



TESTIMONY

Transportation Finance Challenges

**Testimony before the
House Select Committee on Transportation Funding**

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INTRODUCTION

The Select Committee on Transportation Funding has asked for a primer on transportation finance. This testimony provides information about the sources of revenue to the State Highway Fund, explains the federal budget process for transportation, and outlines some of the significant financial challenges we face.

The testimony concludes with an overview of how much money is available for transportation contracts over the next few years.

SOURCES OF REVENUE

State Highway Fund 006 is a fund in the state treasury from which appropriations are made by the Legislature to various state agencies including the Texas Department of Transportation (TxDOT). Most of the revenue made available to TxDOT is from the State Highway Fund. There are several sources of revenue to the fund as depicted in the chart on page 3.

State Motor Fuel Taxes

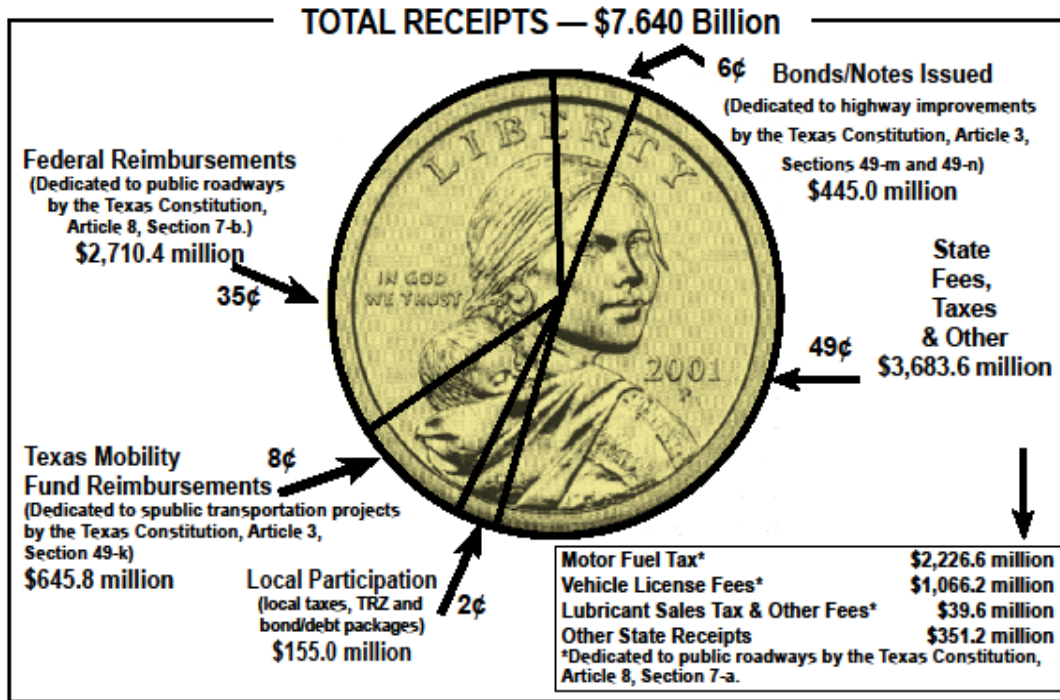
Much of the department's highway operations are financed by revenue generated by the tax on motor fuels. The state motor fuels tax is \$.20 per gallon and has not been raised since 1991. State gasoline tax revenue is generally allocated three-fourths to the State Highway Fund (less \$7.3 million to the county and road district highway fund) and one-fourth to the Available School Fund. Diesel fuel and liquefied gas tax revenues are also allocated three-fourths to the highway fund and one-fourth to the school fund.

State motor fuel tax revenue comprised 29 percent of State Highway Fund deposits in Fiscal Year (FY) 2009.

Vehicle License Fees

Texas law requires the owner of a motor vehicle, trailer, or semitrailer to register and pay a fee for a vehicle for each year in which the vehicle is used on a public highway. Registration fees are collected by county tax-assessor collectors who retain a portion of the fees and the remainder are deposited to the State Highway Fund and comprised 14 percent of total deposits to the fund in FY 2009. In FY 2009 the counties retained 29% of the fees collected and the remaining 71% was deposited to the State Highway Fund.

