July 24, 2017

The Honorable Elaine L. Chao
Secretary of Transportation
U.S. Department of Transportation
1200 New Jersey Avenue, SE, 9th Floor
Washington, DC 20590

Ms. Lana T. Hurdle
Assistant Secretary for Budget and Program and Chief Financial Officer (Acting)
U.S. Department of Transportation
1200 New Jersey Avenue, SE, Room W95-330
Washington, DC 20590

Re: New Financing Concerns Related to the Ability of All Aboard Florida (AAF) to Repay a Federal Loan

Dear Secretary Chao and Acting Assistant Secretary Hurdle:

We are writing on behalf of Indian River and Martin Counties (the Counties) and Citizens Against Rail Expansion in Florida (CARE FL) regarding the application of All Aboard Florida (AAF)/Brightline for a Railroad Rehabilitation and Improvement Financing (RRIF) loan from the U.S. Department of Transportation (DOT) to pay for all of its facilities. The Counties and CARE FL have information and facts regarding the AAF project that indicates such a loan is unlikely to be payable and creates a very high risk of default. We ask that DOT and the Credit Council carefully consider these facts before making a decision on the issuance of a RRIF loan.

Credit Analysis for Pricing Any Loan to AAF Must Reflect the Extraordinary Riskiness of This Speculative Start-Up Venture

Any federal credit extended to the AAF project must be priced to reflect the extraordinary risk posed by this venture. With the assistance of the largest investment banks in the country, AAF has repeatedly gone to market with offering plans to sell private activity bonds (PABs) and has not been able to find buyers for these bonds, even at interest rates far higher than investment-grade tax-exempt debt. The DOT should demand that AAF open its books and provide it with the "order book" for each of its efforts to market the PABs, which will give DOT insight into how sophisticated Wall Street investors priced the credit risk posed by AAF's speculative venture. In this regard, it is noteworthy that AAF's 5-year senior secured PIK toggle notes – issued at a 12% nominal interest in 2014 – are now less than 2 years to maturity (and thus would ordinarily be considered low risk) but were last traded on June 13, 2017 at a yield-to-maturity of more than 400% of short-term bonds with comparable maturity (using, as a point of comparison, the iShares iBonds Dec 2019 Term Corp ETF for bonds maturing in 2019). A potential investor would need to be satisfied with C grade debt ("substantial risks, extremely speculative") to buy bonds that only have two years' duration and interest rates (yield-to-maturity) comparable to the AAF senior secured PIK toggle notes.

AAF's venture would be the first for-profit passenger railroad built in the United States in decades. AAF's ridership estimates have changed repeatedly, with each iteration increasing projected ridership, goosing up projected revenues. The Louis Berger Group (LBG), the author of AAF's supposed "investment-grade" ridership study, increased its ridership projections for the AAF project by more than 50% between LBG's 2013 draft and 2015 final study, without explanation. As part of its due diligence, the DOT should examine not only the most recent version of AAF's demand forecasts, but also the prior drafts of these forecasts, and should demand a detailed explanation for why they have increased over time, with factual backup. DOT should also demand to see all communications between AAF and LBG.[1]

A "point estimate" demand forecast – even if it supposedly represents the "expected value" – can mask considerable uncertainty in the projected demand for this risky start-up venture. Any sensitivity analysis for the extension of federal credit to AAF should assume that revenue may be much less than projected (because there is a substantial risk that ridership may fall well short of AAF's rosy marketing scenarios) and costs may exceed those that are projected, because large complex railroad projects often exceed their budgets. Instead of relying upon the revenue projections of a consulting firm under AAF's supervision and control, DOT should retain, at AAF's expense, a truly independent expert to estimate demand – under both the reasonable best case and reasonable worst case. Of course, it should be the latter scenario that is used for any credit analysis for the project.

As noted above, any reasonable credit analysis for the AAF project would assume that costs may escalate substantially above AAF's estimates. In a study of 58 rail projects by Professor Flyvbjerg and his colleagues, 9 out of 10 had suffered cost overruns, with an average overrun of 44.7%. *See* Flyvbjerg, et al., *Journal of the American Planning Association*, Vol. 68 , Issue 3 (Summer 2002). For the 19 rail projects in North America included in the study, the average budget exceedance was 40.8%.

In a different article, Professor Flyvbjerg and his colleagues opined that "[h]igh-speed rail tops the list of cost underestimation." The overly optimistic projections in their view extended not just to cost estimates, but to projections for passenger ridership as well. In their paper entitled "*How (In)accurate Are Demand Forecasts in Public Works Projects, The Case for Transportation,*" Professor Flyvbjerg and his colleagues analyzed a sample of 27 railroads and found that "for 9 out of 10 rail projects, passenger forecasts are overestimated; the average overestimation is 106%." This means that for every 100 passengers in an estimate, the actual ridership was only 48.6 people. In other words, the initial passenger ridership estimate was on average off by 51%. The authors also

