HIGHWAYS STATE SPECIAL REVENUE ACCOUNT UPDATE

A Report Prepared for the

Legislative Finance Committee

By

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INTRODUCTION

The highways state special revenue account (HSRA) provides the state funding match for more than $360 million federal transportation funding annually for a total of $600 million of transportation spending to maintain and expand the state transportation infrastructure. It is because of the significant impact on the state economy and the historical instability of the account that the Legislative Finance Committee (LFC) pays particular interest to the fiscal condition of this account. This report is prepared for the LFC to provide awareness of the fiscal condition of the account going into the 2009 legislative session.

This report presents the latest working capital analysis as of the end of FY 2008 and explains: 1) the assumptions used in the analysis; 2) the analysis results; 3) challenges the department faces due to financial stress of the federal highway trust fund; and 4) an issue with the practice of the Department of Transportation in managing HSRA expenditures in accordance to constitutional and statutory directives.

For this update a deviation was made from the practice used in past updates. This update shows separate working capital balance projections for the restricted and nonrestricted highways state special revenue accounts. Showing the two accounts separately is in contrast to the past practice of showing only one combined analysis for the two accounts. The most recent analyses are based on actual revenue and expenditures through FY 2008 and show that both the restricted and nonrestricted highways state special revenue accounts are in structural balance with regard to revenues and expenditures. The restricted account is forecast to grow from a FY 2008 balance of $41.1 million to $71.9 million by the end of FY 2011. In addition, the nonrestricted account is forecast to grow from a FY 2008 balance of $151,747 to $34.5 million by the end of FY 2011 if funds are not transferred to the restricted account in accordance to the enabling statute for the restricted account.

Uncertainty with how the state will be impacted by a financially stressed federal highway trust fund, declining motor fuel revenues, and conservative expenditures estimates lend themselves to viewing the implied stable status of HSRA with caution.

THE HIGHWAYS STATE SPECIAL REVENUE ACCOUNT

General Purpose

HSRA is used, among other purposes, to fund the major activities of the Montana Department of Transportation (DOT). Two accounts form HSRA: 1) the constitutionally restricted fund (fund 02422); and 2) the nonrestricted fund (fund 02349). The department records revenues in the account most appropriate to the constitutional and statutory directions for the revenue source. However, the department makes all expenditures from the restricted fund, with the balance from the nonrestricted fund transferred to the restricted fund each year.

During the current interim a review of statutory language associated with the state budgeting and appropriations process identified that the current practice of the department to transfer the balance from the nonrestricted account is inconsistent with state law. The statute that establishes the nonrestricted account states that any unexpended balance in the account must stay in the account.[1] This issue will be discussed in further detail below in the Statutory Restrictions section of this update. However, because of this issue, this update presents a separate working capital analysis for each account.

[1] 15-70-125, MCA, states that there is a highway nonrestricted account in the state special revenue fund. All interest and penalties collected under this chapter, except those collected by a justice's court, must, in accordance with the provisions of 17-2-124, be placed in the highway nonrestricted account. All interest and income earned on the account must be deposited to the credit of the account and any unexpended balance in the account must remain in the account.

Specific Uses

HSRA funds the operations of five programs of the DOT that administer, enforce, and support the construction, maintenance, and safe operations of Montana highways. HSRA also funds Long-range Building Program projects for DOT facilities and those of the Department of Fish, Wildlife and Parks (FWP) related to roadway activities, and for programs of the Department of Justice (DOJ) that support highway or motor vehicle activities. Programs of DOJ that are partially funded with HSRA are: 1) Legal Services Division; 2) Motor Vehicle Division; 3) Montana Highway Patrol; 4) Central Services Division; and 5) Information Technology Services Division. Appendix A shows the FY 2008 funding profiles for the programs of the DOJ funded with HSRA.

HSRA also funds statutory appropriations that totaled $21.7 million in FY 2008, transfers of $0.1 million per year to the noxious weed trust fund, alcohol production incentives capped at $6.0 million per year, and ethanol consumption incentives. Alcohol production incentives have never been paid since enactment of the law that provides them. The report assumes no changes in the allocations of the funds in future biennia.

