



Arizona State Senate *Issue Brief*

December 20, 2010

Note to Reader:

The Senate Research Staff provides nonpartisan, objective legislative research, policy analysis and related assistance to the members of the Arizona State Senate. The *Research Briefs* series, which includes the *Issue Brief*, *Background Brief* and *Issue Paper*, is intended to introduce a reader to various legislatively related issues and provide useful resources to assist the reader in learning more on a given topic. Because of frequent legislative and executive activity, topics may undergo frequent changes. Additionally, nothing in the *Brief* should be used to draw conclusions on the legality of an issue.

HIGHWAY FUNDING AND CONSTRUCTION

INTRODUCTION

Congestion and mobility are key issues facing Arizona. How to solve gridlock with a growing population and a high ratio of personal vehicle use is a crucial question facing state policymakers. Congestion relief measures undergo intense scrutiny and are influenced by lobbying efforts from environmental groups and industry. Transportation philosophies and growth management styles differ; however, one constant is that sustained funding is necessary for transportation projects of all kinds to proceed.

According to the National Conference of State Legislatures' (NCSL) Surface Transportation Funding report, historically, states have funded transportation projects by paying for construction, maintenance and administration as money becomes available from user fees and federal grants. NCSL further asserts that, increasingly, states with rapid growth are finding that existing revenues may not be enough. In many states, legislatures cannot solve transportation problems because they cannot afford to do so. Rapid growth has also increased public demand for transportation services, strained existing infrastructure and drained financial resources. To pay for projects, states more frequently are turning to bonds and newer financing methods to meet transportation needs.

HIGHWAY USER REVENUES

States are responsible for approximately 75 percent of the total capital expenditures for highway and mass transit programs, with the remaining 25 percent derived from local and federal sources. The majority of state transportation funding comes from highway user revenues.

The Arizona Highway User Revenue Fund (HURF), established in 1974 and administered by the Arizona Department of Transportation (ADOT), is the depository fund for motor fuel tax revenues and revenue collected from a variety of fees and charges relative to the registration and operation of motor vehicles on Arizona's public roadways.

Article IX, Section 14 of the Arizona Constitution, requires monies derived from fees, excises or taxes relating to motor vehicles or fuels to be expended for highway and street purposes.

This requirement applies to all HURF revenues except **vehicle license tax (VLT)** monies. The following fees and taxes are the primary sources of revenue for HURF:

Gasoline taxes are the taxes paid at the pump when purchasing gasoline for cars and trucks. Arizona’s **motor vehicle fuel tax** rate is 18 cents per gallon, which has been the rate since 1990, and is levied on each gallon of gasoline produced or imported into the state by a distributor. The vast majority of the motor vehicle tax revenues are deposited in the HURF and pay for highway construction and maintenance.

Use fuel tax refers to taxes on diesel fuel. Since July 1, 2000, the tax for use class motor vehicles, such as a truck or tractor with a gross vehicle weight of more than 26,000 pounds or more than two axles on a highway, has been 26 cents per gallon. Diesel vehicles used for government, nonprofit or religious purposes as well as light class motor vehicles pay 18 cents per gallon. Additionally, from September 1, 2005 to December 31, 2010, vehicles that are used to transport forest products may pay a reduced use fuel tax of 13 cents per gallon.

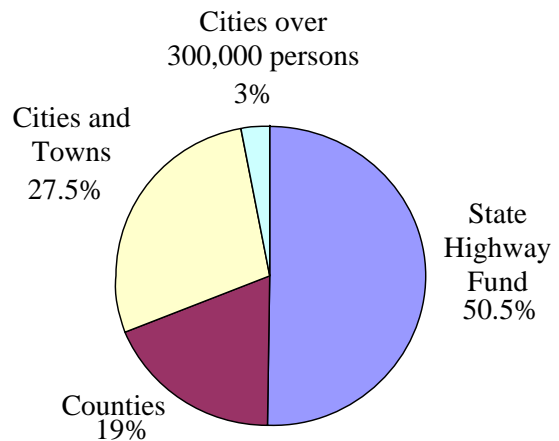
A **motor carrier tax** was first introduced in Arizona in 1979 as a motor carrier use tax. It has undergone several changes over the years. Currently, motor carrier fees are based strictly on the weight of the vehicle and generate the least amount of HURF revenue. The motor carrier use tax is paid by interstate commercial carriers.

The **VLT** is an ad valorem tax originally approved by the voters at the General Election of November 5, 1940, amending Article 9, Section 11 of the Arizona Constitution. The VLT is levied per \$100 of a vehicle’s assessed value, which, for the first 12 months of the life of the vehicle, is 60% of the manufacturer’s base retail price and 16.25% less than the previous year for each subsequent year. The VLT rate per \$100 of assessed value is currently \$2.80 for new vehicles and \$2.89 for renewals. The VLT is thus the only inflation-responsive revenue source for HURF. Between 1998 and 2000, the Legislature reduced the VLT rate by approximately 33 percent.

