Legislative Fiscal Bureau
One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873
Email: fiscal.bureau@legis.wisconsin.gov • Website: http://legis.wisconsin.gov/lfb

November 4, 2015

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Transportation: Section 13.10 Request for Approval of Highway Contingency Bonding -- Agenda Item II

REQUEST

The Department of Transportation (DOT) submitted a request for approval to use $200 million in general fund-supported, general obligation bonds in 2015-16 to the Joint Committee on Finance under a 14-day passive review process, as provided for in section 9145 (1v) of 2015 Act 55. Under this provision of the Act, subject to certain conditions, DOT may request up to $350 million in contingent, general obligation bonds for use in the state highway rehabilitation and/or major highway development programs in 2015-17. Notice of an objection to the Department's request was made on October 27. If this request is approved as submitted, $75 million in bonds would be used for the state highway rehabilitation program and $125 million would be used for the major highway development program.

Act 55 provided initial funding to these programs as follows: (a) $757.1 million in 2015-16 and $757.3 million in 2016-17 for the state highway rehabilitation program; and (b) $243.4 million in 2015-16 and $242.5 million in 2016-17 for the major highway development program. If DOT's request is approved, total program resources in 2015-16 for the state highway rehabilitation and major highway development programs would be equal to $832.1 million and $368.4 million, respectively

BACKGROUND

Program Descriptions and Funding Levels

The state highway rehabilitation program is responsible for the reconstruction, reconditioning, and resurfacing of the highways and bridges of the state highway system, except for highway projects that exceed the capacity expansion thresholds established for the major highway development, southeast Wisconsin freeway megaprojects, high-cost bridge, and major interstate bridge programs.

The major highway development program is responsible for the expansion of existing highways, construction of new highways, and certain high-cost highway rehabilitation projects. With certain exceptions, capacity expansion projects are considered major highway projects if they have an estimated cost exceeding $35.7 million and involve one of the following: (a) the addition of one or more lanes at least five miles in length to an existing highway; (b) construction of a new highway 2.5 miles or more in length; (c) relocation of 2.5 miles or more of existing roadway; or (d) the improvement of 10 miles or more of an existing divided highway to freeway standards. Highway rehabilitation projects are considered major highway projects if they have an estimated cost exceeding $89.2 million. [Exceptions to these standards are provided for southeast Wisconsin freeway megaprojects (exceeding $596.8 million), high-cost bridge projects (exceeding $150 million), and interstate bridge projects (with the state's share over $100 million).]

Major highway projects that meet the capacity expansion thresholds must be enumerated in the statutes before the DOT can begin construction. Potential projects are considered for enumeration by the Transportation Projects Commission (TPC), a body consisting of the Governor, as chair, five senators, five representatives, three public members, appointed by the Governor, and the DOT Secretary (a nonvoting member). DOT submits potential projects to the TPC for consideration and also submits a recommendation of which of those projects should be advanced for enumeration. The TPC then makes a recommendation to the Governor and Legislature of which projects should be enumerated. Major highway projects that meet the definition based on the high-cost threshold, but not the capacity expansion thresholds, must be approved by the TPC prior to construction, but do not need to be enumerated in the statutes. By statute, the Department reports project costs in the major highway development and southeast Wisconsin freeway megaprojects programs to the TPC in February and August of each year.

Table 1 shows the total resources provided to the state highway rehabilitation and major highway development programs since the start of the 2005-07 biennium, as well as the amounts requested by DOT in 2015-17, the Governor's 2015-17 recommendation, and the Department's 2015-16 contingent bonding request. The amounts shown reflect FED, SEG, and bonds.

TABLE 1

State Highway Rehabilitation and Major Funding -- Total Program Resources (In Millions)

Biennium	State Highway Rehabilitation	Major Highway Development
2005-07	$1,202.8	$565.6
2007-09	1,560.8	695.9
2009-11	1,545.8	713.6
2011-13	1,607.6	743.6
2013-15	1,640.4	728.4
2015-17 (Act 55)	1,514.4	485.9
2015-17 Proposals		
DOT's 2015-17 Request	$1,841.1	$836.1
Governor's 2015-17 Recommendation	1,614.7	836.1
2015-16 Contingent Bonding Request	1,589.4	610.9

Note: The "2015-16 Contingent Bonding Request" category reflects the sum of the programs' existing, total 2015-17 resources, plus the 2015-16 amounts requested by DOT. However, the Department's request indicates that the Department intends to ask for an additional $150 million for these programs in 2016-17 ($75 million for state highway rehabilitation and $75 million for major highway development). If such a 2016-17 request is submitted and approved, total biennial funding would be $1,664.4 million for state highway rehabilitation and $685.9 million for major highway development.