Statutory Restrictions

Restricted Account

The Constitution of the State of Montana places restrictions on expenditures the restricted account of HSRA can be used for. The Constitution places a higher standard on appropriations that do not meet the constitutional restrictions. Specifically, appropriations for purposes other than those specified may be made only by a three-fifths vote of the members of each house of the legislature. The constitution restricts appropriations of the restricted account, after deduction of statutory refunds and adjustments, solely for:

- Payment of obligations incurred for construction, reconstruction, repair, operation, and maintenance of public highways, streets, roads, and bridges
- Payment of county, city, and town obligations on streets, roads, and bridges
- Enforcement of highway safety, driver education, tourist promotion, and administrative collection costs

Nonrestricted Account

The statute that establishes the nonrestricted account specifies that all interest and income earned on the account must be deposited to the credit of the account, and also specifies that any unexpended balance in the account must remain in the account. Statute specifies which fees, charges, and transfers must be deposited into the nonresticted account and transfers from the account. However, the current practice of the department conflicts with this statutory direction and forms the basis for the following issue.

Issue – Conflict Between Statute and Agency Practice

Since the creation of the nonrestricted account, the department has deposited revenues into the account as directed by statute. However, in conflict with the requirement that any unexpended balance must remain in the account, the department transfers the balance from the nonrestricted account to the restricted account where it is expended under an appropriation of restricted account funds. Transferring the balance from the nonrestricted account to the restricted account is not a valid expenditure of funds. The legislature established this account and isolated the revenues from the constitutional restrictions of the restricted account so appropriations that do not meet the uses stated in the constitution could be made without requiring a supermajority of members of both houses of the legislature, but placed a heavier burden on appropriating highway user fees for purposes other than specified in the constitution. Transferring the funds to the restricted account inappropriately shields nearly $11.0 million annually of revenues from being prioritized and appropriated for other purposes.

The issue with how to deal with the department practice mentioned above is being addressed in the Budget and Appropriations Subcommittee and is only raised here to explain why separate working capital balance summaries are provided for the restricted and nonrestricted accounts of HSRA. No recommendations are provided separately from the Budget and Appropriations Subcommittee deliberations and recommendations.

REPORT SUMMARY

Working Capital

The analysis identifies the working capital for the two accounts of HSRA. Working capital is the difference between current assets and current liabilities, and provides some indication of the ability of the account to meet its current obligations. Current assets are cash and other resources that are reasonably expected to be realized in cash within one year. Likewise, current liabilities are obligations that are reasonably expected to be paid from existing current assets or through the creation of other current liabilities within one year. The adequacy of the working capital balance to sustain the operating costs of the department provides an indicator of the need for potential adjustments of revenues or service levels so the department can satisfy its mission in the long-term.

Summary of Results

Using assumptions listed in Appendix B, working capital projections were made for the restricted and nonrestricted accounts. Figures 1 and 2 show the results for fiscal years 2008 through 2011, which are summarized below. The balances shown are projections of available funds available for appropriations. Concerns, identified later in this report, are raised regarding the uncertainties associated with motor fuel revenues to the state, and with federal funding for highways and the potential state funding impacts should be considered when determining the solvency of the account.

Restricted Account

The analysis shows actual expenditures and revenues for FY 2008, outstanding appropriations for FY 2009, and adjusted base for the 2011 biennium. Adjusted base shows the starting point for appropriation deliberations and only factors in impacts of previous legislative funding decisions. The present law budget for the 2011 biennium as requested in the executive budget would likely be higher than the adjusted base, which would result in lower ending balances than shown on Figure 1. Also, since the Revenue and Transportation has not recommended updated gasoline, diesel, and GVW revenues and HJR 2 revenue assumptions of the 2007 Legislature did not anticipate the revenue impacts of high petroleum prices independent estimates were developed. Updated revenue estimates will be made in November and will be included in the HSRA working capital analysis included in the Legislative Budget Analysis – 2011 Biennium.