Distribution of Total State Highway Fund Receipts Fiscal Year Ended August 31, 2009



Borrowed Funds

Texas Mobility Fund bond proceeds are deposited to that fund and the State Highway Fund Revenue bond proceeds are deposited to a separate account in the State Highway Fund. Proceeds from our short-term borrowing program are deposited to the State Highway Fund to fund the operations of the Department in times of cash shortages. As expenditures ultimately funded by the Texas Mobility Fund are made they are initially paid from the State Highway Fund and then the Texas Mobility Fund reimburses the State Highway Fund. The reimbursements from the Texas Mobility Fund and the receipts from our short-term borrowing program comprised 14 percent of the revenue deposited to the State Highway Fund in FY 2009.

Local Participation

Money provided by local entities to help finance projects in their areas comprised 2 percent of the revenue deposited to the State Highway Fund in FY 2009.

Other Revenues

Other state receipts and the sales tax on lubricants comprise 5 percent of the fund.

Federal Reimbursements

Most of the federal money deposited to the State Highway Fund is for federal-aid highway projects. There is also a small amount for traffic safety grants, and transit and

aviation projects. Federal reimbursements comprise 35 percent of the revenue deposited to the State Highway Fund in FY 2009.

FEDERAL BUDGET PROCESS

Texas relies heavily on federal funds to help address the state's transportation needs. However, federal funding is increasingly unreliable, due to the expiration of the federal-aid program, the insolvency of the Federal Highway Trust Fund, and the lack of clear goals and strategies for transportation at the federal level.

Highway projects take many years to develop from the moment a need is detected, to the point at which the contractors are paid and the road is open to traffic. Project development does not occur neatly within the yearly appropriations cycle at the federal level. Recognizing this situation, Congress provides varying levels of authority to states to plan, program, and finance projects. To fully understand the federal budget process, it is important to know the following terms.

SAFETEA-LU

SAFETEA-LU is the name of the federal surface transportation authorization act covering the period from 2005 to 2009. The act establishes each state's yearly apportionment which functions similar to a ceiling on the amount of obligation authority that may be allocated in annual appropriation bills. The Act expired on September 1, 2009. Congress recently extended the program through December of 2010.

Highway Trust Fund

The Highway Trust Fund (HTF) is the source of funding for most surface transportation programs. There is an \$0.184 per gallon tax on gasoline and a \$0.244 per gallon tax on diesel fuel. The fund is composed of the Highway Account, which funds highway and intermodal programs, and the Mass Transit Account. Federal motor fuel taxes are the major source of income into the HTF.

Apportionment

Apportionment, also known as "contract authority," is a form of budget authority that permits planning to occur in advance of appropriations. Contract authority therefore is unfunded and requires a subsequent appropriation to pay obligations. In FY 2009 prior to rescission, TxDOT's apportionment, as established by SAFETEA-LU, was \$3,150,917,328.

Obligation Authority

Obligation Authority is the authority provided by federal law to make funds available for obligation and expenditure. For transportation programs, obligation authority is established annually by Congress in appropriation acts, is allocated to the states, and controls the amount of apportioned contract authority that can be obligated by the states in a given fiscal year. In 2009, TxDOT's obligation authority, as established by congressional appropriation, was \$2,868,608,137. Once federal funds have been

obligated they remain available to reimburse TxDOT for project-related expenditures over the life of the project which may take several years.

Reimbursements

After receiving its obligation authority, TxDOT may enter into contracts for projects. TxDOT uses state funds to pay for projects and is typically reimbursed at 80 percent for those projects with federal participation. The federal reimbursement is deposited to the State Highway Fund and is appropriated to TxDOT for transportation projects.

Rescissions

A rescission is legislation enacted by Congress that cancels the availability of budget authority previously enacted. Rescissions typically target “unobligated funds,” however in recent years rescissions have impacted TxDOT's obligation authority and therefore they have also impacted our ability to award projects.

