November 15, 2017

Senator Debbie Mayfield &
Representative Jennifer Sullivan
Alternating Chairs
Joint Legislative Auditing Committee
111 W. Madison Street
Tallahassee, FL 32399-1400

Re: OPPAGA's Review of the Florida Development Finance Corporation

Dear Alternating Chairs Mayfield and Sullivan:

We write regarding the Joint Legislative Auditing Committee (JLAC) meeting that will be held on November 16, 2017 to, among other things, discuss the Office of Program Policy Analysis and Government Accountability (OPPAGA) review of the Florida Development Finance Corporation (FDFC).

Citizens Against Rail Expansion in Florida (CARE FL), Indian River County and Martin County share a number of serious concerns relating to the FDFC's consideration and ultimate approval of Private Activity Bonds (PABs) for the All Aboard Florida (AAF)/Brightline passenger rail project. These concerns span more than three years and include substantial procedural defects in the actions and composition of the FDFC's Board of Directors. We believe the AAF PAB issue can and should be used as a case study for OPPAGA's review of FDFC's most questionable practices.

<u>Background</u>

New information has been made public regarding AAF's plans to use a tax-exempt PAB allocation from the U.S. Department of Transportation (DOT). While this funding is reportedly only for Phase I of the AAF project (Miami to West Palm Beach), not Phase II from West Palm Beach to Orlando that will affect our communities, it is nonetheless important to unpack this latest development.

After DOT granted AAF a $1.75 billion PAB allocation in December 2014 for Phases I and II, AAF attempted to sell the bonds four times beginning in August 2015 and was never able to do so. In November 2016, AAF was forced to abandon this $1.75 billion allocation, following an adverse U.S. District Court ruling in August 2016 that found the PABs were subject to the National Environmental Policy Act (NEPA). To avoid compliance with safety, health and environmental requirements, AAF terminated the bonds.

On November 22, 2016, DOT provided a "new" $600 million PAB allocation for Phase I only. This was a transparent attempt to give AAF approximately one-third of the original $1.75 billion

PAB allocation but, by tying it to Phase I only, escape safety, health and environmental requirements on Phase II. Nearly one year later, on October 27, 2017, the FDFC renewed its agreement to serve as the conduit issuer of the bonds on behalf AAF.

In the August 2016 ruling, District Court Judge Cooper found that the $1.75 billion PAB allocation would cost the U.S. Treasury up to $600 million in foregone tax revenue over 10 years. Extrapolating from that conclusion, we can assume that the foregone tax revenue would equal up to approximately one-third of the new $600 million PAB allocation—approximately $200 million over 10 years.

Questionable FDFC Practices – Then and Now

Public notice of the FDFC's October 27 meeting, during which it approved a bond resolution and related financing documents for the $600 million PAB allocation, was publicly posted 72 hours before the meeting took place. We have now reviewed FDFC's documents and recent exchanges with AAF. These records reveal that AAF officials were in touch with the FDFC staff by email and phone regularly before the public posting. It shows a contempt for opponents to provide so little notice of the proceeding when AAF and FDFC staff were long aware of the hearing.

Additionally, we are concerned by the lack of a public hearing required under the Tax Equity and Fiscal Responsibility Act (TEFRA) for the $600 million PAB allocation. In 2015, a TEFRA hearing was held for the issuance of the $1.75 billion PAB request. In 2017, the October 27 FDFC meeting packet indicates that TEFRA approval occurred on August 1, 2017, without a hearing.

Upon review of the August 1 TEFRA approval letter, an obvious concern is that the 2017 letter describes the maximum bond amount as $1.75 billion, not the current $600 million. In addition, the current $600 million PAB allocation is specifically for Phase I of the project, yet the TEFRA letter of August 1 lists two Counties located in Phase II—Brevard County and Orange County. The FDFC needs to explain to the public and OPPAGA if this letter was written in error, or if AAF intends to exploit this ambiguity to use some of the new $600 million allocation for Phase II of the project.

These questionable practices are nothing new. During the 2014-2015 FDFC approval process, Indian River County, Martin County, CARE FL and other concerned parties repeatedly raised numerous concerns, including, but not limited to:

- **Multiple Communications Between FDFC Board Members and AAF**. Previous public records requests revealed that the FDFC Board Members and FDFC staff engaged in extensive communications with AAF and/or its affiliates. In fact, while Indian River County, Martin County, CARE FL and other opposition voices often got no response to formal correspondence to the FDFC, AAF was having a series of private meals and briefings with the Board Members. For instance:

