

FEDERAL HIGHWAYS FUNDING ACT OF 2005 (SAFETEA-LU): WHAT IT CONTAINS AND WHAT IT MEANS TO MONTANA

A Report Prepared for the

Legislative Finance Committee

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October 3, 2005

Legislative Fiscal Division



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INTRODUCTION

Montana finances a significant portion of its highway construction, maintenance, and operating activities with federal funds. These funds must also be matched by state and local entities. Federal highway funding is provided by way of the U.S. Department of Transportation, primarily through the Federal Highway Administration (FHWA), and is authorized through multiyear funding legislation. On August 10, 2005, the President signed the latest highway funding legislation, the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU). SAFETEA-LU provides authorization for federal-aid transportation programs and funding for federal fiscal years 2005 through 2009¹. This report highlights the expected short and long-term impacts of SAFETEA-LU on Montana and the following areas of impact:

- The levels of funding Montana expects to receive, including impacts of obligation limitations as compared to published funding levels
- Earmarked funding, including the impacts of earmarks on other planned projects and future federal-aid funding
- Budget impacts, including the impacts of inflationary factors and purchasing power of the funding
- Status of the federal highway trust fund and the impacts of a declining balance on future funding for Montana
- Status of the state special revenue account and the impacts of a declining balance on future funding and program policies

REAUTHORIZING FEDERAL HIGHWAY FUNDING

DURING THE TRANSITION

SAFETEA-LU replaced the Transportation Efficiency Act of the 21st Century (TEA-21) that expired on September 30, 2003. From the time TEA-21 expired and SAFETEA-LU became public law, 11 temporary extensions of TEA-21 were enacted. The federal funding authorizations for FFY 2004 were entirely enacted through extensions of TEA-21, with TEA-21 programs and funding priorities. For 10 months during FFY 2005, funding was authorized through extensions of TEA-21, but SAFETEA-LU also included authorizations for funding FFY 2005. SAFETEA-LU and TEA-21 contain different transportation funding priorities and programs, so the activities performed prior to enactment of SAFETEA-LU will need to be reviewed and reconciled. How the reconciliation will impact Montana raises a concern. The impacts of the reconciliation will be monitored and any issues will be reported to the legislature as they are identified. Current indications are that there will be no impacts to Montana from the reconciliation.

LEVEL OF FUNDING IN SAFETEA-LU

SAFETEA-LU reflects a transportation authorization with record levels of funding for states transportation infrastructures and other programs. For the five years of SAFETEA-LU, funding for

¹ Because references to both Montana's and the federal fiscal years appear throughout the report and cover different time periods, FFY represents a federal fiscal year that runs from October through September and FY represents a Montana fiscal year that runs from July through June.

highways, highway safety, and public transportation totals \$286.4 billion². Over the five years of SAFETEA-LU, Montana is apportioned \$1.8 billion of formula driven funding and earmarked funding for high priority projects through FHWA. Montana also stands to receive \$230.7 million in other earmarked funds that are outside the formula driven programs and \$56.0 million in transit funds through the Federal Transit Administration.

For the formula driven programs under FHWA, Montana is designated to receive, on average, \$355 million each year, with annual amounts increasing from \$334.8 million in FFY 2005 to \$373.9 million in FFY 2009³. The growth means Montana would receive \$82.5 million more each year compared to the TEA-21 average annual amount of \$272.5 million.

Transit Funding

Montana is also allocated \$56.0 million in transit funds that are passed through MDT to local transit entities, which match the funds with local sources of revenue. The transit funding level of \$5.1 million for FFY 2005 is similar to levels under TEA-21, but in FFY 2006 funding level more than doubles to \$11.5 million and grows to \$14.1 million by FFY 2009.

The program with the most significant funding increase under SAFETEA-LU is the rural general public transit program⁴ in which funding will nearly triple from TEA-21 levels, to \$7 million in FFY 2006 and \$8 million in FFY 2009. MDT administers a grant program for these funds but passes the funding through to local transit operators. The local transit operators provide the non-federal match for the program from service revenues. The program funding increase will add significant challenges for local operators to fully match. However, a new provision in SAFETEA-LU will allow funds to be matched according to the sliding scale match rate of 86.58 percent federal instead of the previous rate of 80 percent federal under TEA-21. The ability to match at the sliding scale rate will soften the amount of the match increase seen from the tripling of available funds and was previously available only for some federal-aid highway programs.

DONOR STATES ISSUE

A key issue that delayed a long-term reauthorization of TEA-21 was the on-going dispute between states that collect more highway trust fund revenue than are distributed back to the state from the trust fund (donor states) and states that receive more back from the trust fund than are collected in the state (donee states). Montana is a state in the later category and receives about 2.2 times the amount of federal-aid

² Includes \$52.6 billion for federal transit programs funded through the Federal Transit Administration, a 46 percent increase over TEA-21. Most transit funds are administered through the Montana Department of Transportation, but go to and are matched by local transportation authorities.

³ Annual apportionments, based on tables published by FHWA, for Montana before penalties, program distribution, or Byrd Test are: \$334,792,584 for FFY 2005, \$339,067,668 for FFY 2006, \$357,534,817 for FFY 2007, \$370,203,499 for FFY 2008, and \$373,884,361 for FFY 2009. The apportionments provide funding for the following federal-aid programs under which Montana receives federal-aid funding: Interstate Maintenance, National Highway System, Surface Transportation Program, Bridge Replacement and Rehabilitation, Congestion Mitigation and Air Quality, Recreation Trails, Metropolitan Planning, Safety, Rail-Highway Crossings, Border Infrastructure Program, Safe Routes to School, High Priority Projects, and Equity Bonus.