SPECIFIC FINANCE CHALLENGES

According to the 2030 Committee, a panel comprised of twelve Texas business and civic leaders appointed by the Texas Transportation Commission to determine the fiscal requirements for the state's future transportation needs, we need to invest \$315 billion in today's dollars between now and 2030 just to prevent worsening traffic and maintain existing assets.

At the same time we are trying to solve for the \$315 billion, we have to grapple with disturbing trends and circumstances that limit the department's ability to go to contract on as many new projects as needed.

Demands on the System

During the last 25 years, Texas' population increased 53 percent while the use of our roads grew 103 percent. The trend is continuing, with some projecting an additional 27 percent in population growth and 67 percent in road usage over the next 25 years.

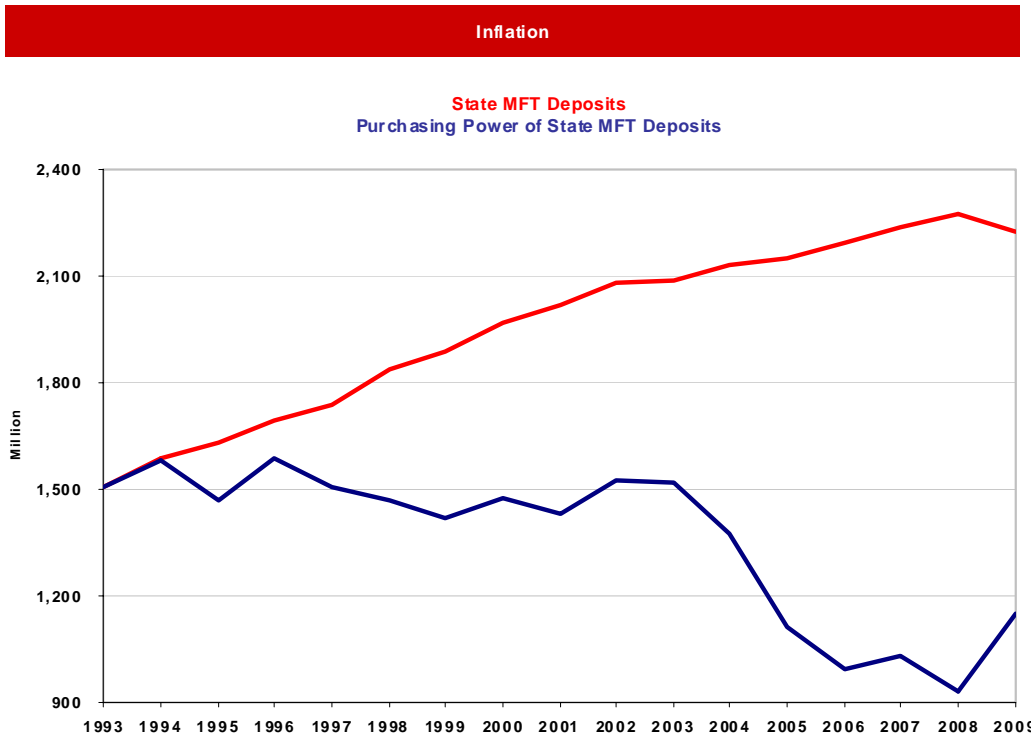
Inflation

One of the most significant challenges we face is the declining purchasing power of the State Highway Fund. Because more people are moving here and driving more, state fuel tax revenues tend to rise over time.

But the purchasing power of these funds is declining as the costs of commodities used in highway projects, such as steel and asphalt have risen over the years.

In Texas, highway construction inflation increased 65 percent between 2002 and 2008. Since the downturn in the national economy, prices have fallen. But as the economy improves, it is likely that prices will continue their upward trend.

The chart below shows state motor fuel tax revenue steadily increasing until recently. But you will also see the purchasing power of those funds rapidly declining.



Declining Revenues

As noted above, for many years state gas tax revenue has increased as the state population has increased and miles-driven have increased. But since the downturn in the economy in 2008, revenue has actually declined. The chart below compares tax collections from 2006 to 2009. In 2009, state motor fuel tax revenues declined 2.17 percent from 2008.

