear Statutory Authority

The plan, as presented to the Authority's Board of Directors, entails the defeasance of 1997 Series A Western Turnpike Revenue Bonds by tapping three distinct funding sources: (1) approximately \$90 million in general reserves; (2) approximately \$22 million in debt service reserves; and (3) approximately \$86 million derived via the securitization of lease revenues on the Western Turnpike's service plazas.

It is the third element of this plan, the securitization of lease revenues, that is legally questionable. Section 26 of the Turnpike Authority's enabling statute, M.G.L. c.81A, states that the Authority and the Department may only effectuate such a transfer through a series of written agreements which "shall provide that all nontoll turnpike revenues shall thereafter be dedicated solely to the operation and maintenance of the turnpike." The intent and meaning of this passage are clear: Nontoll revenues that pre-exist the transfer should be used to fund the turnpike's maintenance once toll revenues are no longer available.

The plan under consideration seeks to sidestep Section 26 by signing away future

service plaza lease revenues, potentially for decades to come, in order help pay down the bonds. It is true that Section 4(f) of the Authority's enabling legislation grants the Authority wide discretion with respect to leases, but it is also true that Section 26 was signed into law at a time when the terms of those leases, and the resultant revenue stream, were understood by the framers. In other words, the Authority had discretion to set the terms of the service plaza leases under Section 4(f), but once that was accomplished, the manner in which the lessees paid the Authority was well-established, and policymakers expected those payments to help fund operations and maintenance of the Western Turnpike after the roadway was transferred.

The Authority's outside counsel, while opining that Section 26 can also be interpreted to allow the Board to sell service area lease revenues prior to transfer of the roadway, acknowledges that such an interpretation could easily be up-ended by a court. "Although we believe that [counsel's] is the better reading, we note that there is no assurance that a court, if presented with the question and with a degree of statutory ambiguity as to the balancing of these conflicting objectives, would not interpret the statute in a manner that favored preservation of post-transfer nontoll revenue at the expense of the Authority's power to dispose of such revenue."

ACTION STEP: The Authority, if it pursues the Western Turnpike transfer proposal, should seek declaratory judgment in advance to clarify the legality of the plan. Alternatively, the Authority should establish a contingency plan with clearly identified funding sources to minimize the financial impact of the legal risks involved in the proposal. Also, the Authority must disclose the legal risks inherent in its securitization plan to any prospective lessees.

LEGAL CONCERN No. 2: Defining "Good Condition" of the Roadway

Section 26 also states that the transfer of the Western Turnpike from the Authority to the Department may not take place unless and until "the turnpike is deemed to be in good condition and repair to the satisfaction of the highway department." This clause makes it incumbent on the Commissioner to evaluate the condition of the Western Turnpike immediately prior to any transfer. The only reasonable means to do this is via a "stem to stern" analysis and inspection of the Western Turnpike's infrastructure after all necessary legal and financial steps have been taken by the Authority and it has forwarded the transfer request to the Department. In the event that any elements of the Western Turnpike property to be transferred are found to be structurally deficient or in any way less than satisfactory and in working condition, the Authority must repair all such elements at the Authority's own expense and the Department must then re-inspect such elements before the Department can, to the satisfaction of Section 26, accept the roadway in "good condition." Data forwarded to this office by the Authority demonstrates that several pieces of bridge and culvert infrastructure were structurally deficient at the time of the last inspection.

ACTION STEP: The Authority and the Department, if pursuing this proposal, should outline the inspection process described above in any transfer protocol governing the

transfer of the Western Turnpike from the Authority to the Department.

FINANCIAL CONCERN No. 1: Risks to the Commonwealth

This legal uncertainty regarding the securitization of service plaza revenues creates distinct financial risks for the Commonwealth. Should a court indeed invalidate such securitizations, the resultant hole in the Authority's financing of the toll removal plan would total some \$86 million, an amount that would have to come from the Authority or the Commonwealth.

The Authority's ability to fund the shortfall is questionable for the following reasons:

- (a) the new, higher debt coverage ratios mandated under the MHS Trust Agreements in the event that the Western Turnpike tolls are removed prior to 2017;
- (b) increased debt service beginning in 2008; and
- (c) the significant gap between the Commonwealth's \$25 million annual "contract assistance" payment to the Authority for operating and maintaining the Central Artery and the true cost of such work, which consultants believe will grow to roughly \$50 million by 2027.

Given the remote prospects for the Authority to independently foot the bill if the current proposal fails to withstand a court challenge, it is highly likely that the Commonwealth would be required to bail out its instrumentality. Therefore, it is incumbent upon the Authority and the Commonwealth to acknowledge and disclose the risks to the Turnpike's and/or the Commonwealth's financial position relative to the ratings agencies.

