



A 2015 Surface Transportation Primer

The Transportation Transformation Group is an unprecedented alliance of state government, finance, academic and private industry leaders who aspire to transform American transportation policy into a goal-based arrangement that maximizes flexibility to enhance the roles of the state and local public sectors and their private partners to solve the growing problems of congestion and mobility.

T2 publishes primers and other documents to help policy makers and the public understand concepts essential to transportation transformation.

Overview

On August 8, President Barack Obama signed into law the Highway and Transportation Funding Act of 2014 (HTFA, HR 5021, PL 113-520), a \$10.8 billion package keeping federal highway and transit programs authorized and funded through May 31, 2015. The law makes no substantive changes to surface transportation programs, but extends current spending authority and is mostly funded by a provision known as pension smoothing, which allows companies to temporarily lower legally required payments into their employee retirement programs, boosting the company's taxable income.

The HTFA temporarily prevents the insolvency of the Highway Trust Fund (HTF) until May 31, 2015. Without new funding, the HTF was due to run short of money by the end of August 2014. Between January and June 2015, the 114th Congress will have to enact a new authorization, extend the existing one again or allow the nation's surface transportation programs to expire.

The only long-term legislation to emerge from committee in the 113th Congress, S. 2322, funded surface transportation programs at current levels adjusted for inflation, and did not expand transportation resources as proposed by President Barack Obama. Given congressional hostility toward increased taxes, the likelihood is very high that any legislation that advances in the 114th Congress will likewise maintain current program levels and not authorize increased spending or taxes.

In order to meet increased demand for transportation infrastructure, the 114th Congress is likely to examine an increase in existing motor fuels taxes, private financing through public-private partnerships (P3s), Transportation Infrastructure Finance and Innovation Act (TIFIA) financing and toll financing. Long-term, Congress is expected to examine

authorizing tests of future funding mechanisms involving distance-based or mileage-based user fees (MBUFs).

In order to advance these financing alternatives, Congress will need to review and renew existing policies involving tax-exempt bonds, tolling and TIFIA credit assistance program.

The Highway Trust Fund

The HTF is divided into highway and transit program accounts. It is funded primarily by an 18.4-cent per gallon tax on gasoline and a 24.4-cent per gallon tax on diesel fuel. The motor fuels tax rates have been increased four times, in 1959, 1982, 1990 and 1993.

Since 2007, motor fuels tax revenue flowing into the HTF has not met expectations, in part due to increased vehicle fuel efficiency and reduced miles traveled. Because of the fixed nature of the cents-per-gallon motor fuels taxes, the only way the taxes can generate additional revenue for the HTF is if motor-fuel consumption rises. Gasoline and diesel sales for use by highway vehicles peaked in 2007, although it appears gasoline use may have risen in 2013.

On account of declining revenues and increased construction costs, spending on federal highway and transit programs is about \$15 billion more per year than the HTF is taking in. Over five occasions since 2008, Congress has transferred a total of \$65 billion in general fund resources into the HTF to make up the difference. When Congress next considers the surface transportation program in 2015, it will need to choose between identifying additional resources for the program, reducing transportation spending by about 30 percent, expanding financing alternatives or some mix of these options.

Funding Alternatives

Increase the Motor Fuels Tax

An increase in the per gallon motor fuels tax, which already provides the bulk of federal highway revenue, is often the first solution to the HTF dilemma explored by policy-makers.

The National Surface Transportation Infrastructure Financing Commission February 2009 report recommended a 10-cent increase in the gasoline tax and a 15-cent increase in the diesel tax, and commensurate increases in all special fuels taxes, and index these rates to inflation. Senators Bob Corker and Chris Murphy have co-sponsored a bipartisan bill to raise the national gas tax by 12 cents over the next two years and then index it to inflation.

The commission also recommended a transition to a new, more direct user charge system as soon as possible and commit to deploying a comprehensive system by 2020, in part because American vehicles continue to increase fuel-efficiency and reduce miles driven. Less gas consumption means less gas-tax revenue. With cities growing faster than suburbs and federal fuel economy standards set to rise more than 40 percent by

2020, revenue from the tax will continue to decline. Many tax analysts view the motor fuels tax as a declining base for federal surface transportation programs – one that need not be tossed aside until an alternative funding mechanism is agreed to, but not a sustainable foundation long-term.

While some have suggested a sales tax on motor fuels as an alternative to the per gallon tax, such a policy faces the same challenges as the existing structure: less consumption means less revenue. In addition, due to ups and downs in the price of fuel, revenue from a sales tax would be more volatile than under the present system.