⁴ The program funds assistance for public transportation services with the following eligible assistance categories: state administration, planning, and technical assistance; capital expenses including the acquisition, construction, and improvement of public transit facilities (i.e. buses, vans, passenger shelters, wheelchair lifts and restraints, preventive maintenance, and radios and communications equipment); operating expenses directly related to system operations; and project administrative expenses.

than is collected in federal highway trust fund revenues in the state. Only Alaska and the District of Columbia have higher rates of return than Montana.

The issue pits densely populated urban states against sparsely populated rural states. For states like Montana with a large state area and low population, the burden of supporting the costs of maintaining a high number of miles of highways on the national system with a low population places a heavy per capita burden on highway users of the state. To donor states the issue is one of equity. Donor states advocate all federal highway user fee revenues collected in the state should be returned to the state to maintain the federal highway system in the state. Congressional negotiators of the transportation bill settled on a provision of the bill that would guarantee that a minimum percentage of the revenues collected in the state, less than 100 percent, would be returned to the state.

The provision of SAFETEA-LU for guaranteeing a minimum return of trust fund revenues to the state in which they were collected is the equity bonus program. The equity bonus program is an attempt in SAFETEA-LU to address the donor states' concerns and provide a minimum rate of return on contributions to the highway account of the federal highway trust fund. The program also provides a minimum increase relative to the average dollar amount of apportionments under TEA-21.⁵

The concern for Montana is that, over time as the federal-aid program has been reauthorized, the minimum percentage of revenues returned to donor states has grown. If donor states continue to increase the minimum percentage returned to their states, users in sparsely populated rural states like Montana will need to provide higher per capita levels of financial support to maintain the federal highway systems in their states.

Under SAFETEA-LU Montana made some inroads through a percentage lock provision that guaranteed the state a 0.9758 percent share of total apportionments throughout the life of SAFETEA-LU. This is an improvement over TEA-21, under which Montana's percentage share of total apportionments decreased each year. Had the formula mechanism remained the same as in TEA-21, Montana's percentage share of program would have continued to decline, from about .90 percent in 2004 to roughly 0.86 percent at the end of SAFETEA-LU. The implication is that reauthorizations typically start with state apportionment percentage shares that existed at the end the current authorization, so in the post-SAFETEA-LU authorization, Montana will start from a higher point than it would have under a continuation of the provisions of TEA-21.

OBLIGATION LIMITATIONS

Under federal budgeting processes, rarely are all authorizations available for programs funded in authorizing legislation. Budget limitations and appropriations typically limit the amount of funding that can be obligated by the federal government to some level less than the authorization amounts. Obligation limitations are subject to changes that may come out of the annual appropriations process and revenue collection impacts on revenue aligned budget authority (RABA) calculations⁶. Historically, obligation limits have resulted in about 90 to 92 percent of apportionments coming to states. After applying a 92 percent obligation limit to the applicable formula programs, Montana actually could

⁵ The specified percentage, referred to as a relative rate of return, is 90.5 percent for FFY 2005 and FFY 2006, 91.5 percent for FFY 2007, and 92 percent for FFY 2008 and FFY 2009.

⁶ Revenue aligned budget authority is a provision that allows adjustments to budget authority based on revenue collections. The RABA provision in SAFETEA-LU deviates from TEA-21 by not allowing a reduction of budget authority unless the beginning balance of the highway account of the federal highway trust fund falls below \$6 billion.

expect to receive an average of about \$329 million per year compared to an average of \$251 million under TEA-21.

EARMARKS IN SAFETEA-LU

SAFETEA-LU contains funding for a number of projects, grants, or other programs that would directly benefit Montana in some way. Not all of the SAFETEA-LU funding for Montana goes to core programs of MDT. Some funding will be administered directly by a federal agency and some funding is allocated to local governments or transportation organizations. Figures 1 through 4 list or summarize earmarked projects for Montana. Figures 1 through 3 identify separate projects within the earmark categories and specify the amounts for the projects, the entity that requested the funding, and the entity responsible for funding the match for the federal funds. The figures indicate if the project was anticipated in MDT's current 5-year tentative construction plan, the estimated cost of the full project referred to in the earmark, and the year in which the project is currently planned to be let to bid. Figure 4 summarizes the categories of earmarks and shows that \$395 million in earmarked projects or grants are expected for various entities within Montana over the five years of SAFETEA-LU.

Earmarked projects can be grouped into three basic characterizations:

- 1) Projects that have already been anticipated and incorporated in the current state 5-year highway construction plan. These projects are applicable to the core systems of Montana's federal-aid highway infrastructure managed by MDT and would not adversely impact MDT's current planned activities or state funds beyond current assumptions;
- 2) Projects that have not been anticipated or factored into the current state 5-year plan. These earmarks may be for projects applicable to the systems MDT manages but uncertainty still remains and there is a potential to adversely impact other system projects or state funding. The long-term impact for Montana is that these earmarks draw down funds of the federal highway trust fund and the projects could force reprioritization of MDT staff resources;
- 3) Funding for projects or grants that impact some entity in Montana and don't directly involve or impact MDT or state funds. Like the earmarks in the second category, the long-term impact for Montana is that these earmarks draw down funds of the federal highway trust fund.