- A string of texts between a Board Member and Matt Mohler (AAF consultant) regarding meetings for lunch, getting together with AAF to review documents, and coordinating the date for the FDFC meeting continued from April 8, 2015, to July 17, 2015. The Board Member also met with Rusty Roberts—the Vice President of Government Affairs for AAF—as referenced in an email dated April 26, 2015, where the Board Member tell Mr. Roberts "thanks for making the trip last week." An email from Joseph Stanton (FDFC Counsel) references a meeting in Pensacola with the Board Member, Mr. Spivey, and AAF. In addition, the Board Member met with Mr. Mohler on numerous other occasions regarding this Project.
- Then-Vice Chairman Daniel Davis met with Husein Cumber of Florida East Coast Industries (FECI), Joe Gould of Fortress and Ali Elam of Fortress on March 30, 2015; with Mr. Cumber on April 28, 2015; and with Mr. Cumber, Michael Reininger (AAF President), Heather Enderby (AAF CFO), and Vincent Signorello (CEI and President of FECI) on July 7, 2015.
- Board Member Kevin Hale met with Mr. Spivey, Mr. Stanton, Mr. Cumber, and Bank of America representatives on May 21, 2015, in Omaha, Nebraska for a 2 hour meeting.
- Board Member Ryan Tennyson met with AAF on June 29, 2015. In an email to Mr. Spivey the day after that meeting, Mr. Tennyson notes that he is getting many emails from Florida citizens who have AAF concerns, mainly related to safety issues. He states to Mr. Spivey: "I'm sure there must be a dozen or so regulatory bodies to address those concerns. I assume our role is limited to whether the project meets the criteria for tax exempt financing."

- **FDFC's Prejudgment in Formally Including in its Budget an Allocation for $1.8M to be Paid By AAF Before the FDFC Hearing to Approve the Bonds.** The FDFC also improperly benefited by the improper contacts in that the FDFC received $1,809,750.00 in fees from AAF for approving the $1.75 billion in PABs. Historically, the FDFC's yearly budget has been approximately $200,000 to 300,000. This $1.8 million fee from AAF appears to be the single largest fee ever charged by FDFC. In and of itself, this pay-to-play fee being booked in <u>advance</u> received created a tainted process. FDFC counted this amount in its budget before the FDFC meeting on August 5, 2015. This indicated a "prejudgment" of approval by the FDFC Board, or at least the FDFC staff, prior to its August 5, 2015, meeting date. No explanation was afforded to the public as to how such a budget decision was made, who made the decision, when the Board was notified of such a decision.

  More recently, it is also unclear what fees AAF paid for the $600 million bond offering in 2017. FDFC should be asked if the 2015 fee is "covering" the 2017 engagement as well.

- **Improper Constitution of the FDFC Board of Directors.** On August 20, 2014, the FDFC Board agreed by a vote of 3-0 to authorize staff to enter into a memorandum of understanding with AAF to act as a conduit for the $1.75 billion PAB allocation. The Board's vote, however, was later revealed to be invalid due in large part to the fact that the voting Board members' terms had expired. In the Spring of 2015, attempts were made to establish a properly constituted Board, but there continued to be flaws in the constitution of the FDFC's Board of Directors, including lack of Senate confirmation, a lack of the statutorily required appointment of at least three bankers and potential conflicts of interest.

How Will These Tax Exempt Bond Dollars Be Used?

Based on the documents that were part of the FDFC's meeting packet, AAF will use the $600 million to retire its current high price debt, replacing it with lower price debt. Specifically, documents indicate that AAF intends to use almost all of the money from the new tax exempt bonds to pay off the only prior funds it had raised from the market—originally $405 million at 12% but now ballooning above $500 million with interest owed.

In addition, documents indicate AAF intends to pay off $98 million of the Siemen's manufacturer financing of the five trains sets it purchased. The $98 million is only a portion of the cost of the five train sets, and leaves AAF with a debt of approximately $160 million. The trains were financed by Siemens to accommodate the AAF buyer.

In a nutshell, nearly 100 percent of the new $600 million in financing would go to refinance debt already incurred in Phase 1. All AAF has accomplished is to get the right to issue tax exempt bonds to replace expiring or expensive existing debt that was either coming due (the trainsets) or was very expensive (the "toggle" bonds).

Further, a recent article in Bond Buyer reveals the bonds will not be "rated" (because they are unrateable) and that they are "junk bonds".

