

# State Notes

## TOPICS OF LEGISLATIVE INTEREST

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### **Road and Bridge Construction Financing** **By Debra Hollon, Fiscal Analyst**

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The financing of road and bridge construction is a multifaceted issue. As discussed in this article, factors include not only revenue levels and the costs of materials but the timing of projects and the availability of Federal funds, as well. Each factor must be considered as a part of the whole.

#### **Revenue**

Over 95.0% of the revenue credited to the Michigan Transportation Fund (MTF) comes from motor fuel taxes and vehicle registration fees. The current Michigan motor fuel tax rates are 19 cents per gallon for gasoline and 15 cents per gallon for diesel fuel. (Comparison information concerning the fuel tax rates of other states can be found on the Senate Fiscal Agency (SFA) website.) Vehicle registration fees are based upon the value of the vehicle.

Unlike the sales tax, which is a percentage of the dollar amount sold, the motor fuel tax rate is a fixed amount per gallon. As a result, an increase in the price per-gallon of fuel does not increase revenue to the MTF. In fact, as the per gallon price rises, consumer usage often decreases, which results in a decrease in State revenue from this source. One example of this effect can be seen after the surge in fuel prices following Hurricanes Katrina and Rita in 2005. Gasoline and diesel motor fuel tax revenue to the MTF dropped by over \$20.0 million from fiscal year (FY) 2004-05 to FY 2005-06. Revenue from this funding source in FY 2005-06 was essentially the same as that collected in FY 2001-02.

Revenue from vehicle registration fees has increased slightly over that collected five years ago. This trend may not continue, however. As noted above, vehicle registration fees are based upon the value of the vehicle. As consumers shift from more expensive, less fuel-efficient vehicles (such as SUVs) to smaller vehicles that have greater fuel efficiency, revenue from this funding source also will decrease.

Total revenue to the Fund was at virtually the same level in FY 2005-06 as it was in FY 2001-02. Not only has the level of revenue remained relatively constant, the purchasing power of that revenue has decreased. According to data compiled by the SFA, the inflation-adjusted value of gasoline tax revenue (which makes up the vast majority of fuel tax revenue) dropped 19.1% from FY 1998-99 to FY 2005-06.

Not all revenue to the Michigan Transportation Fund can be used for road and bridge construction. Various statutory requirements disburse funds to areas such as rail grade crossings, public transit operations, and economic development transportation projects. After these statutory disbursements are made, 39.1% of the remainder is routed to the State Trunkline Fund for road and bridge construction. Because the revenue to the State Trunkline Fund is a percentage of the balance of the MTF, it also has remained relatively flat over the past several years. An additional \$43.0 million is statutorily designated for debt service for projects financed through bond proceeds. Revenue to the State Trunkline Fund also includes Federal funds, which must be spent for specific uses, including debt service. The



amounts received from the Federal government have fluctuated over the past five fiscal years.

### **Construction Expenditures**

While revenue for the MTF is at virtually the same level as it was five years ago, the costs of construction have increased over the same time frame. According to the U.S. Department of Labor, Bureau of Labor Statistics' Producer Price Index, overall prices for highway and street construction have increased by 21.8% from 2001 through 2005. Final figures for 2006 are not available at this time, but the upward trend continued through October 2006.

Three major contributors to this increase are the prices for iron and steel scrap, cement, and asphalt paving mixtures. Prices increased for iron and steel scrap by 141.5% and for cement by 17.4% over the same five calendar years. The Bureau of Labor Statistics did not begin tracking asphalt paving mixtures prices until December 2003. From that point until December 2005, the prices for this category increased 10.7%. The preliminary figures through October 2006, however, show an increase of 51.7% over December 2003. It should be noted that asphalt prices are directly related to oil prices.

In addition to the rise in the prices of construction components, expenditures also have increased as projects have been accelerated. The Jobs Today program was implemented in 2005 and covered many aspects of State government in an effort to create jobs and stimulate the economy. As it relates to transportation, the program accelerates the timing of over 150 projects over two years. In addition, legislation enacted in 2006 created the Local Jobs Today program to provide increased loans and grants to local units of government to enable them to obtain Federal funding for transportation projects.

