Recommendations of the Work Group for the Consideration of The Blue Ribbon Committee on Highway Finance

Overview

The Work Group considered those items brought forward by the two Subcommittees and by unanimous consent added Reissuance of the GARVEE Bonds for Interstate Reconstruction. This report is broken into four sections: Revenue Proposals, Recommended Studies, Recommended Legislation and Other Recommendations.

For each item in each section, the proposal is stated briefly, followed by a rationale. Work Group Action on that proposal is noted next. Where there was unanimous agreement on the proposal, it is noted. Where there was not, the majority opinion of the Work Group is noted followed by the issues that the full committee may wish to debate and decide.

For revenue items, revenue projections are made with assumptions clearly stated. Background information, if available, is included for the members' information.

Overarching Assumptions

For all revenue projections, unless otherwise noted, it is assumed that 70% of net revenues will go to AHTD, 15% to the counties and 15% to the cities.

All revenue projections are made assuming a 1.7% annual VMT growth over the coming decade, increased average fleet fuel efficiency of 2.8% per year over the same period, and gasoline and diesel prices based on the Moody's Econometrics projections.

Revenue Proposals

1. Index the Gas and Diesel Excise Tax

Proposal:
Index the existing gas and diesel excise taxes to the Construction Cost Index three-year trailing average using 2010 as the base year. The indexing should be an annual and automatic administrative function of the Department of Finance and Administration conducted as soon as practicable after the end of the fiscal year or calendar year, whichever is most advantageous. A cap of 2¢ per gallon per year should be set beyond which an automatic adjustment could not go. Also a hard floor should be set at the previous year's indexed rate so that the excise taxes cannot be automatically reduced by administrative action, but only be reduced by action of the General Assembly.

Rationale:
Indexing the motor fuel taxes is a way to protect the purchasing power of the main highway revenue base from erosion by construction cost inflation. This option provides elasticity to the base, utilizes the existing and highly efficient tax collection system, and is highway-user based. The Construction Cost Index is directly related to the costs of building and maintaining roadways in Arkansas, and the three-year trailing average smoothes the volatility of any sudden price moves due to international events or weather related disaster.

Work Group Action:
The Work Group unanimously recommended this revenue proposal.

Revenue Projections:

Revenue from Indexing the Gas and Diesel Excise Tax (in millions)

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue to AHTD	$293	$333	$357	$365	$367	$371	$376	$380	$384
Revenue to Cities	$ 63	$ 71	$ 76	$ 78	$ 79	$ 79	$ 81	$ 81	$ 82
Revenue to Counties	$ 63	$ 71	$ 76	$ 78	$ 79	$ 79	$ 81	$ 81	$ 82

Background Information:
See New Revenue Subcommittee *Policy Brief on Indexing* and the *Policy Brief on Adjustment Factors* for a discussion on projected construction cost inflation.

2. Levy a New Excise Tax on the Wholesale Price of Motor Fuels

Proposal:
Levy a new excise tax on the wholesale price of motor fuels as a method for raising new revenue over and above protecting the current tax base.

Rationale:
This option has most of the strengths of removing the sales tax exemption on motor fuels without the fatal flaws. It is a user fee. It provides a new revenue source with elasticity. It can be phased-in and has the potential to raise substantial revenue. It can be levied at the same point in the supply chain as the current excise tax on fuel volume, and it is expected the administrative and collection costs will be comparably low. Since it is levied at a uniform rate statewide, it avoids some of the locational disruptions that removing the sales tax exemption would cause, and it does not force oil retailers to make expensive and disruptive changes to their method of operation.

Work Group Action:
The Work Group endorsed this recommendation and for illustrative purposes assumed the tax would be phased in 1% per year up to the 6% of the state general sales tax beginning in state fiscal year 2012. The ultimate tax rate and the phase-in period are variables the General Assembly can adjust based economic and budgetary considerations.

Issue:
1. What is the position of the Arkansas Oil Marketers Association on this proposal?