	Motor Fuel Taxes				
	FY 2008	FY 2009	FY 07 vs 06	FY 08 vs 07	FY 09 vs 08
September	190,343,774	190,760,322	0.55%	1.38%	0.22%
October	195,879,001	180,315,655	-1.81%	8.11%	-7.95%
November	184,443,670	177,054,232	8.54%	-1.41%	-4.01%
December	201,395,123	196,136,748	3.40%	5.70%	-2.61%
January	188,381,673	179,379,435	2.11%	3.25%	-4.78%
February	187,091,450	189,785,411	0.39%	0.69%	1.44%
March	186,799,740	187,878,775	-0.31%	4.03%	0.58%
April	187,859,117	172,414,186	3.96%	4.84%	-8.22%
May	185,894,305	190,735,911	2.51%	-5.49%	2.63%
June	189,917,904	184,194,460	-1.43%	5.01%	-3.01%
July	194,386,156	189,800,412	1.32%	-0.48%	-2.36%
August	183,589,615	188,140,249	2.65%	-4.29%	-2.48%
FY Total	2,275,981,528	2,226,595,797	2.01%	1.69%	-2.17%

Continuing this trend, collections so far in FY 2010 through March are down 2.11 percent when compared to the same seven-month period of FY 2009.

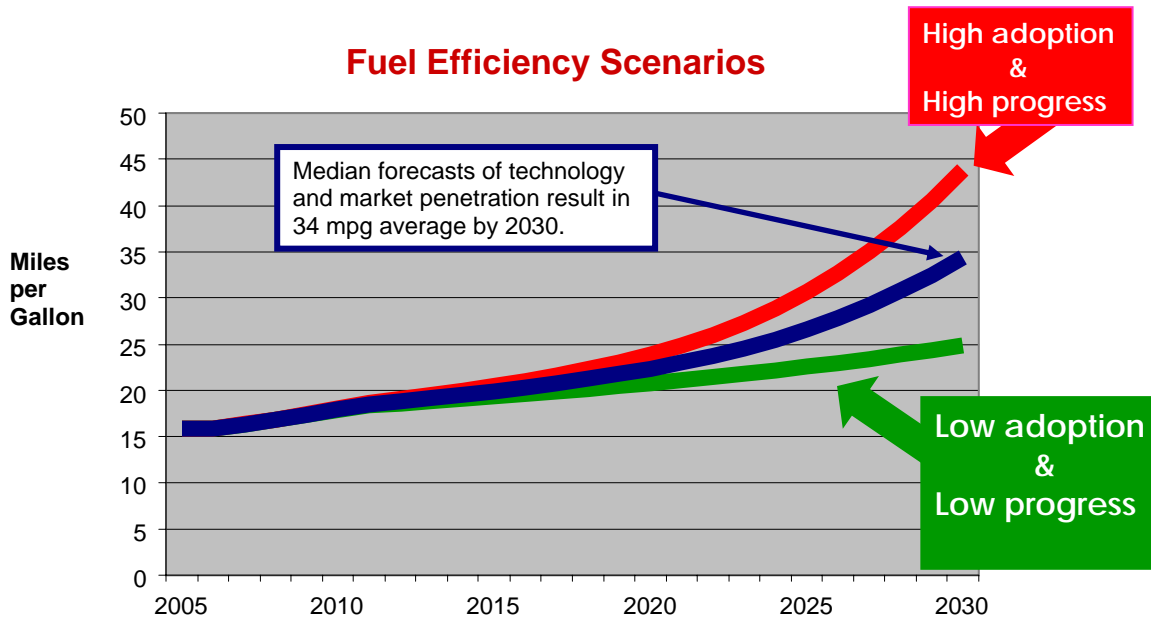
Meanwhile, the amount of State Highway Funds appropriated in 2010 and 2011 correlates with a Comptroller’s revenue estimate that projected state motor fuel tax revenue would be 2.65 percent *higher* in 2010 and 1.98 percent *higher* in 2011.

In other words, some of the revenue that was appropriated to TxDOT for new projects in 2010 and 2011 may never materialize. That will come out of TxDOT’s budget; not from the budgets of other agencies that benefit from diversions out of Fund 6.