[1] The integrity issues that have been repeatedly raised with respect to LBG's work must also be considered in evaluating its "investment-grade" study for AAF. In 2006, the Asian Development Bank debarred LBG after discovering significant integrity deficiencies. In 2010, LBG entered into a deferred prosecution agreement with the U.S. Department of Justice, paying $18 million in criminal penalties for defrauding the government and $50 million in civil penalties for violating the False Claims Act. In 2014, LBG's former president, CEO and chairman pleaded guilty to conspiring to defraud the government with respect to billions of dollars in contracts over a nearly 20-year period. On January 29, 2015, the World Bank debarred LBG for corrupt practices. On March 14, 2016, the U.S. Court of Federal Claims found that another LBG entity, the Louis Berger Aircraft Services, "is part of a family of corporations that has intentionally hidden its history of public corruption scandals through misrepresentations, false certifications, and a scheme to avoid reporting requirements." *Algese v. United States*, No. 15-1279C (Fed. Cl. March 14, 2016) [ECF 71].

determined that “forecasts have not become more accurate over the 30-year period studied, despite claims to the contrary by forecasters.”

Professor Flyvbjerg and his colleagues concluded “[t]hat the traffic estimates used in decision making for rail infrastructure development are highly, systematically, and significantly misleading (inflated).” (Refer to *The Journal of the American Planning Association*, Spring 2005, Vol. 71, No. 2, pages 131-146.) It is also noted that, as stated in the article, the authors found that 84% of the rail projects have actual traffic more than 20% below forecasted traffic and 72% of the rail projects have actual traffic more than 40% below forecasted traffic.

The available research is not limited to academic studies. In a 2008 report prepared by the Federal Transit Administration’s Office of Planning and Environment (the FTA), the authors reported that: “On average, for the 21 projects completed between 2003 and 2007, actual construction costs exceeded the inflation-adjusted estimates developed in alternatives analysis by 40.2 percent.” With regard to ridership estimates, the 2008 FTA study found that the median actual ridership, when adjusted to the forecast year, was just 63.8 percent of their alternatives analysis forecasted ridership. (Refer to the following: (i) Federal Transit Administration Office of Planning and Environment, *The Predicted and Actual Impacts of New Starts Projects – 2007 Capital Cost and Ridership*, April 2008, pages 3-4; and (ii) “*Predicated vs. Actual Costs and Ridership of New Starts Projects,*” presented by Steve Lewis-Workman, Transportation Research Board Session 371, January 14, 2008.) In this study, the median for unadjusted ridership was found to be just 59.5% of the forecasted ridership.

DOT’s credit analysis for pricing any loan to the AAF Project must reflect the extraordinary riskiness of this speculative start-up venture.

Former White House Economic Advisor Projects AAF Will Not Be Able to Repay Its Debt

As noted above, we continue to have serious concerns regarding the integrity of the financials of AAF and believe these concerns should be seriously considered by DOT with respect to AAF’s likely inability to repay a RRIF loan, and the risk of default on the loan which would be borne by the taxpayers.

In February 2015, in response to the lack of publicly disclosed data on the economics of AAF, CARE FL—a coalition of concerned citizens in Florida’s Treasure Coast region—commissioned John Friedman, Ph.D. of Economics, a distinguished Brown University Professor and former White House National Economic Council Special Assistant in the Obama Administration, to provide an economic analysis of the project. Dr. Freidman’s research approach brings together theory and data to yield policy-relevant insights on a wide range of areas. His work has appeared in top academic journals as well as in major media outlets, and his findings have played a key role in policy development at both federal and state levels. (Please see attached for a copy of Dr. Friedman’s report, and the Declaration that Dr. Friedman subsequently submitted in the related U.S. District Court case challenging the now-withdrawn $1.75 billion PAB allocation that AAF was unable to sell.)

In his analysis, Dr. Friedman analyzed the market for the 220-mile rail line connecting Miami and Orlando, as compared with alternative travel options, to project fares and annual ridership. He then took these projections to assess the overall economic feasibility of the project. He found that AAF will generate an average ticket price of $34 and attract between l.5 and 2 million riders. AAF’s own flawed ridership study claimed it would have far more riders—more than 5.3 million in 2020, a number that is more than double the ridership on Amtrak’s Northeast Corridor.

Train fares are limited for business travelers by the relatively cheap airfare for the one-hour flight between Miami and Orlando, as well as the fact that—unlike other long-distance trains— AAF will arrive at the Orlando airport rather than downtown, the latter of which would be more advantageous to many passengers. Dr. Friedman opined that AAF fares for personal travelers will be limited by the relative ease of car travel. Train ridership will also be limited by high levels of urban sprawl and the lack of connecting public transit.

Based on Dr. Friedman's analysis, the report also concluded that in order to compete with other modes of transportation, AAF will only be able to generate an average one way ticket price of $34, yet the railroad would have to charge up to $273 per ticket in order to cover its costs and service its debt (see pages 3 and 11 of his report). In essence, the railroad is caught in a whipsaw, between the price that customers will be willing to pay and the money needed to pay for both operations and servicing its debt burden.