Revenue Projections:

Revenue from New Excise Tax on Wholesale Price of Motor Fuels (in millions)

	2012	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Revenue to AHTD	$41	$82	$124	$169	$215	$262	$266	$270	$273
Revenue to Cities	$ 9	$ 18	$ 27	$ 36	$ 46	$ 56	$ 57	$ 58	$ 58
Revenue to Counties	$ 9	$ 18	$ 27	$ 36	$ 46	$ 56	$ 57	$ 58	$ 58

Background Information:
See New Revenue Committee *Policy Brief on Excise Tax on the Wholesale Price of*

Motor Fuel and the *Policy Brief on Removing the Sales Tax Exemption on Motor Fuels* as well as the *Policy Brief on Adjustment Factors* for a discussion on projected fuel prices.

Revenue projections are dependent upon the rate of excise tax levied and the timeframe over which it is phased in.

3. Transfer Retail Sales Tax on New and Used Cars, Tires, Batteries and Auto Parts and Services from the General Fund to a new Highway Trust Fund

Proposal:
Beginning the first day of September following the issuance of the Treasurer of the State's annual report in which the gross collection of general revenue for sales and use tax exceeds $2.2 billion, a ten-year phase-in of the sales and use tax estimated to represent auto related sales (tires, batteries, auto parts and services) and the actual sales and use tax on new and used motor vehicles, trailers or semi-trailers required to be licensed in this state, will begin.

Rationale:
Arkansas' highway system has traditionally been highway-user fee based. In 14 states, general sales taxes on new and used cars, tires and batteries and/or auto parts and services are considered highway-user related revenues and used to support the highway program. Arkansas has historically used those highway-user related taxes to support General Fund agencies while relying primarily on excise taxes on motor fuels and license fees to support its highway program.

The Revenue Transfer Subcommittee originally recommended transferring all of the general sales and use tax on these highway-related items in four equal increments. That recommendation was changed to ten equal increments with safety triggers to protect the General Fund agencies. Over the decade, General Revenues are projected to grow at a rate that should minimize or negate the impact on the General Fund left by the transfer.

The $2.2 billion trigger represents a slightly higher number than the high point in the gross general sales and use tax receipts that occurred in 2007. Rather than require retailers to keep differentiated tax reports for these sales, the estimated percent of gross sales tax revenue attributed to tires, batteries and auto parts and services is transferred to the highway fund phased over a ten-year period. The sales of motor vehicles and trailers are already recorded separately, therefore the actual tax receipts would be transferred in phases over ten years. Once triggered, the phased-in transfer could only be stopped or delayed by legislative action.

The trigger date under current conditions is expected to be FY13. To the extent the General Assembly reduces sales and use tax revenue by further reducing or removing the tax from groceries, the trigger date would be pushed further into the future.

Finally, as traditional user fees wane at an accelerating rate due to higher average fleet fuel efficiency in the future, more of the tax burden for maintaining roads will have to fall on taxing the vehicle through sales taxes and license fees.

Work Group Action:
The Working Group was supportive of the transfer provided that the triggers were sufficient to protect the General Fund agencies.

Issues:
1. Is the proposed trigger adequate to protect General Fund agencies?

2. Does the phase-in period give the General Fund time to recover from the loss of these revenues?

3. Should the legislation address the conditions (if any exist) under which the transfers are suspended or ended?

Revenue Projections:

Revenue projections are being updated by AHTD based on the percent of gross General Fund revenue assumed to be attributed to tires, batteries and auto parts and services.

Background Information:
See Revenue Transfer Subcommittee report.

4. A ten-year bond program funded with a one-half cent general sales tax ending when the bonds are paid off.

Proposal:
The 2011 General Assembly should refer a constitutional amendment to the voters at the 2012 general election that would (1) levy a one-half cent general sales tax for ten years and (2) authorize the issuance of general obligation bonds in five series to be retired from the proceeds of the ½¢ sales tax to fund a five-year construction program. The primary purpose of the construction program would be to build new state highway capacity on the Four-Lane Grid System – including capacity improvements on existing freeways. Fifteen percent of the sales tax revenue would go to cities and fifteen percent would go to counties for local roadway improvements and would not be bonded unless acted upon separately by individual cities and/or counties.

Rationale:
Like the GARVEE bonds, a bond issue is a way of expediting improvements to preempt projected construction cost increases. The statewide sales tax would allow investment in strategic connectors that highway-user fees alone might not be able to fund in a timely manner.