Subject to the applied assumptions and methodology, the analysis shows that the restricted account is financially stable through the 2011 biennium prior to making legislative appropriation decisions. Except for FY 2009, account revenues are projected to exceed expenditures in all years. In FY 2008, actual revenues into the restricted account exceeded expenditures from the account by $17.6 million. In FY 2009, expenditures are shown to exceed revenues by $34.4 million before considering any level of appropriation reversions, which have run at about 17.2 percent from FY 2000 through FY 2008 or $42.4 million in FY 2009. High expenditures in FY 2009 are primarily due to inclusion of all unexpended appropriations for the 2009 biennium as a consequence of funding the department predominantly through biennial appropriations. After factoring in reversions, all years including FY 2009 will see revenues exceed expenditures.

By the end of the 2011 biennium, the balance of the restricted account would grow to $19.5 million without considering reversions in FY 2009 or to $61.9 million if reversions are considered. It should be noted that the above results assume that the balance of the nonrestricted account will not be transferred to the restricted account beginning in FY 2009. The nonrestricted account is summarized separately and combined would indicate the funds available for appropriation by the legislature subject to the restrictions placed on each account.

Figure 1
Working Capital Balance
Highways State Special Revenue - Restricted Account
Fiscal Years 2008 - 2011
(in Millions)

Description	FY 2008 Actual	FY 2009 Approp.	FY 2010 Forecast	FY 2011 Forecast
Beginning Working Capital Balance	$24.0	$41.1	$6.7	$10.5
Revenues				
Gasoline tax (net of refunds)	125.4	125.4	125.4	125.4
Diesel tax (net of refunds)	71.5	72.9	75.5	77.3
GVW	22.1	23.0	23.6	24.3
Federal indirect cost recovery	37.8	43.0	41.5	42.7
Other revenues:				
Transfer in from highways nonrestricted account	11.4	0.0	0.0	0.0
All other revenues	13.5	8.6	8.6	8.6
Total other revenues	24.9	8.6	8.6	8.6
Revenue deductions:				
Gasahol tax reduction	(1.0)	(1.4)	(1.7)	(2.1)
Alcohol production incentives (15-70-522, MCA)	0.0	0.0	0.0	0.0
Total revenue deductions	(1.0)	(1.4)	(1.7)	(2.1)
Total Revenues	$280.6	$271.5	$272.8	$276.2
Expenditures				
Department of Transportation (DOT)				
Statutory appropriations	20.9	20.9	20.9	20.9
HB 2 and HB 13	208.1	238.3	213.3	211.5
Non-budgeted transactions (including carry forward)	4.3	14.5	2.0	2.0
Total DOT	233.3	273.8	236.3	234.5
Department of Justice (DOJ)	27.4	28.7	29.3	29.4
Long-range Building Program				
Maintenance and repair of DOT buildings	1.3	2.9	2.5	2.5
Department of Fish, Wildlife & Parks	1.0	0.4	0.8	0.8
Total Long-range Building Program	2.2	3.3	3.3	3.3
Transfer to noxious weed (80-7-823, MCA)	0.1	0.1	0.1	0.1
Total Expenditures	$263.1	$305.9	$268.9	$267.3
Revenues less expenditures	17.6	(34.4)	3.8	8.9
Adjustments	(0.5)			
Ending Working Capital Balance (without reversions)	$41.1	$6.7	$10.5	$19.5
Average HB 2 Reversions (FY 2000 through FY 2008)		42.4		
Ending Working Capital Balance (with average reversions)	$41.1	$49.1	$53.0	$61.9

Nonrestricted Account

The analysis shows that the department transferred nearly all the balance from the nonrestricted account to the restricted account, where expenditures are recorded. At the end of FY 2008 the balance in the nonrestricted account was $151,747. Without transferring the balance of the nonrestricted account to the restricted account, the balance available for appropriations made without the need to meet constitutional muster or be approved by a three-fifths vote of the members of each house of the legislature would be $34.5 million by the end of the 2011 biennium.

