M-1 RAIL BRIEFING MEMO
AUGUST 24, 2012

I. OVERVIEW

- The M-1 RAIL project is at a critical juncture as we work to bring closure to the five issues identified in Secretary LaHood's letter of June 24, 2012 in order to qualify for the $25 million federal grant.

- M-1 RAIL has received unprecedented support from business, institutional and philanthropic organizations totaling more than $90 million. Many other supporters have been identified who will step forward to support the project, but time is of the essence after four years of waiting for progress.
- M-1 RAIL has advanced each of these five issues at the staff level (M-1 RAIL, FTA, State of Michigan and City of Detroit) to the point where we understand what the path forward must be.

- Our most critical issues involve the State of Michigan. Specifically, we need to: (1) finalize the State's financial commitment to the project, and (2) confirm that MDOT (instead of SEMCOG) will act as the grantee for the $25 million FTA grant.

- M-1 RAIL is confident that if the State is prepared to support these two lynchpin issues, the FTA grant will be approved and this important project will go forward.

II. ISSUES AND ACTION ITEMS

Secretary LaHood's letter identified five conditions to the $25 million federal million grant.

1. A CREDIBLE OPERATING PLAN TO COVER SHORT AND LONG-TERM OPERATING COSTS

- M-1 RAIL continues to need $15 million in State support to demonstrate a clearly credible 10-year operating plan, while having sufficient funding to satisfy FTA on the capital side. Repurposing a portion of the TIGER I funds for operations is not an option, as those funds are the likely source for the FTA commitment of $25 million and are strictly limited to capital.

- To raise $15 million in State support, M-1 RAIL has worked with the State along several tracks:

    - We are in advanced discussions with MEDC for $5 million in advertising funds to be paid over 10 years. That work is proceeding in a satisfactory manner, but we need a firm commitment on this funding that is acceptable to the FTA.

    - We have worked with MDOT at a staff level to ascertain the best means to secure $10 million in additional State funding, most likely to come as capital that will free a corresponding amount of M-1 RAIL's funds to be added to the existing $10 million operating reserve fund raised through M-1 RAIL's efforts. The sources discussed to date include: (1) "Transportation Enhancements" federal transportation funds that MDOT receives each year; and (2) an increase in MDOT's budget for the road rebuild (and corresponding increase in its scope of work) to cover some of the utility and other roadwork currently in M-1 RAIL's budget. M-1 RAIL is fully confident that the State has the flexibility to provide the latter source of funding under the new federal transportation bill that was enacted into law in July.

    - We also are exploring the possibility of direct grants from the University of Michigan and Michigan State University.

- Here is how the operating financial plan works if the State commits $15 million to the project. The annual operating costs are approximately $5 million. Because FTA has directed that M-1 RAIL lower

its projection for the fare box recovery rate to 33% of operating costs, we have reduced our assumption to $1.6 million from passenger fares and $1 million from our current private sinking fund per year, leaving a $2.4 million annual operating gap. The State's combined $15 million would lower the annual gap to a very manageable $900,000. M-1 RAIL has identified a range of potential funding sources well in excess of the $900,000 gap.

- To meet the Secretary's conditions, we need closure on this issue through a firm written commitment from the State.

2. HAVING MDOT AGREE TO SERVE AS THE GRANTEE FOR THE PROJECT

- FTA has made clear that, in its view, MDOT is the only viable candidate to serve as the federal grantee for the project, in large part because it does not believe that SEMCOG has either the legal or institutional capacity to serve in this role. This is a make-or-break issue because without a grantee, there is no grant and no federal support for the project.

- M-1 RAIL has provided a detailed memorandum outlining the incremental responsibilities associated with this role and how the incremental responsibilities will be ameliorated at the transactional level (largely through having M-1 RAIL become a sub-obligee of many of these responsibilities).

- Our impression is that the main barrier for MDOT to serve in this role is the concern about a federal labor protection requirement known as "Section 13(c)." Section 13(c) requires a federal transit grantee to enter into agreements with transit labor unions in the area providing that the grantee will protect transit workers against any adverse impacts that the federally-funded project may cause.

    - To illustrate the Section 13(c) implications, if adding M-1 RAIL service on Woodward Avenue causes bus drivers on the Woodward route to lose their jobs, those affected drivers would have potential claims under Section 13(c). (Note: We believe that liability in the real world will be very limited, because even if the addition of streetcar service by M-1 RAIL results in a reduction in bus service along Woodward, the affected drivers presumably would be reassigned to meet other desperately needed bus service needs).

- We also understand that there may be legal implications if the State were to undertake to comply in its own name with Section 13(c) requirements.

- As the preferred way to meet these concerns, we suggest that the State and M-1 RAIL request USDOT to allow MDOT to pass through the Section 13(c) obligations to M-1 RAIL; i.e., M-1 RAIL will be treated as a sub-grantee and will enter into the Section 13(c) arrangements.