Registration fees are composed of county registration, noncommercial and commercial vehicle registration and commercial weight fees; apportioned registration and commercial registration fees allocated according to miles traveled in Arizona; and miscellaneous registration, nonresident permits, unassigned registration, prorate stickers and registration penalties.

HURF Distribution

Statute requires \$1 million in HURF monies to be transferred to the Economic Strength Project Fund and up to \$10 million to be transferred to the Department of Public Safety (DPS) for highway patrol expenditures. These statutory transfers, as well as any legislative appropriations from HURF, are completed prior to the distribution to local governments and the State Highway Fund (SHF). Pursuant to A.R.S. § 28-6538, the distribution of remaining HURF monies is as follows:



Counties with a population of over 400,000, and cities with a population of over 30,000 that are located within those counties, are required to maintain a certain level of expenditures of local revenue for street and highway purposes. This requirement is known as “maintenance of effort” and requires these local entities to expend local revenue at a level computed as an average of local funds expended in any four of the five fiscal years between FY 1981-1982 and FY 1985-1986. Local revenue does not include state or federal grants, interest income, bond

proceeds, HURF monies, Local Transportation Assistance Fund monies or funds specifically collected for debt service.

Cities and counties required to comply with maintenance of effort statutes must certify their compliance with ADOT by December 31 of each year. Failure to comply with or annually certify maintenance of effort results in a reduction of HURF distribution to that city or county. In 2002, the Legislature enacted an emergency measure that suspended the maintenance of effort requirements for three years. Maintenance of effort requirements became effective again on July 1, 2005.

STATE TRANSPORTATION ACCELERATION NEEDS (STAN) ACCOUNT

Funds needed to expedite approved transportation projects in Arizona generally come from the State Transportation Acceleration Needs (STAN) Account. The STAN Account was established in 2006 and was initially funded with a \$245 million appropriation from the state General Fund and \$62 million from the SHF in FY 2006-2007. Utilized monies appropriated by the Legislature from the STAN Account are distributed in the following manner:

- 60 percent to Maricopa County.
- 16 percent to Pima County.
- 24 percent to all other counties.

STAN Account monies are restricted to expenditures used for construction or reconstruction of freeways, state highways, bridges and interchanges contained in a county's regional transportation plan or ADOT's long-range statewide transportation plan. STAN Account monies can also be used to pay for materials, labor, acquisition of right-of-way, design and other engineering services or directly related costs.

Under the law governing the STAN Account, the regional planning agencies in Maricopa and Pima counties must establish a process to review and approve projects. In rural counties, ADOT, in cooperation with the metropolitan planning organization or the council of governments, must develop requests for expenditures of STAN monies. Upon

receiving approval from the local agency, the State Transportation Board (STB) reviews each request and either approves the request or requires a modification of the request before approval. The entire cost of a construction project must be covered before any STAN Account monies may be released.

In 2007, the Legislature created two subaccounts within the STAN Account, the Transportation Acceleration Interest Reimbursement (Interest Reimbursement) Account and the Roads of Regional Significance Congestion Mitigation (RRSCM) Account. Monies in the Interest Reimbursement Account are used to reimburse interest costs associated with the acceleration of a transportation project while monies from the RRSCM Account are used to construct, design or plan roads or bridges that are contained, but not funded, in the transportation plan of a city, town or county. A governmental entity that receives monies from the RRSCM Account before July 1, 2012 is not required to reimburse the monies received for the transportation project.

Laws 2008, Second Regular Session, Chapter 53 transferred \$42 million from the SHF to the STAN Account. This amount was subsequently transferred to DPS for highway patrol costs. Laws 2009, First Special Session, Chapter 1 transferred \$104 million originally appropriated to the STAN Account back to the state General Fund. This effectively eliminated STAN funding for three Maricopa Association of Governments (MAG) transportation projects – the I-10 (Verrado to Sarival), I-17 (SR-74 to Anthem) and SR 802.

Laws 2009, Third Special Session, Chapter 7, allowed the ADOT Director to transfer \$10 million from any STAN subaccounts to a new subaccount established by the ADOT Director to restore funding previously approved by STB for less than \$21 million. In 2010, Director John Halikowski established the new STAN Restoration subaccount with \$10 million from the MAG share of the STAN Account.

As of June 30, 2010, the STAN Account had an ending balance of \$55.3 million, reflecting \$33.4 million in earned interest and \$201.1 million in project cost disbursements. Of the \$55.3 million ending balance, approximately

\$14 million is held in the STAN subaccounts, with the remainder available for project costs.

