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Are Toll Road Companies Getting Guaranteed Profits?



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One of the strangest claims I've heard from populist opponents of toll roads developed and operated by private companies under long-term concession agreements (public-private partnership toll roads) is that they involve "guaranteed" profits. The reality is almost exactly the opposite.

Compared with regular "free" roads, toll roads are inherently risky, because people can generally choose not to use them. By far the riskiest kind of toll road is a brand new toll road, especially in an area where there are few or no existing toll roads. One of the reasons I advise governments against going into the toll road business is because of its riskiness. Taxpayers should not be required to shoulder the risk of bailing out a toll road that finds it cannot meet its debt-service payments because it has too few customers and hence too little revenue.

One of the greatest virtues of the public-private partnership (PPP) toll road model is to shift that kind of risk (which is called "traffic & revenue risk") from taxpayers to investors. Typically, the long-term PPP agreements also shift construction cost risk and late-completion risk to the toll road company. That's especially important for "mega-projects" in the billion-dollar size range; there is a long and sorry history of transportation mega-projects coming in way over budget and much later than originally scheduled.

An example of this risk-transfer in action is taking place today in San Diego County, California. The South Bay Expressway filed for Chapter 11 bankruptcy several months ago, after only two years in operation. Why? One reason is that its traffic projections were based on a continuation of the real estate boom that was under way in Southern California when the road was financed. When the housing bubble burst, and the economy tanked, so did traffic levels (and hence, revenue) on the new toll road. Its other problem is that its construction contractor went way over budget, and the firms have been fighting over who is responsible for the cost overruns.

The only point that is not in contention in the toll road's bankruptcy proceeding is who will NOT be called on to bail the company out: the taxpayers. Because both construction risk and traffic & revenue risk were willingly taken on by the company and its investors, they are the ones who will take the losses.

I have been researching public-private partnership toll roads—in Europe, Australia, South America, and elsewhere, in addition to the United States—for more than 20 years. While there are some long-term toll road contracts in developing countries that provide some degree of revenue guarantees, there is not a single such agreement for any PPP toll road in the United States. The risk of not making a profit is inherent in all of these projects.

One growing trend is revenue-sharing. If traffic turns out to be robust and revenues exceed certain pre-defined thresholds, the agreement provides that a portion of the toll revenue gets shared with the government. That kind of revenue-sharing provision is included in the long-term agreements for the Capitol Beltway high-occupancy toll (HOT) lanes in the suburbs of Washington, DC, and in two “managed lanes” projects in the Dallas/Ft. Worth metro area, the LBJ and the North Tarrant Express (NTE). All three are mega-projects and all three are in the construction phase, so it’s way too early to know if they will actually make a profit. But there is no provision anywhere in their long-term agreements that would guarantee them any profit. All three are prime examples of the kind of risk transfer discussed above.

Public-private partnership toll roads are not the right answer for every transportation project, so it’s useful to debate whether a particular case is a good use of this mechanism. But we should debate these issues based on facts, not imaginary provisions about guaranteed profits.

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