High Priority Projects

High priority projects fall under the first earmark characterization mentioned above. Of the earmarks, only high priority projects, shown on Figure 1, are included within the \$355 million average funding referenced above when comparing to TEA-21 average funding levels. These earmarks, which account for \$164.6 million over the life of SAFETEA-LU, are referred to as being "below the line". Being below the line means that they are considered in the calculations that determine how much additional funding states receive to provide a minimum amount of returns of gasoline tax revenues to the state in which they were collected – the equity bonus program.

Some of the key characteristics of high priority project earmarks are:

- Except for project 1322, for construction of secondary 323 from Alzada to Ekalaka, funds allocated for other high priority projects in Montana may be obligated for any other high priority projects in Montana, except that the authorization for a project from the category list may not be reduced (project flexibility provision)
- Funds will be allotted in 20 percent increments each year of SAFETEA-LU, but state funds may be used for advance construction and refunded when federal funds are available or high priority projects may also be advanced with other apportioned funds

- Montana is one of six states to which the sliding scale match applies for high priority projects, resulting in a federal participation rate of roughly 86.58 percent as opposed to 80 percent for other states outside the sliding scale match
- Obligations remain until used

Figure 1 - Montana Projects Earmarked in SAFETEA-LU (High Priority Projects)

Project Name	Amount	Core MDT Program	In Current Plan	Responsible for Match	Requirer	Estimated Project Cost	Estimate Bid Year
Sec. 1702 - High Priority Project Authorization							
1322 Construction of S. 323 from Alzada to Ekalaka	\$9,600,000	Yes	Yes	MDT	MDT	\$25,300,000	2007
4412 Transportation improvements for MT 78 Corridor Development	10,000,000	Yes	Yes	MDT	MDT	12,775,961	2005
4413 Transportation improvements for Bench Boulevard Connection and Corridor Project Billings See Note 1	17,000,000	Yes	Yes	MDT	Local	17,000,000	2009
4414							
Transportation improvements for Babcock to Kagy Project, Bozeman	5,000,000	Yes	Yes	MDT	MDT	6,239,200	2007
4415							
Transportation improvements for Townsend - South Project, U.S. 287	10,000,000	Yes	Yes	MDT	MDT	11,080,985	2009
4416							
Transportation improvements for Cut Bank Railroad Overpass, Cut Bank	6,000,000	Yes	Yes	MDT	MDT	8,350,100	2008
4417 Transportation improvements for Havre - East Project, including Glasgow to Poplar, U.S. 2 See Note 2	10,000,000	Yes	Yes	MDT	MDT	13,109,455	2006
4418							
Transportation improvements for Lonepine North and East Project, MT 28	7,000,000	Yes	Yes	MDT	MDT	10,390,240	2008
4419							
U.S. 93 transportation improvement projects between Lolo and Hamilton	15,000,000	Yes	Yes	MDT	MDT	26,680,145	2006/2007
4420 U.S. 2 transportation improvement projects between North Dakota state line and Browning See Note 2	20,000,000	Yes	Yes	MDT	MDT	15,800,000	2005
4421							
MT 3 transportation improvement projects between Billings and Great Falls	15,000,000	Yes	Yes	MDT	MDT	14,346,610	2007
4422							
MT 16, reconstruction of roadway and structures northeast of Glendive	7,000,000	Yes	Yes	MDT	MDT	11,751,603	2009
4423 Develop and reconstruct Two Medicine Bridge, U.S. 2, East of Glacier National Park	25,000,000	Yes	Yes	MDT	MDT	25,000,000	2008
4424 U.S. 93 Ninepipe to Ronan transportation improvement projects	8,000,000	Yes	Yes	MDT	MDT	60,000,000	2009
Total High Priority Earmarked Projects	<u>\$164,600,000</u>						

Note 1: Project 4413 is not in MDT's long-range construction program
Note 2: Projects 4417 and 4420 overlap on a common corridor. Costs and funding are shown separately, but would be combined for corridor projects as needed.

Transportation Improvements

Transportation improvement earmarks fall within the first and second earmark characterization. The earmarks shown on Figure 2 as being in the current plan are in the first characterization and all other earmarks are in the second characterization. Transportation improvement earmarks account for \$153.6 million of funding designated for Montana and are shown on Figure 2. Transportation improvement earmark funding is over and above the \$355 million average funding referenced above when comparing to TEA-21 average funding levels. As such, these earmarks are referred to as being “above the line” in that they are not included in the calculation for the equity bonus program.