FINANCIAL CONCERN No. 2: A Loss of Significant Nontoll Maintenance Funds

Regardless of such a court ruling, other significant financial factors render the plan problematic for the Commonwealth. With lease revenues signed away for decades to come, the state will have to shoulder the entire burden of operating and maintaining the Western Turnpike. (The anticipated operating budget transfer from the Authority to the state would cost \$21 million annually.) In addition, the Turnpike's five-year capital spending plan calls for \$108 million, and the cost of removing the toll booths and reengineering ramps will cost at least \$49 million by the Authority's estimates. (One Authority document reviewed by this Office pegged the toll removal figure at \$129 million.)

Of course, the Commonwealth has always anticipated taking on the financial burdens of operating and maintaining the Western Turnpike. But the nontoll revenues were to be a means of financing that work. If the Authority's proposal is effectuated, the Commonwealth will lose significant revenues for years to come. Currently, revenues from McDonald's and Tosco (the food and gasoline services vendors on the Western Turnpike service plazas) total roughly \$16 million per annum.

However, those lease revenues are estimated by the Authority's consultants to rise

dramatically in coming years. By 2027, the total is expected to reach roughly \$29 million per annum, and by 2082, to \$147 million annually.

This means, in simple terms, that the Commonwealth will lose large amounts of nontoll revenues that should be available for Western Turnpike operations and maintenance beginning in 2017, when the bonds mature. Here is the breakdown, using figures derived solely from the Authority's expert consultants examining this proposal:

A) Net Present Value of Securitization of McDonald's and Tosco Leases

20-year lease (@7% discount rate):	\$213 million
75-year lease (@9% discount rate):	\$263 million

B) Estimated Revenues of McDonald's and Tosco Leases (Assuming 3% Rent Inflation) For Period Beginning 2017 (When W. Turnpike Bonds Mature)

2017-2027:	\$275 million
2017-2082:	\$4.3 billion

C) Net Gains (Losses) to Commonwealth Under Authority Plan If Removal Accelerated From 2017 to 2007 (A-B=C)

20-year lease:	(\$62 million)
75-year lease:	(\$4 billion)

As the above demonstrates, the losses the Commonwealth will suffer under the present plan – all to fill an \$86 million funding gap – are significant. What's more, these figures could actually understate the losses because any prospective buyer informed of the legal ambiguity surrounding the securitization, as well as concerns under federal law relative to service plazas on non-tolled Interstate highways, will likely diminish the net present values even more.

I should note that when the 1997 Western Turnpike bonds were first sold, the Authority had planned to defease the bonds and take down tolls in 2010, even though the bonds are set to mature by 2017. However, that policy decision apparently changed at the time of the 1999 Metropolitan Highway System bond sale, when an amendment was inserted into the Metropolitan Highway System Trust Agreement that required a far higher debt coverage ratio in the event that the Western Turnpike bond defeasance took place any time prior to their maturity. In other words, the financial realities of the "Big Dig" were such that taking down the Western Turnpike tolls before the Western Turnpike bonds had matured was no longer viable. That the Authority's audited financial statements since at least 2002 have made no mention of the 2010 defeasance plan is testament to the policy's demise.

FINANCIAL CONCERN No. 3: The Plan Entails Far Higher Costs Than Necessary

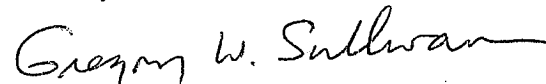
The documents this office has reviewed to date indicate that the Authority's consultants have concluded that there are far more affordable options for removing the Western Turnpike tolls, should lawmakers and policymakers see the wisdom in such a plan. Were the Commonwealth to issue General Obligation bonds to pay off the Western Turnpike bonds, the savings would be significant. G.O. bonds would carry an interest rate of approximately 4% -- and the state could still hold onto nontoll revenues for the roadway's operations and maintenance. That compared with a taxable securitization by a private entity that would carry an interest rate of anywhere from 6% to 11%. With higher interest rates, of course, would come lower bids. As a matter of policy, we in Massachusetts government should not be in the business of offering sale prices on public assets if more cost effective tools are present.

CONCLUSION

In conclusion, I want to emphasize that this Office is neutral on the policy questions surrounding the elimination of tolls on the Western Turnpike. Because policymakers have always contemplated removing those tolls, it is entirely right and justified that the Authority and the Department actively examine this plan. However, the risks and costs to the Commonwealth inherent in the proposal currently before the Authority are significant, and thus it is incumbent on me to notify you of these concerns and insist that you strongly consider the action steps listed above.

Please feel free to contact me with any questions.

Sincerely,



Gregory W. Sullivan
Inspector General

CC: Treasurer Timothy Cahill
Auditor A. Joseph DeNucci
House Speaker Salvatore DiMasi
Senate President Robert Travaglini
House Transportation Chairman Joseph Wagner
Senate Transportation Chairman Steven Baddour