In addition, costs are projected to rise as the Interstate systems' pavement deteriorates and requires replacement. Most pavement was built to last 50 years, and most of the pavement was laid 50 years ago. The Reason Foundation's Director of Transportation Policy Robert Poole estimated in 2013 that it would cost \$983 billion (in 2010 dollars) to rebuild interstates and expand the most congested sections. As Poole noted in his study, "The 20th century fuel tax system is inadequate for this trillion-dollar task."

Public-private partnerships (P3s)

To help fund projects that are needed now and for which HTF funding may not be available for many years, many states are turning to private sector financing of highway and transit infrastructure through P3s. The federal government and Congress influence the availability and structure of P3s through transportation programs, tax policy, funding, and regulatory oversight.

P3s typically require an anticipated project-related revenue stream such as vehicle tolls, container fees, or in the case of transit station development, building rents. Private-sector resources may come from an initial payment to lease an existing asset in exchange for future revenue, as with the Indiana Toll Road and Chicago Skyway, or they may arise from a newly developed asset that creates a new revenue stream. Either way, a facility user fee is often the key to unlocking private-sector participation and resources.

In some cases, private sector financing is backed by "availability payments," regular payments made by government to the private entity based on negotiated quality and performance standards of the facility. For example, a private company under a 35-year contract made major improvements to I-595 near Fort Lauderdale, Florida. The Florida Department of Transportation (FDOT) began making availability payments to the private partner when the facility opened in 2014. Toll rates on the new express lanes are set by FDOT, and revenue collected is retained by the state. The financing includes a federal TIFIA credit assistance and state funds.

It is widely believed that there are hundreds of billions of dollars of private monies available globally for infrastructure investment. P3s are projected to finance as much as \$100 billion in highway and transit projects over the next several years in the United States, assuming that Congress acts to maintain the financial underpinning of P3s.

Ultimately, investors in infrastructure expect a return on their investment that is almost always paid for by user fees or taxpayer funding. Financing programs, including TIFIA, can access new sources of borrowing and allow leveraging of public funds. But they don't create new funding sources.

Since Congress increased the availability of TIFIA in MAP-21, many P3 projects have brought together financing from TIFIA credit assistance, Private Activity Bonds (PABs), private equity and government grants.

TIFIA

To fulfill the extraordinary promise of P3 financing, maintaining the current statutory authority for TIFIA credit assistance is essential. The Transportation Infrastructure Financing and Innovation Act (TIFIA) program, enacted in 1998 as part of TEA-21 and expanded in SAFETEA-LU and MAP-21, provides credit assistance to major transportation investments in the form of direct loans, loan guarantees, and lines of credit and is designed to fill market gaps and leverage private co-investment by providing supplemental and subordinate capital to projects.

TIFIA may cover up to 49 percent of eligible project costs, although the U.S. Department of Transportation has generally chosen to limit financing at 33 percent. The program is targeted to large-scale transportation projects with specifically dedicated revenue streams.

The lower rate and project risk provided by TIFIA credit assistance helps secure other financing at lower rates and helps leverage non-federal funding, including investment from the private sector. Loans must be repaid with a dedicated revenue stream, typically a project-related user fee but sometimes also including dedicated tax revenue. As of June 10, 2014, TIFIA has provided assistance of \$17.1 billion to 45 projects valued at \$63.7 billion. MAP-21 greatly enlarged TIFIA by increasing its funding from \$122 million annually to \$750 million in Fiscal Year 2013 and \$1 billion in Fiscal Year 2014.

According to USDOT, that \$1.75 billion translates to \$17.5 billion in loans, which in turn can leverage \$20-\$30 billion in transportation infrastructure investment (each dollar of federal funds can provide approximately \$10 in TIFIA credit assistance). Continued availability of TIFIA credit assistance will be vital to continued utilization of P3s as a vehicle for attracting billions of dollars in private monies for transportation infrastructure investment.

Private Activity Bonds

It is critically important that the cap on surface transportation PABs be increased. PABs are tax-exempt revenue bonds, originally capped at \$15 billion for surface transportation facilities in the 2005 highway bill. Only about \$5 billion in PABs remain available under the original cap and that amount is likely to be consumed in 2015.

Congress should consider increasing the PAB volume cap by the amount needed to keep P3s working for the duration of any future highway bill; the need would appear to be about \$5 billion per year.