Work Group Action:
The following issues were identified:

(1) Legal Form – The only way for the proposal to be referred from the General Assembly to the public with both the sunsetting sales tax and the bond authorization in the same issue is through a constitutional amendment. Presenting these two actions in a single ballot issue prevents the approval of one with the other. This is the option preferred by the Work Group.

Other alternatives included an initiated act, a bond authorization election contingent on the subsequent levying of a ten-year sales tax, or the levying of a temporary ten-year ½¢ sales tax contingent on the subsequent authorizing bond election.

(2) Project List – The intent is to build a specific list of state roadway improvements with these revenues. Clearly the list would be developed by the Highway Commission but it was unclear how the list would be approved by the legislature and/or the public. Concern was expressed that, given the uncertainties in highway construction and in construction cost inflation, it may not be possible to deliver all of the promised projects with a tax that would sunset on a date certain. The relatively short five-year construction program serves to minimize that uncertainty.

(3) Sales Tax Equity – The New Revenue Sub-committee strongly opposed the use of the general sales tax to finance highway operations, preferring the traditional user fee. Does that objection apply to this proposal? It is noted that even some members

of the New Revenue Committee were willing to entertain an exception to that general rule in the case of a temporary tax voted on by the people.

(4) Restrictions on Local Government Uses of Funds – Since these revenues are from the sales tax and are not highway user fees, can local governments use the revenues for other transportation investments other than roads and streets, such as public transit?

The Work Group supported the recommendation.

Revenue Projections:

AHTD estimates the projected revenue will support a $1.794 billion construction program with bonds issued in five equal series beginning in 2012.

Revenue from the Levy of a ½cent General Sales Tax to fund a Bond Issuance to be sunset at the end of 10 years (in millions)

	2012	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
Revenue Dedicated to Bond Repayment	$157	$157	$157	$157	$157	$157	$157	$157	$157	$157
Additional Revenue to AHTD	$2	$2	$4	$4	$5	$6	$6	$7	$8	$8
Revenue to Cities	$ 34	$ 34	$ 34	$ 35	$ 35	$ 35	$ 35	$ 35	$ 35	$ 35
Revenue to Counties	$ 34	$ 34	$ 34	$ 35	$ 35	$ 35	$ 35	$ 35	$ 35	$ 35

Background Information:
See *Possible Options for Generating Additional Revenue for Highways, Roads and Streets*, June 16, 2010

5. Increase the State Aid to Counties program from 1¢ to 3¢ and Index to CCI-3.

Proposal:
By levying new excise taxes on motor fuel (volume), increase the State Aid to Counties program ½¢ per year until it equals 3¢ per gallon, at which point it would be indexed using the Construction Cost Index three-year trailing average to maintain its purchasing power.

Rationale:
The State Aid to Counties Program was begun in 1973 with a $9 million appropriation that has grown to a full 1¢ motor fuels tax generating approximately $20 million per year today. However, adjusted for inflation, the original appropriation would require 2.25¢ of motor fuel tax to retain the same purchasing power. There are currently 15,000 miles authorized for the County Aid sys stem, yet only 9,339 miles are currently designated due, in large part to the inadequate revenue available for it and the large amount of mileage not meeting the established criteria for the system.

Increasing the tax dedicated to the County Aid program would allow the program to recover lost purchasing power and to expand the participating mileage in the system to the authorization ceiling. Indexing it would protect its purchasing power in the future.

Work Group Action:
The Work Group was of different minds on the proposal with the majority favoring leaving the County Aid program unchanged and some still favoring some increase and indexing.

Issues:
(1) Leave the State Aid to County's program at 1¢ per gallon or increase to recoup lost purchasing power? If increase, to what level?

(2) Index or don't index.

Revenue Projections:
Projections are provided below for three alternatives – No Change, Current Rate Indexed, Increase Rate to 3¢/ gallon in ½¢ Increments Then Index.

Revenue to Counties from 3 State Aid Options (millions)

	2011	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
No Change	$19.07	$19.10	$19.11	$19.11	$19.09	$19.06	$19.00	$18.92	$18.82	$18.66
Current Rate Indexed	$19.07	$19.82	$22.50	$24.07	$24.59	$24.75	$25.01	$25.34	$25.65	$25.89
Increase Rate, Indexed	$19.07	$28.65	$38.22	$47.78	$57.27	$57.18	$57.00	$58.65	$58.34	$57.85

Background Information:
State Aid Program for Counties, AHTD powerpoint presentation.