Figure 2
Working Capital Balance
Highways State Special Revenue - Nonrestricted Account
Fiscal Years 2008 - 2011

Description	FY 2008 Actual	FY 2009 Approp.	FY 2010 Forecast	FY 2011 Forecast
Beginning Working Capital Balance	95,773	151,747	11,562,440	23,020,275
Revenues				
Transfer in from the general fund	3,096,301	3,142,746	3,189,887	3,237,735
All other revenues	8,367,948	8,367,948	8,367,948	8,367,948
Total Revenues	$11,464,249	$11,510,693	$11,557,835	$11,605,683
Expenditures				
Nonbudgeted transfer out to restricted account	11,309,235	0	0	0
Statutory transfer to noxious weed state special revenue account	100,000	100,000	100,000	100,000
Total Expenditures	$11,409,235	$100,000	$100,000	$100,000
Revenues less expenditures	55,014	11,410,693	11,457,835	11,505,683
Adjustments	960			
Ending Working Capital Balance	$151,747	$11,562,440	$23,020,275	$34,525,958

Combined Balance for Restricted and Nonrestricted Accounts

If the nonresticted account balance were considered along with the restricted account the balance prior to legislative consideration of budget decision packages would be $18.3 million going into the 2011 biennium and $54.0 million at the end of the biennium.

Other Concerns to Consider for HSRA

When considering how secure HSRA is as a funding source for the operations of Montana's highway transportation system, consideration should be given to two related concerns that would impact the overall funding for this purpose: 1) status of the federal highway trust fund and federal funding reauthorization; and 2) interrelationship between fuel costs and consumer driving and purchase patterns.

Federal Highway Trust Fund

Federal highway funds are apportioned to states in multiyear federal funding authorizations. The latest authorization was signed into law by the President on August 10, 2005, and is titled The Safe, Accountable, Flexible, and Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU). SAFETEA-LU sets specific annual funding levels for most federal highway programs on the basis of projected receipts to the federal Highway Trust Fund for federal fiscal years 2005 through 2009. According to a September 5, 2008, speech by Mary Peters, the Secretary of the U.S. Department of Transportation (U.S. DOT), the federal highway trust fund will have a zero balance on October 1, 2008, when federal fiscal year 2009 begins. The depleted balance is a result of expenditures from the trust far exceeding revenues. In FY 2008 alone, outlays from the trust exceeded revenues by more than $8.0 billion.

Short-Term

In the short-term or until a more long-term solution is developed, the U.S. DOT intends to limit the frequency of reimbursement requests by states and reimburse only a portion of the requests as revenues allow. This means that for federally participating highway projects the state will see delayed and reduced reimbursements for expenditures already made and funded with state funds. The delays and reduced reimbursements will impact state funding such as HSRA by requiring the state funds to carry the financial burden for federal participation on projects for a longer time. These delays and reductions will place unanticipated burdens on state funds, would reduce available interest revenues, and could cause cash flow problems. For projects yet to be awarded, the uncertainties with federal funding would result in project delays and possible reprioritization. For Montana, the bright spot may be that this federal fiscal crisis is occurring at the later stages of the summer peak construction season.

Long-Term

SAFETEA-LU commissioned a study of national surface transportation infrastructure financing in a effort to identify options for reforming how national transportation is funded. In February 2008, the commission[2] released an interim report with its final report and recommendations due near the end of 2008. Preliminary observations contained in the report are:

- Transportation system demands are outpacing required investment
- Maintenance costs are competing with necessary expansion of the system
- The fuel tax, which has been the key federal funding source for our system, is no longer sufficient at current rates
- More direct user charges should be explored
- We need not only more investment in our system, but more intelligent investment complemented by better operation of the system

The report expanded more on the federal fuel tax, saying that it may not be a sustainable strategy in the long run, because as fuel economy continues to rise, the fuel taxes will continue to shrink relative to use and needs of the system.