Dr. Friedman concluded that even making all optimistic assumptions to favor AAF, it will generate annual losses of more than $100 million and will be unable to service its debt burden. (This is the same $1.75 billion amount in PABs that equates to the RRIF loan amount reportedly being sought by AAF. An apples to apples comparison is made easier by AAF's chronic inability to raise the $1.75 billion without U.S. taxpayer subsidies—whether in the form of PABs or a RRIF loan.)

In summarizing the railroad's projected annual revenues, operating costs and debt services costs, he stated on page 3 of his report: "AAF has no way to pay the resulting annual deficit, except perhaps by non-train-related business such as real estate profits."

AAF made many public claims that default on the PABs would only harm private parties, not Florida or U.S. taxpayers. That argument is no longer valid. Without Amtrak Acela-level seat pricing by AAF, it will not be able to pay the likely amount due as principal and interest on a RRIF loan.

While fares will not be officially announced until just before operations begin, an article in Miami Today from June 13, 2017 (http://www.miamitodaynews.com/2017/06/13/brightline-rail-will-start-deeply-discounted-fares/) noted that the AAF plans to begin service for Phase I by offering "deeply discounted" fares. This development further validates the 2015 analysis of Dr. Friedman with respect to competitive ticket pricing.

Ownership Changes of Fortress and FECR Create Significant New Financial Uncertainties

When the Final Environmental Impact Statement (FEIS) was issued in August 2015, Fortress Investment Group (Fortress) managed Florida East Coast Industries (FECI), parent company to AAF. Fortress also managed Florida East Coast Railway (FECR), the freight railroad that owns the rail corridor on which AAF proposes to run.

In February 2017, Japanese company SoftBank Group (SoftBank) announced it would buy Fortress for about $3.3 billion. Subsequently, in March 2017, Mexican mining and railroad company Grupo Mexico announced it had agreed to buy FECR for $2.1 billion. Both deals have gone forward, including approval from the Surface Transportation Board (STB) for the Grupo Mexico deal.

These two ownership changes have significant implications for the AAF project—both from a financial and environmental perspective.

Fortress's unwillingness to use its capital to finance AAF was evident, as AAF has since 2014 been seeking government subsidies in the form of a $1.75 billion PAB allocation. Even after AAF tried—unsuccessfully—four times to sell the bonds, neither Fortress nor any equity investor stepped up to supply additional capital to the project.

Now, under SoftBank ownership, there in an indication that the parent company may be even less likely to provide the capital support the AAF project needs, as evidenced by AAF's new request to pursue a RRIF loan, reportedly in the same amount of $1.75 billion.

In addition, the financial health or lack thereof of Grupo Mexico is now very important to AAF's future, as Grupo Mexico will now own the rail corridor on which AAF would run. AAF only has an easement to use the corridor and will not own the tracks, even if paid for by the RRIF loan. Is Grupo Mexico a sound business partner or a potential threat to the repayment of the RRIF loan? How would the bankruptcy of Grupo Mexico's subsidiary impact the AAF loan repayment?

Whether and how these easements will need to be renegotiated under Grupo Mexico's new ownership adds to the financial questions surrounding AAF's ability to finance its project and repay a potential RRIF loan.

Unique Financing Concerns for the New Administration

A DOT decision to make this loan to AAF creates issues for the Administration that are unusual. If the loan is made, some—including the proponents of the project—will argue that the AAF project benefits the neighbors of the three proposed rail stations in Phase I. This includes the President's Mar-a-Lago Resort, which is located near the West Palm Beach Station. Therefore, granting the loan arguably impacts the President's property. Critics may argue the loan creates an improper benefit to a private business of the President's.

An alternative argument that we believe is more accurate is that the AAF project creates safety risks to President Trump and reduces the value of nearby properties such as Mar-a-Lago. From a safety perspective, the U.S. Secret Service and others responsible for the safety of the President should be asked to consider the safety implications that could result from speeding up freight trains (carrying dangerous substances including LNG) interspersed with fast moving AAF passenger trains on the same tracks. These security and policy considerations should be fully examined before a RRIF loan decision is made.

Conclusion

Thank you for your review of these varied and very important financial considerations related to AAF's finances. Please do not hesitate to contact any of us directly if you have questions or need additional information. We look forward to your response.

Sincerely,

Dylan Reingold, Esq., County Attorney
Kate Pingolt Cotner, Esq., Assistant County Attorney
Indian River County
1801 27th Street
Vero Beach, Florida 32960-3365
772.226.1424
dreingold@ircgov.com
kcotner@ircgov.com

Ruth Holmes, Esq., Senior Assistant County Attorney
Martin County
2401 SE Monterey Road
Stuart, FL 34996
772.288.5400
rholmes@martin.fl.us

Stephen M. Ryan, Esq., Counsel for CARE FL
Ms. Erica Stocker, Advisor to CARE FL
McDermott Will & Emery
500 North Capitol Street, NW
Washington, DC 20001
202.756.8333
sryan@mwe.com
estocker@mwe.com

cc: Philip Karmel, Esq. (Indian River County Counsel)
J. Kevin Healy, Esq. (Indian River County Counsel)
Sam Neel, Esq. (CARE FL and Martin County Counsel)