If Congress fails to increase the cap on surface transportation PABs, the ability of P3 projects to answer public demand for transportation financing is likely to fade substantially. The loss of PABs would increase the cost of funds, damaging the ability of P3s to deliver the greatest value for the taxpayer and adding pressure on the fiscal viability of the HTF.

Tolling

Tolls can be an important solution in many states for certain projects. Tolling is operational in 35 states and has been drawing increased interest at county and regional levels as an alternative method of advancing badly needed projects and transportation improvements.

Technological advances have made tolling much more convenient for drivers. Electronic toll collection (ETC) has been in use for 25 years and is now well established and well received by toll road users. New toll projects are going forward with all-electronic tolling (AET), which eliminates tollbooths and toll plazas altogether. ETC has also allowed the introduction of express lanes and high occupancy toll (HOT) lanes that help to manage traffic congestion through pricing and allow more effective use of underused dedicated HOV lanes.

Major highways such as the Interstates have a design life of 50 years if properly maintained; therefore, most of the Interstates will exceed that life and will need reconstruction over the next two decades. The cost of reconstruction and selective widening has been estimated as close to \$1 trillion. Yet there is no available state or federal funding source for a set of projects of this magnitude.

While MAP-21 allows for the tolling of new Interstate System capacity, there are limitations on tolling on existing Interstate highways. An existing demonstration program only allows three states to use toll finance to pay for reconstructing aging and worn-out Interstates.

It is difficult for any state to reach political consensus on toll-financed reconstruction, as has been demonstrated by the inability of the three states holding slots in the existing pilot program to advance their proposals. To maximize the likelihood of one “pathfinder” state resolving this question, the Pilot Program should be expanded to include all states, and to allow the consideration of system-wide and regional projects.

Highway user groups have expressed concern over “tolling existing corridors,” fearing (with some justification) that toll revenues on interstate travelers would become a general transportation funding source, rather than a user fee dedicated just to the

replacement and maintenance of the roadway. To address these concerns, Congress should consider highway user safeguards in any tolling flexibility provision of the reauthorization bill. Such safeguards would apply only to currently non-tolled Interstate corridors whose reconstruction is to be toll-financed. Four specific policies that have support among highway user groups are:

- (1) Limit the use of toll revenues to the set of reconstructed Interstates, (2) Charge only enough to cover the full capital and operating costs of the reconstructed corridors, including a reasonable return on investment and possible future additions;
- (2) Begin tolling only when reconstruction of a corridor is completed, so as to offer users value for the money they are asked to pay, and
- (3) Use tolling to replace, not in addition to, existing state fuel taxes, by offering state fuel tax rebates for the miles driven on newly tolled Interstates.

Mileage-Based User Fees

Fees based on vehicle miles traveled have been the subject of extensive study by many groups over several years. The studies almost always conclude a transition to a per-mile system of funding is desirable and feasible, but that a transition would take years and face obstacles, such as consumer fears about privacy.

Federal MBUFs could be used to provide revenue to the HTF, either in place of or in addition to motor fuel taxes.

MBUFs would treat all highway users equally whether gasoline, diesel, natural gas, batteries, or other fuels power their vehicles. The technology to collect MBUFs already exists with electronics installed in almost all new vehicles. Privacy, cost, and administrative hurdles are being assessed in pilots to test feasibility.

Global Positioning System (GPS) tracking involved in some proposed collection schemes causes unease among privacy advocates. Alternative technologies would allow tracking of vehicle mileage without the use of GPS. A pilot study in Oregon relied on a periodic odometer reading of each vehicle, which could be done at some fixed interval by visiting a special facility, or else during refueling at a gas station equipped to record an electronically transmitted odometer reading. Another approach would use cellular-linked technology, such as a weekly automated contact between a vehicle and a collection center, to collect mileage information without disclosing details about individual travel.

Depending on the collection technology required for a MBUF system, drivers of older vehicles could face the need to install new equipment. A MBUF system could avoid this problem by allowing owners of older vehicles to continue to pay fuel taxes until they replace their vehicles, adding some complexity and administrative cost to the system.

A transition from a tax collected at a few places to a charge collected at many places would create issues and concerns, including avoidance and fraud. These complexities

would need to be overcome for MBUFs to become an efficient source of revenue.

T2 is happy to exchange ideas about this or any other matter related to the next surface transportation bill. Contact Billy Moore at (202) 288-0892 to set up a discussion. You can also get additional information at our website www.trans2group.com