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States' Initiatives Offer Solution to Impending Highway Trust Fund Shortfall

By: Kenneth Orski
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On June 4 the Heritage Foundation held a Capitol Hill briefing for Congressional staff. Entitled "Which Way for the Highway Bill?" the well-attended briefing focused on the policy issues facing Congress as it considers the future of the federal surface transportation program. The panel included Emily Goff, Policy Analyst at The Heritage Foundation; Chris Edwards, Director of Tax Policy at Cato Institute; and Ken Orski, Editor and Publisher of Innovation NewsBriefs. The latter's remarks are reproduced below.

While transportation stakeholders and the Washington press corps are agonizing about the impending Highway Trust Fund shortfall and its impact on the federal transportation program, they are ignoring developments outside the Beltway that go a long way toward mitigating the prospective funding shortage. For in fact, individual states, far from standing idly by, are responding to the fiscal uncertainties in Washington by stepping up and augmenting their transportation budgets.

Some states are increasing local fuel taxes (MD, WY, MA, VT, NH), others are finding new ways to raise revenue such as taxing fuel at wholesale level (e.g. PA), enacting dedicated sales taxes for transportation (e.g. VA, AK) or floating toll revenue bonds (e.g. OH, MA). In the words of Sen. Roger Wicker (R-MS), states have become "laboratories for fiscal experimentation." (*For a full listing of state funding initiatives, see Appendix, below.*)

Surveys by the National Council of State Legislatures, American Association of State Highway Transportation Officials (AASHTO) and the American Road and Builders Association (ARTBA) have documented transportation-related revenue initiatives in 26 states. In addition, last November, voters approved four local bond referenda and 12 measures to increase local transportation sales taxes. More such grassroots initiatives are expected this coming November.

These measures are cumulatively generating millions of additional dollars for state and local transportation programs and offer a partial antidote to stagnant federal revenue.

Funding Major Transportation Investments

To further make themselves fiscally independent, states are adopting innovative ways of funding major transportation investments.

More than 20 jurisdictions have turned to financing costly construction projects with long term credit -- borrowing front-end capital and repaying it over extended periods of time with dedicated sources of revenue such as tolls or sales taxes. To raise capital, they have used a variety of financing tools such as Transportation Infrastructure Finance and Innovation Act (TIFIA) loans, private activity bonds, toll revenue bonds and private equity contributions.

An outstanding example is the new Tappan Zee Bridge across Hudson River in upstate New York, which served as a backdrop for President Obama's May 14 appeal for more government infrastructure spending. Ironically, the bridge will not use federal grant money. It will be financed with state bonds and a TIFIA loan, both of which will be paid off through bridge tolls.

In turning to long-term credit to finance costly construction projects, states are following in the footsteps of the private sector. All of the nation's privately owned infrastructure -- railroads, pipelines, telecommunications networks, power plants and refineries -- are funded with loaned capital. So are many transportation facilities at the local level -- $35 billion worth of municipal bonds are sold annually to finance local transportation. State roads and bridges are merely latecomers to the ranks of infrastructure projects financed with long-term investment capital.

Turning to Public-Private Partnerships

Another way in which states are seeking to reduce their dependence on federal assistance is by entering into public-private partnerships. These allow states to shift the burden of financing costly construction projects to private contractors and concessionaires. The private firms are repaid in installments over an extended period of time with so-called "availability payments" upon proof of meeting stipulated performance standards. In the last two years, six states have entered into partnerships based on availability payments, and their number is expected to increase as more states gain familiarity with this type of financing arrangements.

In sum, states are not waiting passively for Congress to come to the rescue with more revenue -- certainly not with $100 billion, the amount we are told is needed to fund the Senate's proposed six-year transportation measure. Instead, governors, state legislatures and local governments are taking aggressive steps to make themselves fiscally more independent. They are increasing fuel taxes, passing local bond referenda, financing costly construction projects with long-term credit, and entering into investment partnerships with the private sector.

And, in so doing, they are hastening the process of *de facto* devolution -- which many libertarians welcome as the one positive consequence of the federal fiscal crisis.

Shifting Expenditures Out of Trust Fund

Will the states' efforts at revenue enhancement make the Highway Trust Fund superfluous? They will not -- certainly not in the foreseeable future. Federal fuel taxes will continue to play an essential part in maintaining the nation's highways and transit systems. Taxes at current rates (of

18.4 cents/gal) will keep earning the Trust Fund an estimated $39 billion a year ($34 billion for highways and $5 billion for transit), and help fund regular program activities. But Trust Fund revenues will no longer be required to fund big-ticket capital investments. Those will be financed increasingly with long-term loans and availability payments. At least that's the scenario envisioned by some thinkers looking for a long-term solution to the Highway Trust Fund crisis.