6. Create a new State Aid to Cities program

Proposal:
Create a new State Aid to Cities program commensurate with the State to Counties program funded by increasing the current motor fuels excise tax by 1¢ per gallon.

Rationale:
The objective is to rebalance the current funding division to the historically accepted 70/15/15. As it is currently, the State Aid to Counties program is counted in the state 70% but only flows through AHTD to the counties.

The proposed new program would focus on non-freeway state highways within incorporated municipalities that are serving as urban arterials. If the State Aid to Counties program is increased as proposed, the State Aid to Cities program would start at one and one-half cents per gallon of motor fuel excise tax increase to 3¢ in half cent increments and be indexed to the Construction Cost Index three-year trailing average thereafter. If the State Aid to Counties remains at 1¢ per gallon, the State Aid to Cities program would likewise be funded at 1¢/gallon.

Work Group Action:
The Work Group was in favor of creating a new State Aid to Cities program equal to the County Aid program. There was also general agreement that it should be funded with new revenues rather than coming from the AHTD portion of existing revenues. There was not agreement that it should grow beyond 1¢, nor agreement that it should be indexed.

The question of program structure was raised. Since there are considerably more cities than counties, a direct allocation to each city seems unworkable. A suggestion was made to allocate the revenue by county based on the number of state highway lane miles in incorporated cities in each county, but no final recommendation on program structure was made.

Issues:
(1) Should the existing excise tax be increased 1¢ (or more) to create the City Aid program or should it be created at roughly equal to the County Aid program out of new revenues flowing from previously identified new revenue sources?

(2) What should the program structure be?

(3) If indexing is adopted, should the City Aid program grow as the indexed rate grows?

Revenue Projections:

Revenue to Counties from 3 State Aid Options (millions)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
No Change		$19.10	$19.11	$19.11	$19.09	$19.06	$19.00	$18.92	$18.82	$18.66
Current Rate Indexed		$19.82	$22.50	$24.07	$24.59	$24.75	$25.01	$25.34	$25.65	$25.89
Increase Rate, Indexed		$28.65	$38.22	$47.78	$57.27	$57.18	$57.00	$58.65	$58.34	$57.85

Recommended Studies

1. Heavy Truck Study

Proposal:
When the FHWA cost allocation study is published, the Arkansas State Highway and Transportation Department, in consultation with the Arkansas Trucking Association, analyze diesel taxes and license fees for heavy trucks using Arkansas roads against the methods and standards put forth in the national study to determine if those trucks are fairly compensating the state for the damage they are estimated to be doing. AHTD should then recommend any corrective measures and tax or fee adjustments over and above those otherwise recommended in this report to the General Assembly.

Rationale:
The preferred method for determining the cost of the damage heavy trucks do to the public highways is a cost allocation study. Arkansas has never conducted a state specific cost allocation study, but a new national cost allocation study was due from the Federal Highway Administration this year but has not been released by the time the Blue Ribbon Committee completed its work. Consequently, it has been impossible to independently determine whether Arkansas is being adequately compensated for the damage that heavy trucks do to our roadways.

The committee believes that it is important that the industry and the custodian of the public's roads agree upon a fair and impartial method for accurately determining the answer to this question.

Work Group Action:
The Work Group was informed that AHTD could conduct this analysis and endorsed the recommendation.

Background Material:
See the New Revenue Subcommittee *Policy Brief on Equitable Share for Heavy Trucks.*

2. Vehicle Registration and License Fees Study

Proposal:
The Department of Finance and Administration should be instructed by the General Assembly to conduct a study on modernizing and simplifying Arkansas' license fee classification system. The study should also recommend a method of gradually raising Arkansas' light duty vehicle license fees to the regional average. Finally, the study should coordinate with the Heavy Truck Study which could be conducted by AHTD to recommend adjustments in license fees for heavy trucks.

Rationale:
Vehicle registration fees comprise nearly 20% of the revenue to AHTD yet trail the national and regional averages by considerable amounts. Arkansas' system of charging for registering motor vehicles and issuing license fees has grown more complex over the years and could benefit from simplification. In several instances, the same type of vehicle is charged different fees based on its use rather than its damage to the roadways, a situation that should be corrected. Because of the complexity of this structure, a definitive revenue projection could not be made.