Some of the key characteristics of transportation improvement earmarks are:

- A special section of SAFETEA-LU states that funds made available to Montana for the construction of US 212, Red Lodge North (transportation improvement project 246) or transferred to the project under the project flexibility provision may be used for reconstruction of the Beartooth Highway, to be subsequently reimbursed from emergency relief funds as they become available
- Funds will be allocated 10 percent in FFY 2005, 20 percent in FFY 2006, 25 percent in each of FFY 2007 and FFY 2008, and 20 percent in FFY 2009, but state funds may be used for advance construction and refunded when federal funds are available or transportation improvement projects may be advanced with other apportioned funds or funds allocated for other

transportation improvement projects in Montana, except that the authorization for a project from the category list may not be reduced

- The sliding scale match applies for transportation improvement projects as it does with high priority projects
- Obligations remain until used

Figure 2 - Montana Projects Earmarked in SAFETEA-LU (Transportation Improvements)

Project No.	Project Name	Amount	Core MDT Program	In Current Plan	Responsible for Match	Requester	Estimated Project Cost	Estimate Bid Year
Sec. 1934 - Transportation Improvements								
234	Zimmerman Trail Project, Billings, Montana See Note 1	\$7,000,000	No	No	Local	Local	Unknown	Unknown
235	Taylor Hill Road reconstruction, Secondary 234, Montana See Note 2	3,000,000	Yes	No	MDT/US	MDT	\$3,000,000	Unknown
236	Develop and construct Shiloh Road reconstruction	10,000,000	Yes	Yes	MDT	MDT	17,846,600	>2009
237	Develop and construct U.S. 93 Kalispell Bypass project	30,000,000	Yes	Yes	MDT	MDT	17,000,000	>2009
238	Develop and construct St. Mary water project road and bridge infrastructure including: New bridge and approaches across St. Mary River, stabilization and improvements to U.S. 89, and road/canal from Siphon Bridge to Spider Lake See Note 3	8,000,000	No	No	MT	MT	100,000,000	Unknown
239	U.S. 2, corridor feasibility study, environmental review and construction, which may include construction of a 4-lane highway, for roadway sections from Glasgow east to the North Dakota State line, provided that all currently programmed highway improvement projects move forward	10,000,000	Yes	No	MDT	MDT	Unknown	Unknown
240	Develop East Belgrade Interchange and connecting roadways to include environmental review See Note 4	8,000,000	Yes	No	Unknown	MDT/Local	29,000,000	Unknown
241	Reconstruct Marysville Road consistent with final environmental document, Lewis and Clark County	5,000,000	No	No	MDT	MDT	Unknown	Unknown
242	Develop and construct transportation enhancements including bicycle/pedestrian trails, landscaping, footbridges, parks, and river access on and in the vicinity of the Milltown Dam Site, Missoula County and Deer Lodge County	5,000,000	No	No	Local	Local	Unknown	Unknown
243	Develop Billings bypass, Yellowstone County	7,000,000	Yes	No	MDT	MDT	Unknown	Unknown
244	Develop Great Falls South Arterial, including environmental review	4,500,000	No	No	MDT	MDT	Unknown	Unknown
245	Develop and construct Helena I-15 corridor consistent with final environmental document and record of decision See Note 5	10,000,000	Yes	Yes	MDT/Local	MDT	5,800,000	2006
246	Develop and construct U.S. 212 Red Lodge North (100 percent federal per Sec. 1941) See Note 6	22,000,000	Yes	Yes	MDT	MDT	Unknown	>2009
247	Develop and construct Whitefish pedestrian and bicycle trails	3,000,000	No	No	Local	Local	Unknown	Unknown
248	Develop and construct parking lot and transportation enhancements including bicycle/pedestrian trails and urban plaza, serving the City of Bozeman Public Library	1,125,000	No	No	Local	Local	Unknown	Unknown
249	U.S. 2, Swamp Creek East roadway and bridge reconstruction, Lincoln County	6,000,000	Yes	Yes	MDT	MDT	21,002,700	2007/2009
250	Russell Street reconstruction and bridge expansion over the Clark Fork River, Missoula	6,000,000	Yes	Yes	MDT	MDT	6,600,000	2009
251	Conrad I-15 North Interchange modifications to provide access east of the current interchange, Pondera County	4,000,000	Yes	No	Local	Local	Unknown	Unknown
252	Develop and improve access road and structure serving the Port of Montana and Silicon Mountain Technology Park	4,000,000	No	No	MDT/Local	MDT	Unknown	Unknown
Total Transportation Improvement Earmarked Projects		<u>\$153,625,000</u>						

Note 1: This project is on the urban system, but not in MDT construction program at the time of passage of SAFETEA-LU

Note 2: The project was requested jointly by the Rocky Boy tribal government and MDT

Note 3: The project was not specifically requested by MDT and funding for the project match is being investigated from other state agencies and Glacier County.

Note 4: The match and other issues are currently being negotiated with the local government for this project.

Note 5: Project costs are only shown for the South Helena Interchange. Costs for the Custer Interchange are unknown and the match is still not finalized.

Note 6: The earmark is for a project north of Red Lodge but Section 1941 of SAFETEA-LU specifies that the earmark can be drawn to the Beartooth Highway repairs and repaved with emergency relief (ER) funds. ER funds have been applied for but timing of the funds is unknown. When the ER funds are received the earmark will be repaid and the project north of Red Lodge will be funded.

Many transportation improvement projects were requested through Montana's congressional delegation with varying levels of MDT advanced knowledge or involvement. As noted in Figure 2, about one-third of the projects are included on the current 5-year tentative construction plan with the remaining projects previously unanticipated. For unanticipated projects, the projects are of a magnitude that the earmark will move then toward construction, but actual construction will not occur within the timeframe of

SAFETEA-LU or MDT’s tentative construction program due to funding or scope limitations. The costs or details of many of the projects are yet to be determined as is the funding source for the required non-federal match. Because of these factors, there is a high level of uncertainty with these projects, including uncertainty as to when the funds will be obligated or actually be expended. MDT is working with each affected community to resolve the uncertainties.