BONDS

Bonds are a common mechanism that states use to borrow money for transportation projects. An investor buys a bond on a promise that, on a specified maturity date, the issuing entity will repay the full principal amount. The issuing entity also pays the investor a specified rate of interest for the bond. Bonds can be issued by public authorities or sold by private entities and come in a variety of different forms.

Municipal and Public Bonds – Bonds issued by state and local governments to finance transportation projects or other public works are known as municipal or public bonds. Interest income from public bonds is exempt from federal income taxes and often exempted from taxation by state and local governments. State and local governments issue several types of bonds. Examples include county and city street and highway improvement bonds.

Anticipation Notes – Anticipation notes are public securities issued when money is expected from a specific source. States can issue anticipation notes that can be paid off with future bond issues (bond anticipation notes) or through future tax revenue (tax anticipation notes). States also can use two federal tools – grant anticipation revenue vehicles and transit grant anticipation notes – to issue bonds for highway and transit projects that can be repaid with future aid grants from the federal government. Arizona has adopted a program allowing local communities to issue anticipation notes for transportation projects.

Revenue Bonds – Revenue bonds are public bonds issued to finance projects that generate revenue, such as toll roads or bridges or fares collected from transit projects. The revenue from the project is used to make principal and interest payments to bond holders. In Arizona, the STB has authority to issue revenue bonds for financing needed for transportation improvements throughout the state. Currently, the STB issues two types of revenue bonds: 1) Highway User Revenue Bonds secured by the SHF share of HURF revenues, and 2) Maricopa County Transportation Excise Tax Revenue Bonds secured by the freeways portion (56.2%)

and arterials portion (10.5%) of Proposition 400 monies approved by the Maricopa County voters in November 2004. The Regional Public Transportation Authority (Valley Metro) is authorized to issue bonds on the Proposition 400 monies (33.3%) deposited into the Public Transportation Fund.

Limited and Special Tax Bonds – Limited and special tax bonds are paid through proceeds from a special tax. Unlike a general obligation bond, where a state or local government can raise taxes indefinitely to repay the loan, limited or special tax bonds are tied to a particular tax levied for an express purpose. Often, voter approval may be required for the tax.

Private Activity Bonds – To provide the opportunity for new sources of investment capital to finance the U.S. transportation infrastructure system, the federal Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA – LU) expanded bonding authority for private activity bonds by adding highway facilities and surface freight transfer facilities to the list of activities eligible for tax-exempt facility bonds. These bonds are not subject to the general annual volume cap for private activity bonds for state agencies and other issuers but are subject to a separate national cap of \$15 billion.

In Arizona, the issuer of private activity bonds is generally an industrial development authority, which is sponsored by a county, city or town. Eligible transportation projects include airports, mass commuting facilities, parking facilities and public transportation infrastructure.

ALTERNATIVE FUNDING STRATEGIES

Public-Private Partnerships

Legislatures are turning to the private sector for assistance in improving efficiency and meeting the financial demands of maintaining and improving transportation systems. Transportation facilities represent an area where the private sector is willing to invest in projects in a variety of capacities. As many as 23 states, including Arizona, have statutes that enable the use of various transportation funding approaches involving private entities.

Advantages cited by the Federal Highway Administration (FHWA) include cost savings, cost predictability, reduced project completion time and greater private sector investment. By definition, public-private partnerships (PPPs) give to private entities varying degrees of responsibility for project management and completion. FHWA has estimated that PPPs can save as much 6 percent to 40 percent of the cost of construction and limit the potential for cost overruns.

According to NCSL, concerns about private involvement in transportation projects often include the following:

- existing or interpreted legal prohibitions, regulatory restrictions or procedural restrictions that amount to a lack of authority to engage in PPPs.
- institutional inertia or opposition by parties that fear change to traditional project delivery approaches.
- lack of dedicated revenues or innovative financing mechanisms to support projects.
- a lack of familiarity with the PPP process and allocation of risk.

Laws 2009, Chapter 141 authorized ADOT to enter into PPP agreements for the construction, financing, operation and maintenance of transportation projects throughout the state. ADOT is currently devising the criteria and process for PPP agreements.

State Infrastructure Banks

State infrastructure banks (SIBs) are state or multistate revolving loan funds that provide loans, credit assistance and enhancements, and other financial assistance for surface transportation projects. SIBs are established with initial seed capital from and are administered by states. Revenue from borrowers goes back to the SIB to help fund future projects.