Updated Ridership and Revenue Study

The OPPAGA Research Memorandum dated November 13, 2017 stated: "FDFC staff is responsible for analyzing information provided by the borrower…FDFC also ensures that the borrower has provided documents to demonstrate that the proposed project is financially feasible and has the ability to repay investors." (Page 4)

FDFC's most recent meeting materials included a new Ridership and Revenue Study prepared by Louis Berger US, Inc. ("Louis Berger") for Phase I of the project. This 2017 study (titled "Brightline Ridership and Revenue Study: Miami – Fort Lauderdale – Palm Beach Segment" dated October 2017) sets forth the projections as to ridership and revenue that underpin the *pro forma* financials for the bond issue that FDFC approved. As explained below, this 2017 study is remarkably more optimistic about the prospects for the new train line than the 2013 study that Louis Berger prepared for the senior secured PIK toggle notes that AAF marketed in 2014. (The

2013 Louis Berger study for the PIK toggle notes, dated April 3, 2013, was titled "All Aboard Florida Ridership and Revenue Study.")

The 2013 Louis Berger study included the following Table 6.3-1 providing ridership and revenue projections for the first year of stabilized operation following the ramp-up period:

Table 6.3-1
Forecast Summary - All Aboard Florida - Base Case
Annual Segment Volumes and Revenues, 2019 (First Stabilized Year Following Ramp-up)
(Revenue in 2012 $)

Station Pairs	Northbound Volume	Southbound Volume	Total Volume	Average of Assumed Segment Fare	Estimated Revenue
Miami / Fort Lauderdale	277,300	270,400	547,700	$12.56	$6,877,100
Miami / West Palm Beach	362,500	332,300	694,800	$19.08	$13,255,200
Fort Lauderdale / West Palm Beach	362,900	339,100	702,000	$14.85	$10,421,700
Total	1,002,700	941,800	1,944,500	$15.71	$30,554,000

Source: LBG, 2012.

The 2017 Louis Berger study included the following Table 5-5 providing ridership and revenue projections for the first year of stabilized operation following the ramp-up period:

TABLE 5-5 FORECAST BRIGHTLINE – ANNUAL SEGMENT VOLUMES AND REVENUES, 2020 (2016 $)

Station Pairs	Northbound Volume	Southbound Volume	Total Volume	Segment Fare	Estimated Revenue
Miami / West Palm Beach	288,901	274,244	563,145	$45.36	$25,541,656
Fort Lauderdale / West Palm Beach	520,358	528,179	1,048,538	$29.90	$31,347,885
Fort Lauderdale / Miami	660,793	664,327	1,325,120	$29.55	$39,156,773
Subtotal	**1,470,052**	**1,466,750**	**2,936,802**	**$32.70**	**$96,046,313**

Source: Louis Berger, 2017

It is evident from a comparison of these two tables that Louis Berger's forecasts have become far more optimistic during the four year period between its 2013 and 2017 studies. Fares in 2020 (the first year after ramp-up) are projected to be approximately 100% higher (an average fare of $32.70 instead of $15.71), yet even with much higher fares, there is a projection for 2.94 million trips, instead of 1.94 million trips – a 52% increase in the number of trips. As a result, revenue in 2020, as projected in the 2017 Louis Berger study, is expected to be $96 million rather than the $31 million projected in the 2013 Louis Berger study – a 300% increase in projected revenues.

It would appear that the staggering 300% increase in Louis Berger's revenue projections for the project form the keystone of the *pro forma* financial analysis for the project that FDFC reviewed in approving the new tax-exempt bond issue. Without the extraordinary increase in projected revenues, the cash flows would be dramatically lower and would appear to preclude the bond offering.

The following *pro forma* projections are from the 2017 draft preliminary offering memorandum provided to FDFC in connection with its approval of the tax-exempt bonds:

Cash Flow Summary

($ and Passengers In Millions)	2018	2019	2020	2021	2022	Total
Ramp Up	40%	80%	100%	100%	100%	
Passengers	1.1	2.3	2.9	3.0	3.0	12.3
CASH FLOW						
Revenue	$57	$112	$142	$147	$154	$612
Opex	(60)	(60)	(63)	(65)	(66)	(314)
EBITDA	(3)	52	79	82	88	298
Maintenance Capex	(7)	(4)	(4)	(4)	(4)	(23)
Cash Flow Before Debt Service	(10)	48	75	79	84	276
Interest	24	24	24	24	24	120
Debt Amort. (1)	N/A	N/A	N/A	N/A	N/A	N/A
Cash Flow After Debt Service (2)	($34)	$24	$51	$55	$60	$156

(1) Per Company, assumes amortization begins in Year Six, Debt fully amortized over 25 year period. Initial interest only period estimated Term Mode Rate of 4.00%.
(2) Shortfalls in ramp up period expected to be covered via withdrawal from Ramp Up Reserve Fund, and this Reserve to be funded at closing of 2017 from Borrower Funds.