Transit and Other Earmarks

In addition to earmarks for high priority projects and projects for transportation improvements, \$77 million in other earmarks that would benefit Montana have been included for the projects and grants listed on Figure 3. The earmarks shown on Figure 3 fall in the third of the above earmark characterization in that they benefit Montana, but are not part of the MDT program. None of the

Figure 3 - Montana Projects Earmarked in SAFETEA-LU (Transit and Other Earmarks)

Project No.	Project Name	Amount	Core MDT Program	In Current Plan	Responsible for Match	Requester	Estimated Project Cost	Estimate Bid Year
Sec. 3044 - Projects for Bus and Bus-related Facilities and Clean Fuel Grant Programs								
129	Bozeman, Montana - Vehicular Parking Facility See Note 1	\$3,344,000	No	No	Local	Local	Unknown	Unknown
476	Bozeman, MT, Intermodal and parking facility See Note 1	<u>690,000</u>	No	No	Local	Local	Unknown	Unknown
Total Projects for Bus and Bus-related Facilities and Clean Fuel Grant Programs		<u>\$4,034,000</u>						
Other Earmarked Funding (Section of SAFETEA-LU noted)								
	Going-to-the-Sun Road, Glacier National Park (Sec. 1940) See Note 2	\$50,000,000	No	No	US	US	100,000,000	Unknown
	Western Transportation Institute at Montana State University (Sec. 5401)	16,000,000	No	No	WTI	WTI	N/A	N/A
	University of Montana - Hydrogen-Powered Transportation Research Initiative (Sec. 5513)	3,000,000	No	No	U of M	Uof M	N/A	N/A
	Western Transportation Institute at Montana State University - develop a cold region and rural transportation research facility in Lewistown (Sec. 5513)	<u>4,000,000</u>	No	No	WTI	WTI	N/A	N/A
Total Other Earmarked Funding		<u>\$73,000,000</u>						

Note 1: The Bozeman parking facility was listed in SAFETEA as two separate projects, but is one project. The funding will be administered through the transit program and is anticipated to be completed as a direct relationship between the Federal Transit Administration and the City of Bozeman.

Note 2: The Going-to-the-Sun Road project will be transferred to a federal agency for administration and match funding.

projects shown on Figure 3 would be administered or matched by MDT, so they will not impact the MDT budget or the highway state special revenue account. The projects shown on Figure 3 are above the line projects and do not impact the calculation for the equity bonus program. The funding for earmarks shown on Figure 3 are identified in separate sections of SAFETEA-LU and have requirements and match rates unique to the project or grant.

Impact of Earmarks on Allocation of Other Funds Across Montana

Montana has five financial districts across the state. State statute specifies how the federal-aid funds received for the primary, secondary, and urban highway systems are to be allocated and the factors to be used to determine each district’s portion of the allocations.

Figure 4 - Summary of Earmarked Project Funding

Earmark Category	Amount
High Priority Earmarked Projects	\$164,600,000
Transportation Improvement Earmarked Projects	153,625,000
Projects for Bus and Bus-related Facilities and Clean Fuel Grant Programs	4,034,000
Other Earmarked Funding	<u>73,000,000</u>
Total of all Earmarks	<u>\$395,259,000</u>

In total, earmarks designated for Montana account for \$395 million over the life of SAFETEA-LU. Figure 4 summarizes the categories of earmarks. Because the earmarked projects aren't allocated uniformly across the state or uniformly among the components of Montana's highway infrastructure, a concern is raised as to the impact of the earmarks on other projects across Montana when taking into account Montana's laws for allocating federal-aid funds among the five financial districts of the state⁷. Montana laws that specify how federal-aid highway funds are to be allocated among the state financial districts are silent as to their applicability to funding achieved through federal authorization program formula allocations or earmarks.

MDT does not intend to include earmarked funds in the calculation for fund distribution. If the earmarked funds are combined with other non-earmarked federal-aid funding for the applicable systems projects currently planned for the districts could be impacted. However, all earmarks for high priority projects and 6 of the 19 (or 48 percent) of the funding for transportation improvement projects are in the current tentative construction plan, so they should not impact the current allocations. Rather, to a great extent, the earmarks will ensure or accelerate timely delivery of these projects. Planning for the remaining \$80 million in transportation improvement earmarks has not been completed.

STATE BUDGET IMPLICATIONS OF SAFETEA-LU

APPORTIONMENT VERSES EXPENDITURES

The apportioned amounts of federal funds that Montana may receive after obligation limits are considered don't correspond directly to what Montana expects to expend in any given fiscal year. Federal funds are obligated⁸ when a qualified federal-aid project is awarded under a bid letting process. Once a project is awarded, highway construction projects experience a lag before expenditures are incurred. The delay between awarding of a bid and final expenditure and closeout of funds on a project can range from several months to several years, depending on the type of project and timing of the bid award.

The Montana Department of Transportation (MDT) either uses obligation limit levels provided by FHWA or estimates of obligation limits in an annual review and update of their tentative construction plan to predict how the federal-aid funding will be obligated. Based on the projects included in the updated tentative construction plan, the department uses automated management systems to predict the costs and timing of resources and expenditures for fiscal years covered by the plan.