Work Group Action:
The Working Group endorsed this recommendation.

Background Material.
See the New Revenue Committee *Policy Brief on Vehicle Registration Fees*.

3. State Highway System Reduction Study

Proposal:
It is recommended that AHTD conduct a study to identify those current and planned new state highway routes that meet defined state strategic objectives. A target cap on state mileage should be proposed by the study that would reduce the state highway mileage strategic core.

The AHTD System Reduction Study should identify the specific roadways recommended to be transferred to city and county governments, the cost required to improve those roadways to a state of good repair prior to transfer, legal issues that may be raised by the transfer, and the amount of funds necessary to be provided the individual receiving jurisdictions in order to adequately maintain the roads over time. Because of their long design life and high costs, bridges on routes proposed to be transferred may need special consideration, which should be addressed in the study. The study should also consider whether and under what circumstances a local jurisdiction might refuse to accept a road proposed for transfer.

The study should specifically consider urban arterial mileage and low volume rural state highways that could be gradually transferred to the appropriate cities and counties over the period of a decade. Roadways that met the criteria would be included in the State Aid System that would be expanded to include urban arterial roadways. The roadways should be assumed to be in a state of good repair when transferred and the costs for that should be included in the study.

Rationale:
The purpose of the state highway network is to connect the state – both destinations within the state and the state with the nation. It is not to move people around within those destinations. However, the gradual accretion of old state highways within cities that now function as urban arterial roadways and low volume rural highways burden the state highway system to such a degree that it does not have the resources to make needed strategic investments.

Shrinking the state highway system to its strategic core will require a commensurate investment in local road systems to make any transfer a win-win proposition between AHTD and local governments.

Work Group Action:
The Work Group endorsed the recommendation.

Background Information:
See the *Discussion Paper On Proposals For Reform Of The Public Road Systems In Arkansas.*

4. Pavement Condition Assessment of Local Roadways Study

Proposal:
The General Assembly should commission a professional pavement assessment of all public roads in Arkansas owned and maintained by cities and counties for the purpose of establishing a factual baseline for system preservation needs for local governments.

The initial study should be conducted by private consultants as expeditiously as possible, ideally within a two year period. It is estimated that such an effort would cost $8-10 million over that period. Thereafter, every five years, each local government in the state should conduct a professional and comprehensive condition assessment of all of its roadways and bridges according to standards set by the Arkansas State Highway and Transportation Department in consultation with the Arkansas Municipal League and the Arkansas Association of Counties.

An analysis of the initial assessment should be prepared that clearly spells out the system preservation needs for each local government jurisdiction in the state. Subsequent assessments can be phased over a three to five year cycle. The results should be reported to the citizens of each jurisdiction and to the General Assembly. They can be conducted by properly trained local government staff, consultants or by AHTD under contract (noting that the Department would require additional staff to do so). Training programs at the Arkansas Municipal League and the Arkansas Association of Counties should be established to train local public works officials in the productive use of asset management information in order to reduce the long-term cost to the public.

Rationale:
Unlike the state highway system, there is no reliable and comprehensive data on the needs of cities and counties for either the preservation of their existing roadway systems or the demands for new capacity. Without a measure of need, it is impossible to define an "adequate" financing system.

The fact is that no one knows for sure because there is no requirement that cities and counties routinely assess the condition of their roadways based on accepted professional standards, and it is not general practice among local governments in Arkansas. In far too many instances, local governments are driven to a maintenance policy of "maintain on failure, fix the worst first and wait until next year for the rest". This is the most expensive way to deal with the public's capital assets.

Work Group Action:
While the Work Group thought it was necessary and beneficial to gather a uniform data base of pavement conditions for local governments if the charge of the legislation to identify equitable and sustainable financing mechanisms was to be

met, there was substantial doubt that (a) it was possible to gather or (b) it was affordable. There was also a feeling that the needs would be so overwhelming and impossible to meet that the information would be all but useless. Finally, there was concern that the cost of providing the data in the proposed two years was excessive.

With those concerns expressed, the Work Group accepted the recommendation.