Due in part to concerns over growing transportation debt service and the overall stability of the state's method of financing transportation programs, the 2011-13 budget created the Transportation Finance and Policy Commission to examine these issues and make recommendations. The Commission recommended a series of funding increases for state highway and local transportation assistance programs and several tax and fee increases to generate additional revenues for the transportation fund. As a point of comparison to the levels of funding shown in the table above, among these recommendations was a funding level equal to $2.0 billion per biennium for the state highway rehabilitation program and $943.2 million per biennium for the major highway development program.

Description of Contingent Highway Bonding Provision

Act 55 provided a total of $850.2 million in bonds for transportation purposes (a $450 million reduction from the level of bonding recommended in the Governor's 2015-17 budget). Of this total authorization, $350 million was provided as "contingent" bonding authority for use in the major highway development and/or state highway rehabilitation programs.

This authority is "contingent" because these bonds may be used to restore funding to either program in 2015-17, but only at the Committee's discretion and subject to following conditions: (a) approval of the bonds must be initiated by a request from DOT under a 14-day passive review process; (b) debt service on the first $175 million in approved bonding must be paid from the general fund; (c) debt service on any subsequent approved bonding may be paid from either the general fund or the transportation fund, as determined by the Committee; (d) the use of no more than $200 million may be approved by the Committee in 2015-16; (e) the total amount available for approval by the Committee will be reduced by the amount that actual transportation fund revenues in 2015-16 exceed the amounts projected in the budget, subject to a maximum reduction of $150 million; and (f) the ability of the Committee to approve the use of this bonding will sunset on June 30, 2017.

Under (e) above, any reduction to bonding authority must be determined by comparing the total annual transportation fund revenues for 2015-16 in the annual fiscal report for that year with the corresponding amount from the final fund condition statement for the biennial budget ($1,661,562,400). If this calculation produces a reduction in the amount of contingent bonding that the Committee may approve, the Department may submit a request to the Committee, also under a 14-day passive review process, to supplement the SEG appropriations for the major highway development and/or state highway rehabilitation programs by any combined amount up to the amount of the reduction in the amount of contingent bonding.

Transportation Finance Issues

With respect to the Department's 2015-16 request, and to any future contingent bonding request submitted by DOT, there are a number of ongoing issues related to the solvency of the transportation fund and related transactions with the general fund that the Committee may wish to consider. In recent years, revenues to the transportation fund have been relatively stagnant, particularly since the repeal of annual indexing of the motor vehicle fuel tax rate after that rate was last indexed in April, 2006. A registration fee increase for all vehicle types, effective January 1, 2008, was the last major revenue increase to the fund. Subsequently, from 2006-07 to 2014-15, transportation fund revenue has grown by an average, annual rate of 1.5%. Also during this period, the use of transportation fund-supported bonds has increased, from $350.0 million in 2003-05 to an average of $678.2 million during the 2005-07 through 2013-15 biennia.

Due to the combination of these factors, debt service as a percentage of transportation fund revenue rose during this period, from 10.3% in 2006-07 to an estimated 19.6% in 2015-16. As this percentage has grown over time, an increasingly significant portion of the fund's future revenue stream has been committed to paying for past infrastructure projects. For instance, under Act 55, debt service as a percentage of revenue will increase to an estimated 20.6% in 2016-17, even with no additional transportation fund-supported bonding.

Although the Department's request would be funded wholly with general fund-supported bonds, there are a number of factors related to the use of general fund moneys for transportation purposes that the Committee may find relevant to this request and the transportation fund's ongoing solvency issues. In this regard, between 2003-05 through 2015-17, the Legislature and the Governor enacted a series of financial transactions between the transportation fund and the general fund, which are summarized in Table 2.

TABLE 2

Impact to Transportation Fund of General Fund Transactions
($ in Millions)

	2003-05	2005-07	2007-09	2009-11	2011-13	2013-15	2015-17	14-Year Total
Transfers and Appropriations to General Fund	-$682.6	-$431.7	-$162.0	-$125.6	$0.0	$0.0	$0.0	-$1,401.9
Transportation Fund-Supported Debt Service	-43.9*	0.0	0.0	0.0	0.0	0.0	0.0	- 43.9
Gen. Ob. Bonds for State Hwy. Projects, Gen. Fund-Supported	565.5	250.0	50.0	204.7	115.4	200.0	0.0	1,385.6
General Fund Transfers to Transportation Fund	0.0	0.0	0.0	0.0	160.1	206.1**	84.0***	450.2
Total	-$161.0	-$181.7	-$112.0	$79.1	$275.5	$406.1	$84.0	$390.0****

*In the 2003-05 biennium, debt service on replacement bonds was initially paid from the transportation fund.
**Includes a transfer of $1.4 million under a transfer provision of the road disaster damage aid program.
*** Includes an estimated transfer of $6.5 million under a transfer provision of the road disaster damage aid program.
****This would increase to $590.0 million under the Department's request.