COMPARISON TO ASSUMPTIONS FOR THE 2007 BIENNIUM BUDGET

The budget for the 2007 biennium was approved under a tentative construction plan updated in December 2004 and based on the assumption that the obligation limit for the federal-aid highway construction program would average about \$325 million per year. Earlier it was estimated that with an obligation limit of 92 percent, Montana could expect to receive \$329 million per year. Considering that funding levels in the early years are lower than the average the amount Montana can expect to receive is

⁷ Laws for allocation federal-aid funds among financial districts are in:

- 60-2-127. Transportation commission – allocation of funds for projects
- 60-3-219. Allocation of funds – apportionment
- 60-3-205. Apportionment of state funds to primary highway system
- 60-3-206. Apportionment of funds to secondary highway system
- 60-3-211. Apportionment of state funds to urban highway system

⁸ An obligation is a commitment made by the federal government to make a payment either immediately or in the future.

roughly the estimated amount assumed for the 2007 biennium budget. The funding assumptions in the 2007 biennium budget seem to be appropriate and should not result in a budget shortfall for the 2007 biennium.

For future biennia, the legislature can expect to see higher funding requests in both state and federal funds because of the higher average funding levels of SAFETEA-LU and the funding growth in later years.

PURCHASING POWER OF FUNDING

Costs to construct and maintain highways are increasing at rates higher than inflation. Nationally, the costs of highway construction, construction equipment, and construction and maintenance supplies are rising. The transportation construction producer price index for highways and street construction⁹ had a long-term growth rate of 2.4 percent for the period from January 1982 to July 2005. The index has experience a much higher growth rate in recent years. From July 2004 to July 2005, the growth rate was 11.5 percent. Cement based products have contributed significantly to the higher growth rate. Iron and steel costs have fluctuated significantly in recent years and are up 30 percent since 2002. Higher fuel costs that have occurred since hurricane Katrina have yet to show up in the price index, but would likely apply more pressure to rising construction costs.

Locally, MDT has seen factors that have caused some concern relative to inflation impacts of construction costs. Significant among the factors is the changing contractor community. Several contractor consolidations have produced a smaller bid pool. Often one or few responses are received in response to bid requests and with reduced competition, some bids have returned higher costs than would be expected with larger numbers of bidders. The uncertainty surrounding the delay in providing a long-term reauthorization to TEA-21 has impacted the construction supply chain as producers have adjusted supplies to a smaller demand. Higher construction activities from SAFETEA-LU could lead to higher construction costs in the short-term as constrained availability of construction supplies drive up their costs.

The higher construction costs are offsetting much, if not all, of MDT's program growth anticipated from higher federal-aid funding levels under SAFETEA-LU. Instead of addressing more of Montana's highway system needs, the higher funding levels are likely to provide similar work output as under TEA-21, but at a higher cost per average project.

STATUS OF FEDERAL HIGHWAY TRUST FUND

The federal funds for highway construction are from the highway account of the federal highway trust fund. The highway trust fund receives revenues from user fees and excise taxes on gasoline, diesel, and kerosene fuel; liquefied petroleum and natural gas; gasohol; tires; truck and trailer sales; and heavy vehicle use. Figure 5 shows the actual and projected ending balances of the highway account of the federal highway trust fund from FFY 2000 through FFY 2015.¹⁰ The figure shows a significant decline in ending balance from FFY 2001 through FFY 2004 and a period of structural balance from FFY 2004

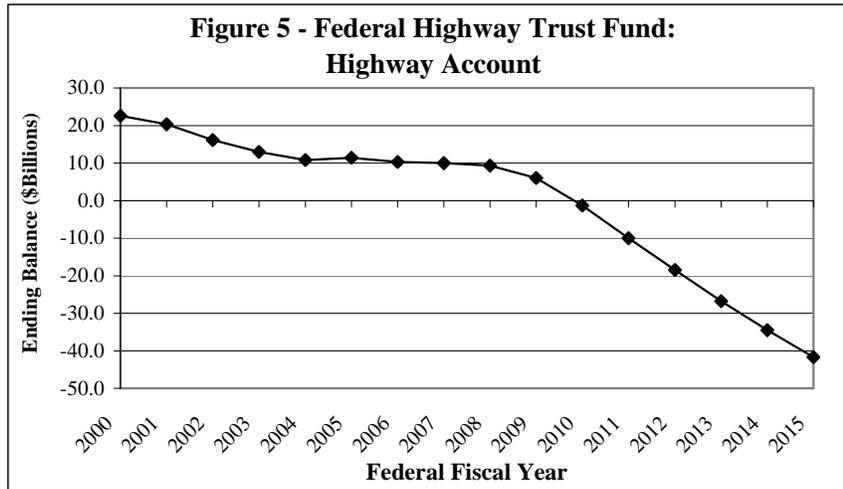
⁹ Source is the August 2005 Producer Prices report published by the American Road & Transportation Builders Association and based on data from the Bureau of Labor Statistics, Producer and Commodity Price Indices.

¹⁰ Sources for Figure 5 are:

For Fiscal Years 2000 through 2003: www.fhwa.dot.gov/policy, Status of Highway Trust Fund

For Fiscal Years 2004 through 2015: American Association of State Highway and Transportation Officers (AASHTO) presentation to the 2005 NCSL Fiscal Management Conference as derived from data from the US Chamber of Commerce Foundation 2005 Study

through FFY 2008. It is unclear why the fund stabilizes during these years. At the end of SAFETEA-LU the expenditures again exceed revenues and the fund balance degrades further.