In 2005, SAFETEA-LU established a new SIB program that allows all states, American Samoa, the Commonwealth of the Northern Mariana Islands, the District of Columbia, Guam, Puerto Rico and the Virgin Islands to capitalize SIBs with federal transportation funds authorized for federal FYs 2005-2009 using an 80-20 federal to nonfederal funds match. The

new law allows states to establish three different SIB accounts for highway, transit and rail projects and allows SIBs to provide loans and credit enhancement to both public and private entities for authorized projects.

Using the federal SIB laws, Arizona established the Highway Expansion and Extension Loan Program (HELP), which is a comprehensive loan and financial assistance program for eligible highway projects in Arizona. The HELP provides the state and communities in Arizona a financing mechanism to accelerate transportation construction projects. The HELP has provided approximately \$665 million in loans to accelerate highway construction projects. Currently, no new loans are being processed in order to allow for the recapitalization of the HELP through repayment of outstanding loans.

Board Funding Obligations

Laws 1999, First Regular Session, Chapter 189 authorized the STB to issue Board Funding Obligations (BFOs) through the Arizona State Treasurer's Office to help capitalize the HELP program and accelerate state highway projects. BFOs are statutorily capped at \$200 million and the State Treasurer is permitted to liquidate the BFOs if the state General Fund balance falls below \$200 million.

In FY 2008 and FY 2009, the state's budget situation forced the State Treasurer's Office to call all outstanding BFOs since the state General Fund balance fell below the \$200 million threshold. Laws 2009, Third Special Session, Chapter 7 allows the STB to sell BFOs to a financial institution in FY 2010 if they are unable to sell them to the State Treasurer. The principal amount may not exceed \$200 million. No BFOs were issued in FY 2010.

Laws 2005, First Regular Session, Chapter 150 provided for the reissuance of BFOs from FY 2006 through FY 2020 with the final maturity no later than FY 2024. The maximum outstanding is limited to \$200 million with a maximum maturity of four years. The BFO split is \$140 million for HELP and \$60 million for the SHF.

Congestion Pricing

This option charges motorists tolls for using congested roads during peak driving hours. Congestion pricing has more frequently been used as a behavior modification tool rather than a fundraising mechanism. There are concerns that congestion pricing could not generate sufficient funding to meet primary transportation funding needs.

Since February 2003, London, England, has charged a fee for driving private vehicles in the city's central area during weekdays as a traffic reduction and revenue generating mechanism. According to a Victoria Transport Policy Institute analysis, the policy has reduced traffic congestion, improved bus and taxi service and generated revenue. Since London's congestion pricing policy adoption, cities such as Singapore, Toronto and San Diego have implemented various manifestations of the strategy.

Facility Tolling

This option charges a toll user fee for a motorist's use of a transportation facility such as a limited access roadway or bridge. Collection of the toll can occur through toll booths, electronic tolling or other means. Toll rates vary depending on the purpose of the toll, and electronic tolling can eliminate congestion caused by traditional toll booths.

Public pressure, however, can make tolling politically difficult. Frequently cited criticisms include: some motorists and truck drivers are unfairly burdened by tolls; the public should not be forced to pay for a road that is already built; they disproportionately affect low-income motorists who can less afford to pay; and some view tolls as double taxation because motorists already pay motor fuel taxes.

High occupancy tolls (HOTs), used in California, Colorado and Virginia, allow single occupants of vehicles to access high occupancy vehicle facilities by paying a toll. HOT lanes

have the ability to shift traffic from free congested lanes to less congested tolled high-occupancy lanes. Currently, Arizona law only allows private tolls. Installing HOT lanes on an interstate or other public thoroughfare would require a statutory change and possibly the permission from the federal government if the project used federal funds.

• **ADDITIONAL RESOURCES** •

- Arizona Constitution, Article IX, Sections 11 and 14
- Arizona Department of Transportation (ADOT)
602.712.7355
<http://www.azdot.gov>
- Congressional Budget Office (CBO)
Congestion Pricing for Highways
<http://www.cbo.gov/doc.cfm?index=4197>
- Federal Highway Administration (FHWA)
Office of Innovative Program Delivery
Public-Private Partnerships
<http://www.fhwa.dot.gov/ipd/p3/index.htm>
- Highway Users Revenue Fund (HURF) Statutes: Arizona Revised Statutes, Title 28, Chapter 18
- Highway Expansion and Extension Loan Program (HELP) Statutes: Arizona Revised Statutes, Title 28, Chapter 21, Article 5
- Maricopa Association of Governments (MAG)
602-254-6300
<http://www.azmag.gov>
- National Conference of State Legislatures Report: Surface Transportation Funding Options for States
<http://www.ncsl.org/documents/transportation/surfacetranfundrept.pdf>
- Statewide Transportation Acceleration Needs (STAN) Account Statutes: Arizona Revised Statutes, Title 28, Chapter 20, Article 4