In support of user-paid tolls

The folly of being seduced by availability payment mechanisms for PPP roads

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The Macquarie Infrastructure Group (MIG) labels itself "one of the largest private developers of toll roads in the world", a claim substantiated by the fact that this particular infrastructure fund operates nine separate assets in six different countries. One of these assets alone is a 2,200km toll road network in France.

However, MIG's recently released full-year financial results made for sobering reading. Valuation write-downs were this year's theme. Westlink M7 (Australia) down from A$802m (US $668m) in 2008 to A$359m in 2009; Chicago's Skyway and the Indiana Toll Road (USA) down from A$236m to A$148m and A$344m to A$98m respectively; while the UK's M6 Toll skydived from A$2.2bn to A$412m.

The whole portfolio suffered a 40% drop in asset value, crashing from A$8.6bn to A$5.1bn in just one year. The reason? Traffic performance that failed to match expectations features large. And Macquarie is not the only toll road operator to be suffering in the current climate. But before we declare that the model is broken, as some would have us believe, let's be very clear about which model we're referring to.

For sure, the strategy of buying infrastructure assets, gearing them up then flipping them into satellite funds (and showing accounting profits through upward revaluations) while collecting fees along the way – that particularly aggressive strategy has taken a hammering. And the shallow realities of other creative approaches to financial engineering based on frankly unrealistic traffic and revenue forecasts have also been exposed by the credit crunch. But toll roads per se? Let's be careful not to throw the baby out with the bathwater.

The knee-jerk policy reaction in certain circles has been to look to remove traffic risk from the equation and promote availability or performance-based payment regimes in place of the traditional user-paid toll road model – even when the business case for stand-alone, self-financing facilities stacks up (or is certainly worthy of close examination). This is short-sighted. It substitutes infrastructure paid for by the user for facilities which rely upon long-term state support.

It is also indicative of a debate that conveniently confuses financing with funding for short-term political gain. PPP roads of all shades are financed by private sector investors. The critical difference between (a) user-paid and (b) availability or performance-based (or shadow toll) roads is that users fund the former and the state funds the latter. Procurement policy discussions across Europe, Australasia and elsewhere too often focus on financing solutions whereas, in the USA, the emphasis is (correctly) on funding solutions. It's no coincidence that American interest in availability, performance or shadow toll constructs is low.

Roads: subject to political whims

There is a danger that the high-profile shenanigans of some of the more aggressive players in the toll road sector mask the fact that many private sector traditional tolling operations around the world remain successful. Their sponsors are more realistic about debt capacity, dividend policy, cash generation (and possible volatility) and more focussed on the long-term play. That is certainly one reason for pausing before assuming that the user-paid toll road model is dead.

However, the bigger picture involves promotion of the market-based concept that drivers should pay at the point-of-use and acknowledgement that the current approach to paying for strategic highway infrastructure in most countries – tax funding – is fundamentally flawed and simply unsustainable. Despite the head-in-the-sand behaviour of many politicians, there is (and has been for many years) a growing recognition that road pricing in conjunction with commercialisation of the sector is the way to pay for roads and road usage, manage the asset base and direct investment.

The economic arguments in support are irrefutable. And user-paid toll roads play a vital role in this context, demonstrating the consumer response to price, the applicability of various tolling technologies, the efficiencies of private sector operations and the importance of whole-life costs (and associated maintenance provisioning). If road pricing is inevitable – and many believe it is – then today's toll roads provide answers to some of the big, practical questions that will face the architects of national road user charging schemes in the future.

The alternative is that road investment remains subject to ever-changing political whims and centralised planning, disconnected from consumers who place little value on road usage ("because they're free") and assume that traffic congestion is a natural phenomenon – not simply the inevitable consequence of incorrect pricing. And, in concert, policy-makers continue with their narrow, short-term focus on availability or performance-based road concessions, seemingly oblivious to the mounting future funding commitments that state-reimbursement concessions entail.

Some time back, Portugal got into difficulty because of the aggregate level of payments required to support its shadow toll motorways. In the UK, estimates suggest that the M25 DBFO scheme will bring the Highways Agency's PFI-related obligations up to nearly 40% of its budget – supporting just 17% of its network. In Spain, state-reimbursement PPPs are starting to impact on public sector credit ratings. Standard & Poor's recently assigned a negative outlook to the Autonomous Community of Madrid (AA+) because servicing PPP debt now accounts for 60-75% of its spending – severely constraining future expenditure flexibility.

Commentators have labelled the phenomenon 'silting-up'. That's what happens when you buy infrastructure, such as roads, on the government's credit card, rather than exploring what consumers might actually be willing to pay for premium facilities like user-paid toll roads. ■