        - There is precedent for this in terms of MDOT passing through Section 13(c) obligations to other sub-grantees that are public agencies.

        - In order for this to be possible, USDOT may have to give M-1 RAIL the same "sub-grantee" status as public agencies receiving funds from the State even though M-1 RAIL is a private entity – which we believe USDOT has the authority to do under a provision in the new federal transportation bill that gives it special flexibility to address barriers to public private partnerships.

3. THE ESTABLISHMENT OF A CAPITAL RESERVE (SUGGESTED TO BE $15 MILLION)

M-1 RAIL's position on the suggested Capital Reserve is as follows:

- M-1 RAIL's current capital budget is $137 million, with $131.5 million in firm commitments. We have had meaningful discussions over the past two months to identify many more prospects, and are in the

process of securing written commitments for support from many of them. We are very confident that through these prospects, we will reach a new target of $140 million, giving M-1 RAIL a built-in reserve of $3 million in primary commitments that bolster the significant contingencies being carried in the project budget.

- In addition, M-1 RAIL has identified a $10 million capital reserve target on top of the foregoing, which we believe can be met through various options:

    - Remove a railcar from the capital budget, which will marginally increase headways in the early years (from 7.5 minutes to 10 minutes) and save $4.7 million in capital costs (as well as $200,000-300,000 in annual operating costs).

    - Seek CMAQ funds from SEMCOG. M-1 RAIL has had preliminary discussions with SEMCOG, and this appears to be a distinct possibility.

    - Assemble a "contingent commitment" of funding from foundations that would not normally support a capital project such as M-1 RAIL. This commitment would be triggered only if capital costs exceed the $140 million level and other sources have been fully tapped.

    - Increase our goal for New Markets Tax Credits in the 2013 round.

    - Utilize grants received over and above the $140 million goal from current and future prospects.

- M-1 RAIL will proceed to build the project only after it has received final construction bids that confirm it has the capital resources to complete the project.

- The foregoing suggests that USDOT should give the project the chance to be successful and should not kill it prematurely merely because M-1 RAIL doesn't have an extremely large reserve fund fully assembled for "what if" costs that may well never arise.

4. CONSIDERABLE PROGRESS TOWARD A REGIONAL TRANSIT AUTHORITY (RTA)

Our strong position is that FTA cannot hold M-1 RAIL accountable for action in the Michigan Legislature, and instead that we should be allowed to meet this requirement by demonstrating an active and visible lobbying effort in support of the RTA.

- M-1 RAIL already has: (1) performed significant lobbying in favor of the RTA; (2) obtained a letter from the Senate Majority and Minority Leaders supporting the RTA (as well as the project); (3) worked with the Administration's point persons on this legislation; and (4) mobilized a consortium of supportive lobbyists to execute the strategy for enacting the legislation.

- M-1 RAIL has offered to make its leaders and certain of its key supporters, those that are legally empowered available at the appropriate time to discuss the need for the RTA with key legislators. M-1 RAIL's leadership is committed to the enactment of the RTA and the concept of regional support for a regional transit system.

5. AN MOU BETWEEN THE PARTIES (M-1 RAIL, STATE OF MICHIGAN AND CITY OF DETROIT) COMMITTING TO UNDERTAKE THE VARIOUS ROLES AND RESPONSIBILITIES.

- The parties have developed a Responsibilities Assignment Matrix outlining the respective roles and responsibilities of a multiplicity of parties – including M-1 RAIL, MDOT, the City (DEGC), FTA, FHWA, the contractor, etc. We believe that the Matrix will satisfy this requirement of the Secretary's condition, if agreement is reached on the State's commitments to the project.

III. CONCLUSIONS

- The State's financial commitment and agreement to serve as the grantee for the FTA grant are the critical preconditions to moving the M-1 RAIL project forward. With this support from the State, M-1 RAIL firmly believes it will obtain a green light from USDOT.

- It is critical that USDOT's approval be obtained no later than September. M-1 RAIL and its investors need and deserve an answer, and we need to maintain credibility with the numerous investors and New Markets Tax Credits allocates who already have been put off for several years.

- The risks and commitments being requested of the State are specific, defined and manageable. The biggest risk is that construction will commence but cost overruns result in suspension of the project. However, M-1 RAIL won't start construction of the project until it has firm construction bids confirming the viability of the project and the ability of M1 RAIL to pay for it. If the bids don't provide this validation, M-1 RAIL will withdraw and the State has no further obligation.

- On the other hand, the State's upside is substantial. For a modest investment, the State will: (1) demonstrate ways to make high-quality transit service available to the region at no local public cost; (2) spawn literally billions of dollars of transit oriented development in the City of Detroit, which desperately needs it; (3) be a very tangible demonstration of how the State's assistance can help the City move forward at this critical juncture; (4) help kick-start the RTA legislation; and (5) add $60 million to a potential federal match for the proposed BRT system (resulting in $60 million of additional federal funds).

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