Increasing Fuel Efficiency

Another trend we must contend with is rising fuel efficiency. According to Cambridge Systematics, the median forecast for fuel efficiency by 2030 could be 34 miles per gallon, up from 17 miles per gallon in 2008.

That’s twice the efficiency, half the revenue, and all the congestion. The three scenarios for growth offered by Cambridge are below.



Fuel efficiency will increase as new technology becomes available to the consumer increasing from 17 mpg in 2008, to 34 mpg in 2030.

Source: Cambridge Systematics/TTI

Rising fuel efficiency is the key component to the argument that motor fuel taxes are a relic of the past. Fuel taxes simply are not the best measure of road use that they once were.

Diversions

“Diversions” is the term given to the practice of appropriating State Highway Funds to agencies and certain functions unrelated to the development and administration of transportation facilities.

The chart below compares diversions from 2006 through 2011. The legislature made good progress in the last session in reversing the trend. But legislation that would statutorily end diversions did not make it to the Governor’s desk.

Purpose	AY 2006-2007	% of TxDOT Appn	AY 2008-2009	% of TxDOT Appn	AY 2010-2011	% of TxDOT Appn
AG - Mineral Rights Litigation	\$ 1,700,000	0.01%	\$ 1,700,000	0.01%	\$ 1,700,000	0.01%
HHS Commission	\$ 20,000,000	0.13%	\$ 20,000,000	0.12%		
TEA - Buses	\$ 100,000,000	0.66%	\$ 100,000,000	0.60%		
Texas Transportation Institute	\$ 13,045,764	0.09%	\$ 14,317,605	0.09%	\$ 14,937,767	0.08%
Department of Public Safety	\$ 985,104,602	6.50%	\$ 1,263,024,785	7.47%	\$ 1,125,019,694	6.01%
Texas Workforce Commission	\$ 13,658,704	0.09%	\$ 13,658,704	0.08%		
Gross Weight Axle Fees	\$ 9,400,000	0.06%	\$ 10,800,000	0.06%		
Commission on the Arts	\$ 1,340,000	0.01%	\$ 1,340,000	0.01%	\$ 1,340,000	0.01%
Historical Commission	\$ 1,000,000	0.01%	\$ 1,000,000	0.01%	\$ 1,000,000	0.01%
Office of Administrative Hearings	\$ 6,549,314	0.04%	\$ 6,736,395	0.04%	\$ 6,885,647	0.04%
Lufkin Tourist Information Center			\$ 150,000	0.00%	\$ 150,000	0.00%
Salary Increase for Schedule C	\$ 69,335,198	0.45%	\$ 22,291,710	0.13%		
Regulation of Controlled Substances			\$ 804,972	0.00%		
Silver Alert			\$ 224,990	0.00%		
Client Transportation Services	\$ 26,033,955	0.17%	\$ 22,363,606	0.13%		
Medical Trans - Medicaid Match	\$ 58,244,717	0.38%	\$ 85,381,725	0.51%		
Auto Theft Prevention	\$ 25,465,255	0.17%	\$ 27,558,755	0.17%		
Total	\$ 1,330,877,509		\$ 1,591,353,247		\$ 1,151,033,108	
TxDOT SHF Appropriation ¹	\$ 6,096,419,466	21.83%	\$ 5,643,425,735	28.20%	\$ 5,711,558,500	20.15%
Total TxDOT Appropriation ^{1,2}	\$ 15,162,095,408	8.78%	\$ 16,678,016,740	9.54%	\$ 18,720,448,879	6.15%

¹ DMV appropriations are included in AY 2010-2011

² AY 2010 - 2011 includes ARRA appropriations totaling \$1,637,800,000

Pressing Maintenance Needs

Increased system use also leads to increased maintenance. At least since 2002, the amount of state motor fuel tax revenue deposited to the State Highway Fund was less than what was spent to maintain the more than 191,000 lane-miles on the State Highway System.

Pavement condition in Texas is slowly getting worse. In FY 2009 we experienced the third drop in pavement condition scores in the last four years.

The Uncertainty of Federal Funding

Texas relies heavily on federal funds to help address the state’s transportation needs, even though we only receive about 70 percent back for highways from all the federal fuel tax dollars we send to Washington.

