And now, the traffic report...

Toll road traffic and revenue reports: improving quality, understanding and communication

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During my years with the infrastructure team at Standard & Poor's and, more recently, running my own technical consultancy for banks and institutional investors, I have reviewed over 100 toll road traffic and revenue (T&R) study reports. Traffic consultants often define their work as 'investment grade', however my analysis suggests this is commonly more of a marketing ploy than a serious attempt to respond to the needs of potential financiers. The traffic studies themselves typically represent variations on a theme – however, the variance in the quality of reporting is staggering. This is unhelpful at a time when investor confidence in traffic forecasts is at an all-time low.

If toll roads globally are going to reassert themselves as attractive propositions to a broad investor base, risk and uncertainty needs to be better understood and communicated. Improved study reporting has a central role to play and those commissioning traffic studies need to be more demanding in their terms of reference. For too long, the outputs from traffic studies have been dictated by traffic consultants – not their clients.

From my reviews, recurring reporting deficiencies have emerged. Addressing these deficiencies would go a long way to restoring investor confidence. This commentary identifies five simple yet practical ways in which the quality and transparency of toll road T&R study reports could be improved.

Clear presentation of (and justification for) the assumptions used

All of the modelling assumptions adopted in a traffic study should be made explicit. The assumptions should be consolidated in a single table for easy review, rather than being scattered across different chapters – and strong empirical evidence (with robust justification) should be provided in support. The implications of adopting alternative assumption sets on the resulting forecasts should be highlighted.

Clear description of the 'product offering'

Traffic reports often fail to describe toll facilities in simple terms highlighting the key characteristics – such as future time savings or improved journey time reliability – that would attract users. Facilities tend to be discussed in engineering terms. Investors need to understand what a toll road represents to consumers; who would use it, why, how, when and for what purpose(s). A simple traffic story with an intuitive appeal is likely to attract a more positive response from credit committees than toll facilities (and their attributes) that remain difficult to comprehend and communicate.

Conduct comprehensive and realistic sensitivity testing

Frequently, sensitivity tests are limited in both scope and scale. Sometimes they appear to have been 'cherry picked' for their lack of impact on future cash flows! Investors need comprehensive sensitivity testing of the key project variables about which there is uncertainty. These sensitivity tests need to be realistic in terms of the alternative parameter values being evaluated. Reducing an input by 10% (with no justification provided) does little to enhance investor confidence. Sensitivity testing should respond intelligently to the specific project risks and uncertainties to which financiers may be exposed.

Discuss what the results mean

Some traffic and revenue reports leave the reader with the impression that the forecasts were produced at a late stage in the study. They are presented, fait accompli, at the end of the report with little or no explanatory text. This is unhelpful. Investors need to know, not only what the results are, but what they mean. Is a forecast of 24,000 vehicles/day in the year 2015 high or low? Is it unexpected, in line with other toll road performance, or what? Traffic consultants would add considerable value to their work if an explanatory commentary followed on from the presentation of their projections.

Provide a candid description of future uncertainties and modelling limitations

In academic literature, researchers are required to highlight any limitations associated with their work. The authors of traffic and revenue studies should adopt this practice. The avoidance of any discussion about modelling limitations – and other sources of uncertainty which could impact on future cash flows – simply undermines confidence. This is especially true when these limitations and uncertainties become apparent only under later cross-examination.

Conclusion

There is a rich seam of literature demonstrating the potential exposure of traffic and revenue forecasts to the influences of error and optimism bias. These commonly represent the most critical operational-period project risks to toll road investors. In Australia, investor confidence in toll demand projections is at an all-time low, encouraging promoters to shy away from the traditional standalone user-paid toll road model. Better reporting could help to reverse this regressive policy trend.

Although advances have been made in transport modelling since the 1950s, for the purposes of accurate revenue prediction, today's models remain crude and imperfect. In the past, financial engineers have been seduced by consultants' marketing brochures and claims of predictive prowess. Too much reliance has been placed on pinpoint forecasting accuracy leading to the development of aggressively structured transactions and financings with restricted flexibility. This has resulted in project distress and, in some cases, failure.

Project stakeholders who commission traffic studies need to reassert their requirements. You don't need to tell traffic consultants how to do their job. You simply need to reinforce your expectations in relation to study outputs. This is no different from the more general PPP philosophy with the spotlight on outcomes rather than inputs. Toll road traffic and revenue forecasting best serves the investment community when it is focused on the identification of likely usage trends and is accompanied by incisive reporting providing an explicit discussion of all project risks. ■

This commentary is an abridged version. For the full article, see www.robbain.com or contact Robert at info@robbain.com.