Putting the issue of interest rates aside,[1] if revenue in 2020 were in line with the 2013 Louis Berger study instead of the 2017 Louis Berger Study (with its 300% revenue increase), the

[1] The 4.00% interest rate (assumed in the *pro forma* above) is hardly expected for these unrated junk bond bonds. A higher interest rate, if required to market the bonds successfully, would require higher annual interest payments, further reducing cash flow after debt service.

revenue in 2020 would be $47 million instead of $142 million. This would reduce 2020 cash flow after debt service from a positive cash flow of $51 million to a negative cash flow of $44 million. The negative cash flow would be higher in magnitude at an interest rate higher than 4.00%.

On an aggregate basis for the 5-year period 2018 through 2022, if revenue were in line with the 2013 Louis Berger study instead of the 2017 Louis Berger Study (with its 300% revenue increase), the revenue for this 5-year time period would be $204 million instead of $612 million. This would reduce cash flow after debt service for the 5-year period from a positive cash flow of $156 million to a negative cash flow of $252 million. The negative cash flow would be higher in magnitude at an interest rate higher than 4.00%.

Based on the foregoing, it would appear that the extraordinarily more optimistic revenue forecasts presented in the 2017 Louis Berger study are absolutely critical to the marketing of the 2017 tax-exempt bonds. The 2017 bonds, as structured, could not be marketed using the 2013 Louis Berger revenue projections, because the *pro forma* presented in the draft 2017 preliminary offering memorandum would indicate massive negative cash flows after debt service.

There is no evidence from FDFC's deliberations that: (a) AAF informed FDFC that the changes in Louis Berger's projections for the project form the keystone to the *pro forma* financial analysis presented for the project; or (b) FDFC provided any scrutiny whatsoever to whether Louis Berger had any *bona fide* basis for increasing its revenue projections for the project by 300% between the time it prepared the 2013 study and the 2017 study. Louis Berger's 2017 study does not acknowledge that its AAF forecasts have become far more optimistic since its prior 2013 study. Louis Berger's new-founded optimism for the project is particular surprising in light of the following:

- Tri Rail fares (in 2016$) are only $6.90 between Miami and West Palm Beach; $5 between Miami and Ft. Lauderdale; and $6.25 between Ft. Lauderdale and West Palm Beach. Tri Rail is a slower service, with greater headways between trains at certain hours, but its fares are far below those projected for the AAF project.

- An entirely new transportation industry has emerged between 2013 and today: the Uber/Lyft phenomenon. These services are widespread in southern Florida. These taxi companies provide beginning-of-journey to end-of-journey service, eliminating the need for travel to stations and travel from stations to the passenger's ultimate destination. According to the 2017 Louis Berger study, the Uber fare is currently $27 - $35 between Miami and Ft. Lauderdale – about the same as a single ticket on the AAF train. But Uber takes the rider door-to-door and does not charge more for a second or third passenger.

We will leave to the sophisticated buyer of AAF bonds the decision about whether such numbers are credible, when they have gotten so much "better" over the last four years. If AAF has an explanation for the mismatch, it is not apparent from the materials provided to the FDFC in connection with its approval of the new bond offering.

There's no word yet on what average ticket prices would be for the longer haul from Miami to Orlando (approximately 235 miles) in Phase II. However, if we take the fares from the 2013 Louis Berger study and assume increases similar to the 2017 Louis Berger study, the numbers are probably enormously higher but proportionately similar.

<u>Timing – Other Factors to Consider</u>

With respect to timing, two factors may have come into play with respect to the hurried nature of the FDFC's October 27, 2017 decision to move forward on the $600 million PAB allocation.

First, the provisional allocation that DOT granted to AAF in November 2016 is due to expire on January 1, 2018, so AAF's time was running out.

Second, the draft tax reform legislation unveiled by House Republicans on November 2 includes a provision that would terminate all PABs issued after 2017. This provision was added to the comprehensive tax reform bill as one of many "offsets" needed to pay for the overall legislation. According to estimates from the Joint Committee on Taxation, eliminating PABs would increase revenues by $38.9 billion over 10 years.

The Republican tax reform bill still has a long way to go before being enacted, and the provision eliminating PABs could certainly be altered or eliminated as the measure makes its way through the legislative process. However, its inclusion—and the possibility that AAF got wind of it before the tax bill was officially unveiled—could explain why AAF moved into "hurry up" mode, in order to be one of last entities ever to be able to take advantage of the crony capitalist loophole that House Republicans are seeking to eliminate.

<u>Tallahassee Review</u>

CARE FL, Indian River County and Martin County appreciate JLAC's efforts to review this issue, including the OPPAGA review of FDFC practices. We urge these entities to continue to investigate the questionable practices of the FDFC, using the AAF PAB issue as a case study.

Please do not hesitate to contact us if we can provide you with additional information or answer any questions.

Sincerely,

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