However, federal funding is increasingly unreliable due to the expiration of the federal-aid program, the insolvency of the Federal Highway Trust Fund, and the lack of clear goals and strategies for transportation at the federal level.

The most pressing matter today is that we do not have a new surface transportation authorization. SAFETEA-LU expired on September 30, 2009 and is temporarily extended through December 2010.

As Congress considers legislation to reauthorize federal transportation programs, Texas must be clear about its goals. We need clear definitions on the roles of the Federal, State and local governments.

We need flexibility in transportation finance, procurement and operation of facilities. And we need to be able to develop and implement seamless multimodal solutions that can best achieve our transportation goals.

LETTINGS

In addition to the traditional sources of transportation funding noted above, TxDOT has available several other sources of revenue that determine the department's letting capability.

Letting is the process of providing notice, issuing proposals, receiving proposals, and awarding contracts for highway improvement contracts. At this stage of project development, department staff must have a realistic view of how much cash will be available over the following few years to make progress payments on contracts awarded.

The table entitled "Total Letting Amounts" on page 12 is our forecast of available funds to award for highway improvement contracts. It also shows the methods of finance. Please note that lettings drop off after 2011 as our bonding capacity runs out, existing Comprehensive Development Agreements (CDAs) end, SH 121 funds are committed, and federal stimulus funds are obligated.

From what is available for letting, we must maintain the State Highway System and comply with certain state and federal requirements on programs such as transportation enhancements, Congestion Mitigation and Air Quality projects, and bridge projects.

In addition to State Highway Fund revenues, the table includes several other funding sources. Please note that very little of the funding represents ongoing, sustainable sources of revenue.

Proposition 12 General Obligation Bonds

In 2007 Texas voters approved a constitutional amendment to allow the legislature to authorize the Texas Transportation Commission to issue up to \$5 billion in general obligation debt.

HB 1 (81st Texas Legislature, First Called Session) authorizes the issuance of general obligation bonds to pay all or part of the costs of highway improvement projects. The bonds are payable from revenue not already dedicated by the constitution, i.e., general revenue. The amount that can be issued, up to an aggregate amount of \$5 billion, is subject to appropriation. \$100 million of general revenue is appropriated to TxDOT in 2011 for debt service and \$2 billion in bonds is appropriated in the biennium.

Of that, \$1 billion is deposited to the State Infrastructure Bank (SIB) in 2011 to make loans to public entities. The remaining \$1 billion is distributed as follows:

In 2010

\$60 million is for Contracted Planning and Design

\$90 million is for ROW

\$250 million is for New Construction

In 2011

\$600 million is for New Construction

(plus \$1 billion for the SIB in Construction Grants and Services)

From these appropriations, TxDOT can go to contract on \$1.85 billion of projects in the biennium, as long as the payouts on those contracts don't exceed what is appropriated. The timing of the debt issuance will ensure that debt service is not due until 2011.

In summary, HB 1 appropriates \$2 billion in 2010-2011. \$1 billion goes to the SIB. The other billion is available to make payments on \$1.85 billion in lettings plus \$150 million for engineering and ROW.

Instructing the department to enter into contracts valued at a greater amount than what is appropriated, signals the legislature's intent to authorize more Proposition 12 debt in the 2012-2013 biennium to complete payment of those projects. In fact, the legislation plainly states that is their intent.

Now that the commission has selected the projects to develop, we have a better understanding of our right of way and engineering needs. We have asked the Legislative Budget Board for permission to move some of the Prop 12 bond proceeds among these categories.

SH 121

In Fiscal Year 2008 the department received approximately \$3.2 billion from the North Texas Tollway Authority (NTTA) in exchange for NTTA's right to construct and collect tolls for the SH 121. The Regional Transportation Council (RTC) selects projects to make use of the funding which can only be used in TxDOT's Dallas District. The revenue is deposited to the State Highway Fund and is expended as the selected projects make their way through the development and construction processes.

