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Leasing the Pennsylvania Turnpike: Let's Do It Right

The Governor has fielded interest in leasing the Pennsylvania Turnpike as a solution to fund the state's desperately needed road and bridge repairs. After the initial request, he received four dozen letters of interest—including one from the Turnpike Commission.

The Governor is hoping to earn an annual lease payment of \$965 million over thirty years. The long-term lease value of the 530-mile road is estimated to be anywhere between \$10 billion to \$15 billion. Whether or not the Turnpike garners this high a price will depend upon the conditions and regulations imposed on any private company willing to take on such a venture.

So how much is the Turnpike worth? At 530 miles, it would be the longest toll road leased in the country. To date there are a few toll roads—in Illinois, Indiana, Virginia, California, and Texas—that have been leased to private operators. The first of these was the 8-mile long Chicago Skyway which was leased to a Spanish-Australian consortium (Cintra-Macquarie) for \$1.83 billion. The Skyway was a white elephant for a City that was facing a deep deficit. Chicago City Council voted unanimously in 2005 to approve the ninety-nine year lease. The City used the money to pay off debt, establish a rainy day fund, and even support some social services.

Cintra-Macquarie also leased the 157-mile Indiana Toll Road for seventy-five years for \$3.85 billion. The Governor of Indiana used the proceeds for a statewide road construction plan.

In both cases, the lease price was a huge multiple of annual toll revenues. The Chicago Skyway collected nearly \$40 million annually in tolls while the Indiana Toll Road was generating \$95.6 million. Thus, each road was leased for more than 40 times their annual revenues, a pattern Governor Rendell obviously would like to continue as he puts the PA Turnpike up for bid. If the lease for the Turnpike fetches 40-times its annual toll revenue of \$600 million, the Commonwealth could be in for a large windfall. Interestingly, many experts believe that Cintra-Macquarie overbid for the Illinois and Indiana roads, paying exorbitant prices to “get into the market.”

Private companies rely on improving efficiencies, better management, and improving customer service to increase usage of the roads they lease. One way they are able to do

this is by replacing toll takers with electronic tolling devices. But will the Legislature force these companies to keep most or all existing Turnpike employees? If they do, it will certainly drive down the price of the lease, if not scare companies away all together. After the Indiana lease took effect, eighty-five percent of toll road workers were retained. In Chicago fewer workers were retained because their wage rate was considered too high. How a private company deals with Pennsylvania toll road workers will depend on the language contained in the lease; the more they are required to keep the lower their offers will be.

Other possible constraints or stipulations on items such as maintenance, security, traffic controls, safety, land use, ability to expand, etc. will also impact bids for the Turnpike. The more constraints to the potential cost savings or revenues, the result will be lower bids for the toll road.

Private companies work to boost traffic levels to earn a profit. Bear in mind that the lease companies will be responsible for all maintenance and improvements to the toll road. They often widen roads to add more lanes, or in the case of Chicago, begin replacement of deteriorating sections, in order to attract more traffic.

A substantial benefit of leasing the Turnpike to a private company would be an end to political patronage that has been standard operating procedure at the Turnpike Commission. A private company will bring professional management that can adopt best practices from private toll roads from around the world. More importantly, since it is a private concern, management will also be held strictly accountable to stockholders unlike government managers who are virtually exempt from the consequences of their mismanagement. The Valentine's Day Interstate fiasco is merely the latest egregious example of state employee mismanagement that has not led to firings or demotions. Unfortunately, authority and commission management is even further insulated from market driven accountability.

Critics contend that private companies only make money by increasing tolls. This claim is unfounded as all leases to date have restrictions on how often and how high a company can change tolls. For example, the toll on the Chicago Skyway was \$2 before privatization in 2004. The tolls are permitted by law to increase only to \$5 by 2017. To date the toll has risen to about \$2.40 for the entire stretch—about 20 percent. Increases do happen more often, but are usually small and confined to the rate of inflation.

Not only do states regulate and set limits on toll rates and future increases, some also regulate the rate of return allowed on the road. In California, Virginia, and Texas, private companies are allowed to keep earnings up to a preset rate of return, with earnings above that rate shared with the state.

It is worth noting that the Pennsylvania Turnpike Commission's alternative proposal to leasing the Turnpike is to raise the existing tolls—specifically to raise tolls three percent each year starting in 2011 and also impose a \$1 congestion surcharge on tolls in the Pittsburgh, Harrisburg, and Philadelphia areas. In addition, their scheme would make

Interstate 80 a toll road. All told, the Commission's proposal would add heavier burdens to Pennsylvania drivers with no guarantee of improving the conditions of the toll road since the money raised in their plan will be dedicated to road and bridge repairs all over the state.

Whether or not the leasing of the Pennsylvania Turnpike will be profitable for a private company remains to be seen. However, it is undoubtedly in the best interest of the Commonwealth to pursue such an option for the Pennsylvania Turnpike. Privatizing this asset could bring significant funds to help with needed road and bridge repairs. But it is important to remember that the offer prices for a lease will be dependent upon the restrictions that are included in the lease terms.

Claims by outsourcing opponents that tolls and profits will be excessive are not supported by evidence from around the country. However, even if the company goes out of business, or violates the terms of the lease, the Turnpike will revert to state control. In such an eventuality, the state can look for another lessee or turn the Turnpike over to a newly formed Turnpike Authority. In short, Pennsylvania has a lot to gain and little to lose from at least making a serious run at leasing the Turnpike.

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