PROTECTIONS IN SAFETEA-LU

SAFETEA-LU contains a rule that limits the decline of fund balance to \$6 billion, in the event of which the Revenue Aligned Budget Authority (RABA) provision of the legislation will result in reductions of allocations from the account. SAFETEA-LU also establishes two commissions to study the following and provide recommendations to Congress for addressing the situation:

- Program direction
- Funding and revenue

Potential options currently being discussed to increase revenues include:

- Increase the gasoline tax (currently at \$0.184 per gallon)
- Index the federal fuel taxes to an economic index
- Increase general fund support for transit
- Leverage a new source of revenue
- Sell tax credit bonds or other financial instruments

SHORT-TERM IMPACTS

In the short-term, the appropriations process and the RABA provision will control the account balance from declining below \$6 billion. Impacts on Montana could include reduced funding through more restrictive obligation limits and rescissions of unobligated apportionments. Reduced funding would primarily result in delays in projects planned under assumptions of funding levels used in the annual updates to the state 5-year tentative construction plan. Rescissions would impact future program development and flexibility.

LONG-TERM IMPACTS

Because of the declining fund balance of the federal highway trust fund, the potential long-term impacts for Montana highway users and Montana, when SAFETEA-LU is reauthorized, include:

- Reduced federal funding levels for highways
- Lower the federal participation rate

- Increased highway user fees
- Shifting of program priorities

Reducing federal funding levels or the federal participation rate on highway construction projects would potentially necessitate using state funds to off set the losses to maintain a highway construction program of equal size. Increased user fees would place more burdens on the system users to fund highways in the state. Shifting program priorities could reduce the flexibility of MDT in matching system needs with funding and potentially result in funding being spent where it may not provide the optimum benefit to the overall system.

STATUS OF STATE HIGHWAYS SPECIAL REVENUE ACCOUNT

MDT funds operations and maintenance for Montana highways and provides the match for federal-aid with the highways state special revenue account (HSRA). HSRA derives revenues from various motor vehicle user fees shown on Figure 6.

TENTATIVE CONSTRUCTION PLAN

MDT uses a tentative construction plan to identify timing and funding for highway construction projects for a 5-year period. Once the plan is completed, MDT uses an automated management system to estimate, based on the projects and schedule of the tentative construction plan, the timing of expenditures on the projects of the plan. The plan is updated every year with the latest update scheduled for November 2005. Because TEA-21 was only recently reauthorized, the current plan included assumed highway funding levels and programs. The budget approved by the 2005 Legislature reflects the assumed levels of federal-aid and not the actual levels contained in SAFETEA-LU. Until the tentative construction plan is updated and the timing of the project costs determined, estimates of future expenditures associated with the federal-aid construction program expenditure estimates cannot be made with any accuracy nor can a true comparison to the budgetary impacts. However, MDT monitored reauthorization and incorporated most of the SAFETEA-LU funding growth into its current tentative construction program.

WORKING CAPITAL ESTIMATES

Because MDT relies heavily on HSRA to pay for the operations of the department, the condition of the account and its ability to provide funding for department expenses are of great concern to the legislature. Figure 6 shows the projected revenues, expenditures, and balances of HSRA from FY 2005 through FY 2011. As stated, accurate estimates of expenditures associated with the federal-aid highway construction program cannot be made until the details of SAFETEA-LU are incorporated into the tentative construction plan and costs programmed for the projects of the plan.

Earlier it was assumed that the budget for the 2007 biennium was approved on assumptions that basically match the funding levels contained in SAFETEA-LU for the 2007 biennium. The estimates contained in Figure 6 are predicated on the following assumptions:

- Projected revenues from gasoline and diesel taxes and gross vehicle weight fees for the 2007 biennium are reflective of HJR 2, the revenue estimating resolution of the 2005 Legislature (as of this writing, it is too early to determine what if any impact increasing fuel prices will have on the factors that impact revenues collected, most notably gallons of fuel purchased)
- Expenditures for the 2007 biennium are appropriations in HB 2 (general appropriations), HB 5 (long-range building), and HB 447 (pay plan)

- Revenues for the sources estimated in HJR 2 for the 2009 and 2011 biennia are FY 2007 revenues adjusted by the growth rate from FY 2006 to FY 2007
- Expenditure estimates for the 2009 and 2011 biennia are FY 2007 appropriations inflated by 3 percent per year

As Figure 6 shows, the revenues are expected to fall short of funding expenditures from FY 2006 and beyond. The imbalance is expected to degrade HSRA and completely deplete the balance by the end of FY 2009.

Figure 6 - Working Capital Analysis - Highways State Special Revenue Account
Fiscal Years 2005 - 2011
(in \$ Millions)