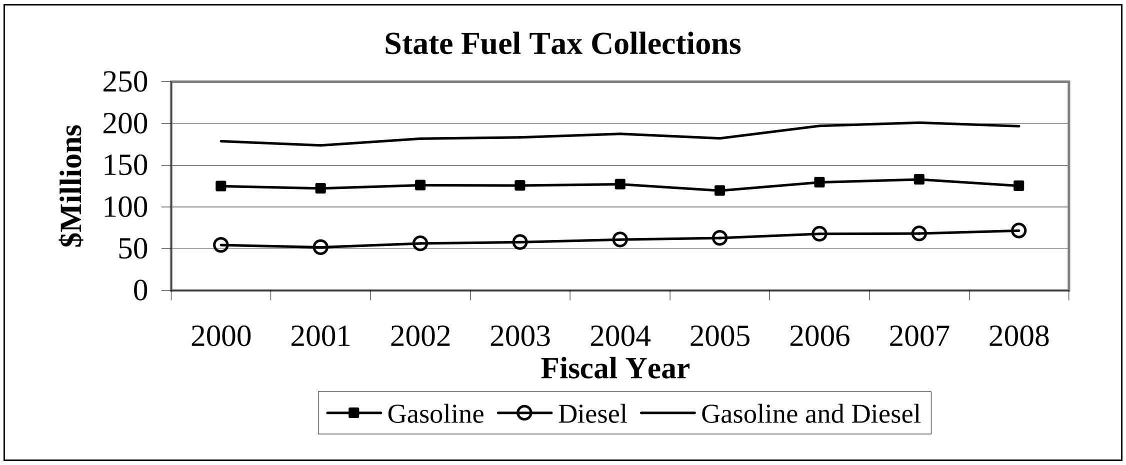
Many of these observations are pertinent to Montana due to its strong reliance on fuel tax as a funding source. In addition to the impacts of fuel economy, consumer driving pattern changes as a result of higher fuel prices impact the volume of fuel consumed and likewise the fuel tax collections. As petroleum prices increase, the cost of petroleum based construction materials increases, but consumers purchase more efficient vehicles or curtail driving and the consumption of fuel. As such, fuel tax collections are decreasing while the cost to maintain the highways is increasing.

State Fuel Tax Collections

Like the federal highway trust fund, Montana collects a tax on each gallon of gasoline and diesel fuel sold in the state. Montana collects 27 cents per gallon on gasoline and 27 ¾ cents per gallon on diesel through a tax collected at the distribution terminals of state petroleum vendors. Figure 3 shows the state fuel tax collections from FY 2000 through FY 2008 for gasoline, diesel, and combined gasoline and diesel after adjusting for refunds and tribal distributions. For the most part, gasoline revenues have risen slightly since 2001 until flattening out between FY 2006 and FY 2007 and then declining in FY 2008. Diesel taxes have risen steadily over the same period, including FY 2008.

The gasoline tax decline is likely due to conservation efforts by consumers to reduce miles travelled and to purchase more efficient vehicles. The continued diesel tax growth is due to trucking traffic that moves commerce through the state.

[2] National Surface Transportation Infrastructure Financing Commission



Federal Funding Due for Reauthorization

SAFETEA-LU, the multiyear federal authorization legislation, will expire at the end September 2009. The interim report by the National Surface Transportation Infrastructure Financing Commission suggests that the commission's recommendations may address allocations issues such as the conflicts between donor and donee states[3]. Montana is a donee state and receives more than two times as much federal highway funding than is collected in the state. If the allocation method is changed, Montana could see a sharp drop in the level of federal funding from what it has received in the past. To make up for the reduction, Montana would either need to increase its state funding for highway projects or limit the amount of work done to operate and maintain the state's highways.

With the federal highway trust fund in financial stress and no certainty on how the funding will be addressed or at what levels when highway funding is reauthorized, the state will face a great deal of uncertainty in planning for future federal aid programs. The uncertainty in the level of federal highway funding Montana would received under reauthorized federal highway funding is something the legislature may want to continue to monitor. Staff will continue to monitor the activities of the National Surface Transportation Infrastructure Financing Commission and inform the legislature as recommendations are made and evaluate the implications of the recommendations. As federal highway funding is reauthorized, staff will monitor its development and provide updates as details become available.

Is it Time Again to Look at State Transportation Funding?