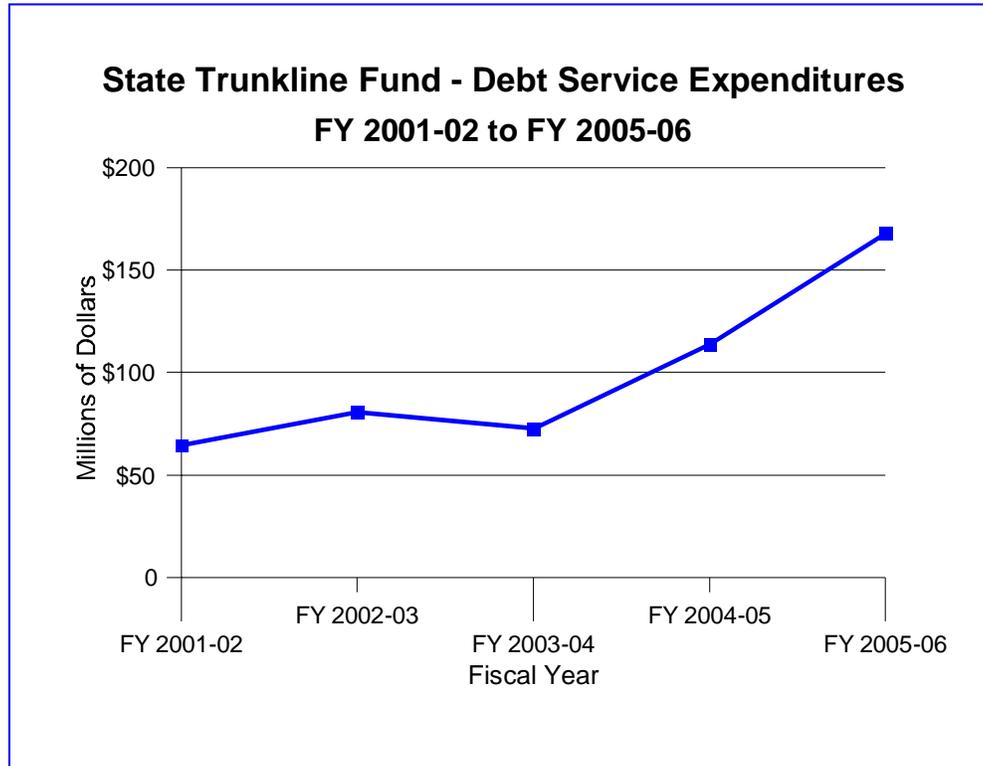
### **Bond Financing**

As a result of static revenue and rising costs, the Michigan Department of Transportation (MDOT) has incurred increasing levels of debt over the past several years. According to MDOT, it has incurred approximately \$1.3 billion in new debt since FY 2000-01. Of this amount, \$600.0 million is for the Build Michigan II program and \$308.2 million is for Build Michigan III.

As noted above, \$43.0 million is statutorily designated to the State Trunkline Fund for debt service. Additional amounts are used for debt service as required. Because the revenue remains relatively flat, as the amount used for debt service increases, the amount left to fund construction projects decreases. Figure 1 reflects debt service obligations from the State Trunkline Fund over the past five years.



**Figure 1**



An increase in the level of indebtedness is not a phenomenon limited only to Michigan. According to data on state obligations for highways compiled by the US Department of Transportation, Federal Highway Administration, Office of Highway Policy Information<sup>1</sup>, Michigan's obligations increased by 36.8% from 2001 to 2005. The national average increased by 33.1% over the same period. Of the surrounding states, increases were seen by Illinois (68.2%), Ohio (5.1%), and Wisconsin (65.8%). Only Indiana showed a decrease over the five-year period (32.4%).

The Michigan Department of Transportation expects this trend for Michigan to continue at least in the near future. The Department plans to issue \$315.0 million in Grant Anticipation Revenue Vehicle (GARVEE) bonds both in 2007 and in 2009. Even with this additional funding, the 2007-2011 Five-Year Highway Program notes a funding gap in the capital program (including routine maintenance) of \$129.0 million over the five years. At this time, MDOT anticipates debt service obligations to peak in FY 2009-10.

<sup>1</sup> Data used to facilitate state-to-state comparisons might not match other figures in this document.