	Fiscal 2005 Actual	Fiscal 2006 Approp.	Fiscal 2007 Approp.	Fiscal 2008 Estimate	Fiscal 2009 Estimate	Fiscal 2010 Estimate	Fiscal 2011 Estimate
Beginning Working Capital Balance	\$39.0	\$51.3	\$40.0	\$23.8	\$4.7	-\$17.4	-\$42.4
Revenues							
Gasoline tax	124.2	128.2	128.9	129.4	130.0	130.5	131.1
Diesel tax	64.2	65.9	68.7	71.5	74.5	77.6	80.9
Gross vehicle weight fees (GVW)	26.5	28.3	28.7	29.2	29.6	30.1	30.6
Indirect cost recovery (federal aid)	34.2	44.2	44.7	37.0	43.4	43.4	43.4
General fund transfer	0.0	3.1	3.1	3.1	3.2	3.2	3.3
Other revenues	10.8	5.4	5.1	4.6	4.0	3.9	3.9
Revenue deductions							
Alcohol production incentives (15-70-522, MCA)	0.0	0.0	-4.8	-6.0	-6.0	-6.0	-6.0
Gasohol tax reduction (15-70-204, MCA/SB 293 2005L)	<u>0.0</u>	<u>-1.5</u>	<u>-1.5</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>
Total Revenues	\$260.0	\$273.7	\$272.9	\$268.9	\$278.8	\$282.8	\$287.2
Expenditures							
Department of Transportation (DOT)							
General Operations Program	20.3	19.6	20.0	20.6	21.2	21.9	22.5
Construction Program							
Federal-aid program match	69.0	65.1	67.8	69.9	72.0	74.1	76.4
State funded program - maintenance of effort	7.8	10.0	10.0	10.0	10.0	10.0	10.0
State funded program - offset indirect cost impacts	12.9	44.2	44.7	37.0	43.4	43.4	43.4
Maintenance Program	86.7	91.9	93.6	96.4	99.3	102.3	105.4
Motor Carriers Services	5.3	6.0	6.2	6.4	6.6	6.8	7.0
Transportation Planning	<u>2.1</u>	<u>2.1</u>	<u>2.1</u>	<u>2.1</u>	<u>2.2</u>	<u>2.3</u>	<u>2.3</u>
Total Department of Transportation	204.0	238.8	244.5	242.5	254.8	260.8	267.1
Statutory Appropriations	16.8	16.8	16.8	16.8	16.8	16.8	16.8
Department of Justice (DOJ)	23.2	26.0	24.6	25.3	26.1	26.9	27.7
Long-Range Building Program							
Maintenance and repair of MDT buildings	2.4	2.5	2.5	2.5	2.5	2.5	2.5
Department of Fish, Wildlife & Parks	<u>1.4</u>	<u>0.8</u>	<u>0.8</u>	<u>0.8</u>	<u>0.8</u>	<u>0.8</u>	<u>0.8</u>
Total Long-Range Building Program	3.8	3.3	3.3	3.3	3.3	3.3	3.3
Transfer for noxious weeds (80-7-823, MCA)	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>
Total Expenditures	\$247.8	\$284.9	\$289.2	\$288.0	\$301.0	\$307.7	\$314.8
Revenues less expenditures	12.2	-11.2	-16.2	-19.0	-22.2	-24.9	-27.7
Adjustments	0.1						
Ending Working Capital Balance	<u>\$51.3</u>	<u>\$40.0</u>	<u>\$23.8</u>	<u>\$4.7</u>	<u>-\$17.4</u>	<u>-\$42.4</u>	<u>-\$70.0</u>

SHORT-TERM IMPACTS OF SAFETEA-LU ON HSRA

For the 2007 biennium, HSRA should be adequate to match projected expenditures from SAFETEA-LU to the level of appropriations of the 2005 Legislature. If revenues and expenditures occur as shown in Figure 6, the HSRA balance at the end of FY 2007 would be just below \$20 million. Until the tentative construction plan is updated to reflect SAFETEA-LU and the expenditure patterns of the resultant plan determined, HSRA impacts after FY 2007 cannot be accurately determined. During the interim, staff will monitor the tentative construction plan update and provide more accurate estimates of HSRA funding impacts relative to the plan.

LONG-TERM IMPACTS OF SAFETEA-LU ON HSRA

Figure 6 includes an item in the revenue section called indirect cost recovery and an item in the expenditure section called state funded program – offset indirect cost impacts. The indirect cost revenue item accounts for revenues deposited in HSRA for reimbursements from the FHWA for indirect costs of the MDT. The expenditure category reflects the policy to fund construction activity equivalent to the amount of federal-aid used to recover indirect costs as state funded construction projects.

If the legislature wants to continue to match all federal-aid funds, continue to reinvest indirect cost recovery revenue in state funded construction projects, and maintain other aspects of the construction program as it current does, the legislature may need to investigate revenue enhancement options to restore a balance between program revenues and planned expenditures, or it may need to investigate program policy changes to bring expenditures in balance with available revenues. During the interim, staff will evaluate in more detail the impacts SAFETEA-LU will have on HSRA projections. In doing so, long-term funding options will be developed and provided to the committee, as will options for adjusting expenditure policies.

CONCLUSION

SAFETEA-LU provides significant increases in funding to various entities in Montana. Not all of the funding from SAFETEA-LU directly benefits the programs administered and delivered by MDT. For example, earmarked funds totaling \$50 million would be directed to repair the Going-to-the-Sun Road in Glacier National Park, research programs of the university system would receive \$23 million of the funding, and grant funding for local transit operators would increase nearly three fold for general public programs. At the same time, programs that support the state highway infrastructure would see significant increases over the levels of TEA-21. However, rising costs of highway construction activities could erode much of the benefits that would be gained if the increased funding could be used to address more of the state's highway infrastructure instead of addressing the same level of infrastructure at a higher cost per unit.

Concerns are raised as to the impacts on Montana from degrading conditions of the federal highway trust fund and the highways state special revenue fund. Because of how recently SAFETEA-LU was enacted, further work is needed to fully evaluate the impacts of SAFETEA-LU and the condition of highways state special revenue account.