As shown in Figures 1 and 2, HSRA is expected to have adequate revenue to fund adjusted base operations of the department under current assumptions and with current federal revenues. Depending upon how many additional appropriations the 2009 Legislature funds, HSRA may remain stable through the 2011 biennium. However, taking a longer term approach, similar concerns identified with the federal highway trust fund may warrant a review of how Montana's transportation infrastructure is funded. Conflicting outcomes between increased fuel economy of motor vehicles and fuel tax collections, compounded with the fuel purchasing patterns of the traveling public under rising fuel costs, could impact Montana's future transportation funding as they currently are impacting the federal highway trust fund. Just as Congress directed a commission to study federal transportation financing, the legislature may want to direct a similar study of Montana's transportation financing.

A Study of Montana Highway Funding

A study of highway funding in Montana could address, among other things, the following topics:

[3] A donor state is a state in which transportation funding received back from the highway trust fund is less than the revenues collected in the state. Likewise, a donee state is a state that receives more federal highway funding than is collected in the state.

- Investigate alternative funding sources and levels for financing highway construction, maintenance, and operations
- Evaluate the allocations of fuel tax collections distributed to cities, towns, counties, and consolidated city-county governments and to the Montana local technical assistance transportation program (15-70-101, MCA)
- Evaluate using a performance based approach the current programs funded with HSRA
- Evaluate whether HSRA is the desired funding source for alcohol production incentives (15-70-522, MCA)
- Evaluate whether HSRA is the desired funding source for ethanol consumption incentives (15-70-204 and 321, MCA)
- Evaluate whether HSRA is the desired funding source for the $100,000 annual transfer to the noxious weed trust fund (80-7-823, MCA)

CONCLUSION

Current projections of HSRA indicate that the working capital balance is adequate to fund current programs and services at the adjusted base level through the 2011 biennium. Projections indicate that the legislature would have roughly $35.7 million for the biennium to allocate to appropriations above the adjusted base level for all programs without drawing on fund balance to fund the appropriations. However, financial stress and uncertainty with the federal highway trust fund would likely complicate the department's future planning efforts and may justify caution in appropriating HSRA during the 2009 Legislature. Just as the federal government is evaluating alternatives for financing and prioritizing federal highway projects funded with a financially stressed federal highway trust fund, Montana may want to consider studying state financing for highways.

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APPENDIX A

Department of Justice -
HSRA Program Funding Profiles

Department of Justice
Program Funding Percentages
FY 2008

Program	General Fund	HSSRA	Other State Special Revenue	Federal Special Revenue	Other
Legal Services Division	38.7	0.7	5.1	8.2	47.3
Motor Vehicle Division	38.0	24.6	21.1	2.6	13.7
Highway Patrol Division	5.3	76.8	14.7	3.2	0.0
Central Services Division	36.5	48.9	8.8	0.0	5.8
Information Technology Division	89.4	1.7	1.9	6.6	0.4

APPENDIX B

Analysis Assumptions

The following assumptions were used to forecast future revenues and expenditures for the October 2008 update of the working capital analysis for the highways state special revenue account

Revenues:

- FY 2008 actual gasoline taxes collections were used to approximate the FY 2009 through FY 2011 expected revenues
- Diesel tax and gross vehicle weight collections are based on a linear regression projection using the past three completed fiscal year actual collections
- Indirect cost recovery revenues are based on Department of Transportation projections published in the Third Quarter FY 2008 department Director's Report
- Gasohol tax reductions and alcohol production incentives are based on a linear regression projection of historical trends
- General fund transfers into the nonrestricted account are FY 2008 amounts inflated by the statutory growth rate of 1.5 percent per year
- Other revenues, which account for numerous miscellaneous revenues that are not estimated by the legislature in HJR 2, are based on the average collections for the past three completed fiscal years

Expenditures:

- FY 2009 expenditures are unexpended appropriations valid for the 2009 biennium (because Long-range Building Program appropriations are continuing appropriations, the FY 2009 appropriation includes unexpended portions of prior biennium appropriations)
- 2011 biennium expenditures are adjusted base amounts, which include adjustments for prior legislative pay plans (HB 13)
- Reversions are the average reversion percentages for the period from FY 2000 through FY 2008 for HB 2 appropriations made to the Departments of Transportation (17.2 percent) and Department of Justice (5.0 percent)