Shifting capital expenditures out of the Trust Fund, they contend, would reduce future drawdowns from the Trust Fund and align spending from the Fund more closely with incoming tax revenues, as proposed in the FY 2015 House Budget Resolution. This, in turn, would put an end to the recurrent Trust Fund shortfalls of the past several years.

As for the states, greater fiscal independence will help them gain a substantially enhanced role in transportation and more freedom and flexibility to manage their transportation programs on their own terms and free of burdensome federal oversight.

One could call it a win-win proposition for everyone.

APPENDIX

Transportation-Related State Funding Initiatives, 2013-14 *(6/4/2014 update)*

In 2013, legislatures in **Maryland, Wyoming, Massachusetts** and **Vermont** raised state gas taxes. **Pennsylvania** approved a massive $2.3 billion bill for roads, bridges and mass transit by lifting the cap on gasoline tax at wholesale level (resulting in a 28 cents/gallon increase in the price of gas at the pump over the next five years). **Virginia** enacted a landmark legislation that will provide $3.4 billion for transportation over the next five years. **Arkansas** approved a dedicated one-half cent sales tax increase whose proceeds will back a $1.3 billion bond issue for highway construction over the next ten years. **Ohio** passed a toll-backed $1.5 billion bond issue for highway and bridge improvements.

Also in 2013, **Oregon** adopted a voluntary mileage-based user fee system that may pave the way for a statewide "VMT" program, the first of its kind. **South Carolina's** legislature provided additional $91 million in recurring annual funding for bridge, resurfacing and interstate projects. **Texas's** legislature adopted a constitutional amendment that might raise $1.2 billion per year for the state's highways by diverting half of the revenue from its oil and gas production Rainy Day Fund. **Florida**'s Governor Rick Scott announced an $8.8 billion program of transportation infrastructure improvements across the state. **Delaware**'s Governor Jack Markell expressed support for raising the state gas tax by 10 cents. **Maine**'s Governor LePage announced a $2 billion program of infrastructure modernization over three years. A House panel of **Iowa**'s state legislature recommended a 10-cent gas tax increase. **Colorado's** Governor John Hickenlooper proposed the formation of an enterprise dedicated to fostering public-private partnerships to fund transportation infrastructure projects.

As 2014 legislative sessions got underway, six states introduced bills to raise state gas taxes or index them to inflation, according to the National Conference of State Legislatures (NCSL). They were **Idaho, Iowa, New Hampshire, New Mexico, South Carolina** and **Utah**. In

Colorado, the state entered into the first public-private partnership for maintenance of the Denver-Boulder highway. The **Massachusetts** legislature passed a $12.7 billion bond bill for transportation over the next five years. The measure includes funds for commuter rail expansion and local road improvements as well as for highway improvements. The **Indiana** legislature authorized $200 million in transportation funding to be released from a savings fund created last year.

New Jersey state Senator Raymond Lesniak introduced a bill to to raise the motor fuel tax by 5 cents/gallon. The bill would generate an extra $250 million annually over the 3-year life of the tax. **Iowa's** legislature passed a $358 million bill for transportation, a 1.5% increase over the current year. **South Carolina** will be studying tolls as a potential funding source for Interstate 73 construction, it was announced. **Tennessee's** Gov. Bill Haslam unveiled a three-year $1.5 billion transportation budget that will fund 14 statewide programs and projects in 41 counties.

Illinois Governor Pat Quinn unveiled a six-year, $8.6 billion construction program that is planned to improve 1,845 miles of highway and replace or rehabilitate 384 bridges across the state. **Connecticut**'s Gov. Dannel Malloy announced that his proposed 2015 transportation budget represents a 165% increase in funding compared to 2010 levels and includes $1.4 billion to fund the largest transportation capital program the state has ever seen. **Virginia**'s Commonwealth Transportation Board released its six-year transportation plan, which totals $13.1 billion, with $9.9 billion earmarked for highway construction and $3.3 billion for transit.

Southern **Nevada** passed a fuel revenue indexing measure and announced $700 million in new transportation projects to be funded with the fuel tax increase. Said Clark County Commissioner Larry Brown In commenting on the new tax initiative, "We're not looking for much money from the federal government over the next few years." **New Jersey** DOT announced a proposed $3.7 billion capital program for transportation improvements in FY 2015; the budget includes $1.2 billion for NJ TRANSIT. **Kentucky** Gov. Steve Beshear signed a $4.1 billion road construction bill into law. (The bill does not include a 1.5 cent/gallon gas tax increase previously passed in the House and advocated by the governor).

Missouri's legislature gave final approval to a proposed constitutional amendment that would impose a three-quarters-of-a-cent sales tax for transportation. If approved by voters, the sales tax increase would take effect in 2015 and run for 10 years. It would mark the first time that Missouri roads will be funded with something other than a fuel tax. The projected $534 million annual revenues would make it the state's largest-ever tax increase.