Between the 2003-05 and 2009-11 biennia, transportation fund revenues were used as part of a strategy to balance the general fund budget. In 2003-05 through 2007-09, general fund-supported bonds were issued for state highway projects in place of these transferred funds, although the total amount transferred was higher than the replacement bonds in each biennium. The net effect of the transactions during this initial period was a $454.7 million loss to the transportation fund. Although the net fiscal effect of these transfers began to reverse in 2009-11, concern during this period over transportation funds being used for other purposes led the Legislature to propose a constitutional amendment intended to limit the possibility of using existing and future transportation revenues for non-transportation purposes. This amendment passed by referendum in the fall, 2014, general election.

In the 2011-13 and 2013-15 biennia, general fund-supported bonds were again issued for state highway projects, while general fund revenues were also transferred to the transportation fund. Subsequently, in the 2015-17 biennium, an estimated $84 million in general fund revenue will be used to fund transportation programs. As shown in the table, the net fiscal effect of these transactions during this 14-year period is an estimated $390 million gain to the transportation fund. If the Committee approves the Department's $200 million, general fund-supported request, the total gain to the transportation fund would increase to $590 million.

ANALYSIS

State Highway Rehabilitation Program

Relative to the 2014-15 base year funding provided to the state highway rehabilitation program ($807.3 million), the funding provided under Act 55 (prior to the approval of any contingent bonding) represents a reduction of about $50 million annually (6.2%) to the program. As a result of this reduction, total program resources are equal to $757.1 million in 2015-16 and $757.3 million in 2016-17.

In response to this reduction, the Department made various program cutbacks, which resulted in estimated project delays within the state highway rehabilitation program. DOT described these project delays in an October 5 letter to the Legislature. [Because Act 55 also reduced major highway development program funding, delays to projects in this program were also described in this letter.] As a part of this communication, the Department indicated that in considering which projects to delay, it gave preference to not delaying the following types of state highway rehabilitation projects: (a) projects that address critical safety issues; (b) projects in the later stages of construction whose delay would cause significant disruption to industry and the traveling public; (c) projects that preserve the more heavily used backbone of the state highway system; and (d) projects that warrant select treatments that add the most additional life to the highway and bridge network.

The Department's request indicates that the $75 million requested for the state highway rehabilitation program would enable DOT to enter into contracts for 21 additional highway rehabilitation projects in 2015-16. In deciding which projects it would fund with the proceeds from the requested contingent bonding, DOT used the same set of criteria listed above to prioritize projects. Although the majority of the work that would be funded relates to the rehabilitation of roadway surfaces throughout the state, the request would also fund two bridge repair projects (in Jefferson and Marathon counties).

In its October 5 letter and in communication related to this request, the Department noted that state trunk highway conditions are generally in a state of decline, such that a large portion of these highways "has either reached the end of its useful life or will do so in the next 5 to 10 years." As a consequence, even at a base level funding ($807.3 million annually), DOT estimates that statewide road conditions, currently reported as 83% in "fair and above condition," would drop to 68% in this condition over a 10-year period (the remaining roads would be considered in "poor and below" condition). Under Act 55's $50 million annual reduction to this program, DOT estimates that statewide road conditions in fair and above condition would fall to 66% over a 10-year period (if inflationary increases to program funding are provided in future years). If the Committee approves contingent bonding equal to $75 million per year for this program in 2015-17 (this request and DOT's intended request for 2016-17) and maintains funding at this level in future years (while also providing inflationary increases in future years), a slight improvement in this percentage, to 69%, would be expected.

Major Highway Development Program

Relative to the major highway development program's 2014-15 base year funding ($368.0 million), the level of funding provided under Act 55 (prior to the approval of any contingent bonding) represents a reduction of about $125 million annually (34.0%) to the program. As result of this reduction, total program resources are equal to $243.4 million in 2015-16 and $242.5 million in 2016-17.

In the same October 5 letter to the Legislature, DOT indicated that the level of funding provided under Act 55 would result in two-year delays to the projects listed in Table 3.

TABLE 3

Anticipated Major Highway Development Project Delays Under 2015 Act 55*
($ in Millions)

Highway	Project Segment	Counties	Completion Delay	Revised Estimate Completion Date	Estimated, Total Project Cost
USH 10/441	Winnebago CTH CB to Oneida Street	Outagamie, Calumet, & Winnebago	Two Years	2021	$482.0
STH 15	STH 76 to New London	Outagamie	Two Years	2021	148.0
USH 18/151	Verona Road/Madison Beltline	Dane	Two Years	2021	250.9
STH 23	STH 67 to USH 41	Sheboygan & Fond du Lac	Two Years	Subject to Litigation	150.5
I-39/90	Illinois State Line to USH 12/18	Dane & Rock	Two Years	2023	1,195.3

* Assumes annual funding of $318 million in 2017-19 and beyond.