SH 130 Segments 5&6

In Fiscal Year 2007 the department entered into a Comprehensive Development Agreement with a private developer to build Segments 5 & 6 of SH 130 in central Texas. The developer agreed to finance and construct the \$1.3 billion project in exchange for the right to collect tolls on the facility. In addition to a share of the toll revenue over time, the state also received an up-front payment of \$25 million. The department's forecasted letting program anticipates letting projects in Central Texas making use of the concession fee and toll revenue.

Federal Economic Stimulus (ARRA)

In early 2009 Congress enacted the American Recovery and Reinvestment Act (ARRA) which made \$2.25 billion available to Texas for transportation projects. TxDOT and the Metropolitan Planning Organizations have obligated the money. These funds have boosted TxDOT's annual lettings in FY 2009 and FY 2010.

Comprehensive Development Agreements

A Comprehensive Development Agreement (CDA) is a contract with a private entity that, at a minimum, provides for the design and construction of certain transportation projects and may also provide for the financing, acquisition, maintenance, or operation of certain projects. Concession CDAs allow the public to tap into private capital to supplement state funds in building publicly-owned infrastructure.

In exchange for financing the construction of the facility and taking the revenue risk, the developer has the right to collect some or all of the toll revenue. Developers are not guaranteed to recoup their investment or to make a profit.

TxDOT no longer has the general authority to enter into CDAs as of September 1, 2009. However, several projects were specifically exempted from the CDA sunset date and are reflected in the letting for FY 2009 on the following chart.

Total Letting Amounts

January 2010 Forecast

Letting Program

<u>Funding Source</u>	FY 2008 Actual	FY 2009 Actual	FY 2010 Forecast	FY 2011 Forecast	FY 2012 Forecast	FY 2013 Forecast	FY 2014 Forecast
State Highway Fund ¹	2,452,377,184	1,525,402,068	1,580,979,808	1,540,117,574	2,009,768,115	2,100,218,114	2,114,718,114
Texas Mobility Fund	272,742,323	-	-	-	-	-	-
Proposition 14	35,794,829	300,936,080	688,237,831	711,762,169	-	-	-
Proposition 12 ²	-	-	575,094,079	1,183,120,498	-	-	-
SH 121	253,379,338	272,801,957	228,473,719	1,067,639,823	235,737,280	-	29,742,435
SH 130 (Seg. 5 & 6)	8,279,334	-	8,000,000	2,000,000	2,000,000	4,300,000	6,000,000
ARRA	-	728,753,183	1,278,461,963	-	-	-	-
Total Letting	3,022,573,008	2,827,893,288	4,359,247,400	4,504,640,064	2,247,505,395	2,104,518,114	2,150,460,549
Proposition 12 Scenario	-	-	-	-	800,000,000	800,000,000	-
Total Potential Letting	3,022,573,008	2,827,893,288	4,359,247,400	4,504,640,064	3,047,505,395	2,904,518,114	2,150,460,549

Comprehensive Development Agreements (CDAs)

<u>Funding Source</u>	FY 2008 Actual	FY 2009 Actual	FY 2010 Forecast	FY 2011 Forecast	FY 2012 Forecast	FY 2013 Forecast	FY 2014 Forecast
State Highway Fund ²	-	1,533,088,768	-	-	-	-	-
Local Funds	-	73,000,000	-	-	-	-	-
ARRA	-	250,000,000	-	-	-	-	-
SH 121	-	100,000,000	-	-	-	-	-
Private ³	-	3,827,807,407	-	-	-	-	-
Total CDA Letting	-	5,783,896,175	-	-	-	-	-
Grand Total Project Awards	3,022,573,008	8,611,789,463	4,359,247,400	4,504,640,064	3,047,505,395	2,904,518,114	2,150,460,549

Ongoing CDA O&M (Private) ⁴	-	4,000,000,000	-	-	-	-	-
Total CDA Value	-	9,783,896,175	-	-	-	-	-

CONCLUSION

We know that the next legislative session will be difficult for budget writers. But there is a general consensus that we need to examine new ways to add capacity to our transportation network and maintain the very valuable assets we currently have.

We at the Texas Department of Transportation look forward to working with state policy-makers on identifying the solutions that will best protect our quality of life and enhance our economic competitiveness.