Michigan transportation funding bills would provide more than $400 million for transportation. Michigan's House transportation committee voted to replace the current gas and diesel taxes with a 6 percent tax on the wholesale price of both types of fuel. **Ohio**'s voters overwhelmingly approved a new state bond issue that will provide almost $1.9 billion for roads, bridges and local infrastructure projects over the next 10 years. The newly passed amendment to the State Capital Improvement Program provides up to $175 million in state borrowing annually for five years, increasing to $200 million/year for the remaining five years. The ballot measure passed with broad bipartisan support.

Iowa's Transportation Commission is considering a five-year transportation plan calling for $2.7 billion in highway and bridge improvements. **South Dakota**'s governor Dennis Daugaard, in a major position change, said that if reelected he might be willing to consider raising fuel taxes to improve the state's roads and bridges. The current state gas tax is 22 cents per gallon.

California's Transportation Commission announced that it has allocated $1.3 billion in transportation funding, with $541 million dedicated to preserving existing transportation infrastructure. In a related story, Caltrans announced that the pavement condition on highways across the state was "at its best and healthiest level in more than 10 years. **North Carolina's** Senate released a budget proposal that would increase available $1.2 billion in state transportation revenue by about $15 million. **Vermont** approved a $685.7 million transportation bill, "the largest investment in transportation infrastructure in the state's history."

Wisconsin's 2015-17 transportation budget request will include long-term transportation funding. The budget request is considering several revenue options to help boost funding, notably a 5-cent per gallon gas tax hike and the adoption of a mileage-based fee system. Transportation funding also is being debated in **Minnesota and Alaska.**

(Sources: NCSL's Transportation Funding and Finance Legislation Database; AASHTO's Center for Excellence in Project Finance; ARTBA's Transportation Investment Advocacy Center; press announcements)

Financing large-scale infrastructure projects

Long-term credit, private capital and availability payments have replaced federal grants in virtually all large-scale, capital-intensive highway/bridge infrastructure projects. Prominent examples (and their state sponsors and total cost in $ bilions) include:

(1) I-495 Beltway HOT lanes in Northern Virginia (VA, $2.1B)

(2) New York Tappan Zee Bridge replacement (NY, $6.4; $4.8B in TIFIA loan)

(3) San Francisco Bay Bridge Eastern Span replacement (CA, $6.4B)

(4)(5) Highway 520 floating bridge and Alaskan Way Viaduct in Seattle (WA, $4.1B, $3.2B)

(6) Elizabeth River Midtown tunnels linking Norfolk and Portsmouth (VA, $2.1B)

(7) East End Crossing over the Ohio River near Louisville (IN, $1.15B)

(8) PortMiami Tunnel (FL, $1.1B)

(9) Goethals Bridge replacement, (NY-NJ, $1.4B;$474M in TIFIA loan)

(10) I-69 "Section 5" project (a 21-mile stretch of the I-69 Canada-to-Mexico corridor) (IN)

(11) Proposed second Detroit-Winsor Bridge Crossing (MI)

(12) North Tarrant Express project in the Fort Worth area (TX, $2.0B, $531M in TIFIA loan)

(13) Intercounty Connector in suburban Washington D.C. (MD, $2.4B)

(14) LBJ Expressway/managed lanes, Dallas (TX, $2.6B, $850M in TIFIA loan)

(15) Presidio Parkway (CA, $0.85B)

(16) Florida I-595 reconstruction/managed lanes (FL, $1.6B)

(17) Virginia I-95 HOT Lanes (VA, $0.92B)

(18) Illiana Expressway (IN-IL, $1.6B);

(19) Nevada I-15 reconstruction (Project NEON) (NV, $1.5B)

(20) Pennsylvania's Rapid Bridge Replacement Project (PA)

(21) Florida I-4 reconstruction in Orange/Seminole counties, incl. managed lanes (FL, $2.3B)

(22) North Carolina's I-77 managed lanes, north of Charlotte (NC, $0.65)

Note on Availability Payment Debt Financing

The risks associated with forecasting demand and revenue have shifted the interest from toll revenue concessions to availability payments -- an approach where developer financing is repaid by the sponsoring public agency with public funds once performance requirements have been met. Availability payments are funded with toll revenues, dedicated fuel taxes or dedicated sales taxes, with any shortfall made up by state transportation budgets.

Of the 12 major road projects with procurement underway, all but three are being financed with availability payments, reports *Public Works Financing (PWF).* The latest availability payments project is Florida's $2.3 billion I-4 reconstruction, announced in late April 2014.

To quote PWF, "The availability payment-for-performance model offers timely completion, long-term budget certainty, contractually defined performance standards, taxpayer protection from costly overruns, built-in warranty for defective design and construction, and lower life-cycle costs. ...However, for projects that don't have their own revenue stream, it is a matter of debate whether this method of financing is wise or sustainable." (which, we might add, is why there have been few megadeals with unsecured availability payments).