The two-year delays in the table assume that major highway development program funding levels would return to $318 million per year in 2017-19, and beyond. However, if no contingent bonding is provided and funding continues at the 2016-17 base level in future biennia, the project delays shown in the table would increase by an additional year, with the exception of the delays to the USH 10/441 and I-39/90 projects, which would increase by two years.

If contingent bonding equal to $125 million in 2015-16 and $75 million in 2016-17 is provided, the Department estimates that the delays listed in Table 3 would be reduced to one year for all projects (this assumes an ongoing funding level of $366 million per year, plus inflationary increases). In order to return all the projects to their pre-Act 55 schedules, the Department estimates that the following program resources would be needed in the subsequent three years: (a) $425 million in 2017-18; (b) $449 million in 2018-19; and (c) $447 million in 2019-20. To calculate those amounts, DOT used projected inflation from the Global Insight forecast for state and local investment in highways and streets, which averaged 3.15% in the three out years.

If approved, the $125 million requested by DOT for use in 2015-16 would fund work on the I-39/90 project in Dane and Rock counties and the USH 10/441 projects in Outagamie, Calumet, and Winnebago counties. DOT indicates that it would fund these project in order to maximize its available funding in relation to the existing phases and staging of these projects.

Discussion of Alternatives

Under Act 55, the Committee may decide whether debt service on contingent highway bonds issued in excess of $175 million would be paid from the general fund or the transportation fund. Under the Department's $200 million request, this provision would apply to the $25 million of the bonds in excess of that threshold. Once fully issued, estimated debt service on the first $175 million in general fund-supported bonds would be equal to $12.5 million annually, while the estimated payment on the remaining $25 million in bonds would be equal $1.8 million per year. Estimated debt service on the entire $200 million in bonds would be equal to $14.3 million per year. Due to the lag between bond issuance and the initial payment of debt service, it is projected that the debt service on contingency bonds issued in 2015-16 would first be paid in 2016-17.

If the Committee approves the Department's request as submitted, debt service on the entire $200 million in bonds, estimated at $14.3 million annually, would be paid from the general fund. [Alternative #1] If the Committee decides that the transportation fund should pay for the debt service on the $25 million of the requested bonds where this is an option, the general fund would pay an estimated $12.5 million per year in debt service and the transportation fund would pay $1.8 million per year. [Alternative #2]

In making state highway program budget recommendations for 2015-17, the Governor recommended providing $807.3 million annually for the state highway rehabilitation program (base year funding) and $418.0 million annually for the major highway development program (an annual increase of $50 million over the base year). Relative to Governor's budget recommendations, Act 55 reduced funding to the state highway rehabilitation by $50 million per year, but reduced major highway development funding by $175 million annually. In order to restore program funding to levels that align more closely to those recommended by the Governor, the Committee could decide to provide $150 million to the major highway development program and reduce the Department's request for the state highway rehabilitation program to $50 million. [Alternatives #3a or #3b]

ALTERNATIVES

1. Approve the Department's request for the use of $200,000,000 in general fund-supported, general obligation bonds in 2015-16 and allocate $75,000,000 to the state highway rehabilitation program and $125,000,000 to the major highway development program. Increase estimated debt service in 2016-17 by $14,328,000 GPR to reflect the estimated payments on these bonds.

2. Modify the Department's request to instead approve the use of $175,000,000 in general fund-supported, general obligation bonds and $25,000,000 in transportation fund-supported, general

obligation bonds in 2015-16. Allocate $75,000,000 to the state highway rehabilitation program and $125,000,000 to the major highway development program. Increase estimated debt service in 2016-17 by $12,537,000 GPR and $1,791,000 SEG to reflect the estimated payments on these bonds.

3. Modify the Department's request and instead allocate $50,000,000 to the state highway rehabilitation program and $150,000,000 to the major highway development program in 2015-16 by doing one of the following:

a. Approve the use of $200,000,000 in general fund-supported, general obligation bonds in 2015-16. Increase estimated debt service in 2016-17 by $14,328,000 GPR to reflect the estimated payments on these bonds.

b. Approve the use of $175,000,000 in general fund-supported, general obligation bonds and $25,000,000 in transportation fund-supported, general obligation bonds in 2015-16. Increase estimated debt service in 2016-17 by $12,537,000 GPR and $1,791,000 SEG to reflect the estimated payments on these bonds.

4. Deny the request.

Prepared by: John Wilson-Tepeli