Issues:
1. AHTD would need additional staff if they undertook the additional responsibilities suggested above.

Other Recommendations

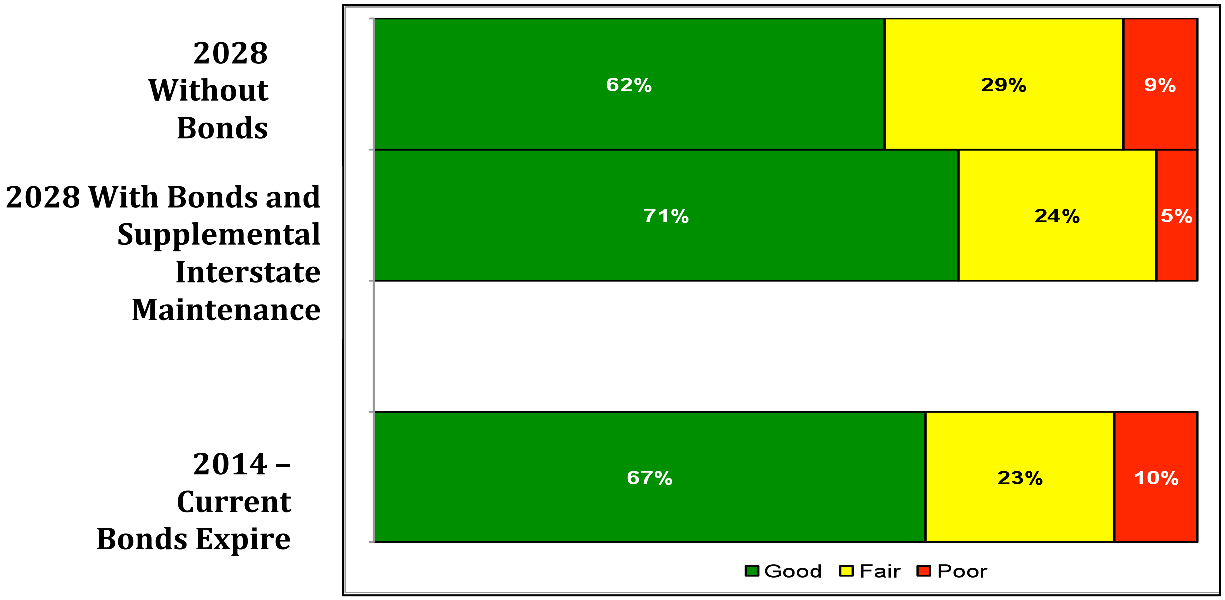
1. Reauthorize GARVEE Bonds for Interstate Reconstruction

Proposal:
Act 511 of 2007, the "Arkansas Interstate Highway Financing Act of 2007" provided the mechanism to allow the Department to reissue bonds for Interstate rehabilitation. Act 153 of 2009 extended the time period for the issuance of the bonds. The maximum amount of bonds that can be reissued remains at $575 million (similar to the 1999 program). The last series of bonds must be reissued by December 31, 2015 and the proposed bond program must be passed by a vote of the people.

It is recommended that the proposed Interstate Rehabilitation Bond program be forwarded to a vote of the people as soon as practicable.

Rationale:
As a financing tool, issuing bonds would allow for accelerated improvements. This would also serve as a hedge against anticipated cost inflation by making improvements now. Reissuance of the bonds would not require any additional taxes or fees as they will continue to be funded by the Federal-aid Interstate Maintenance funds and the existing diesel tax revenues approved in 1999.

Conversely, if further improvements cannot be made to the Interstate System with these bond proceeds, funds that are currently being used to improve other highways may have to be redirected to the Interstates. The chart below shows the forecast condition of the Interstate System in 2014 (the year the existing bonds will be retired), in 2008 without a new bond issue, and in 2028 with a new bond issue.



Work Group Action:
The Working Group unanimously endorsed this recommendation.

Revenue Forecast:
It is estimated that $575 million in bonds, coupled with additional available Federal-aid Interstate Maintenance funds and state match, would generate a $998.6 million construction program. This does not represent new revenues, but is a valuable tool for managing the revenues and innovative financing tools that are available to us.

Background Information:
In the 1999 Interstate Reconstruction Program (IRP), the AHTD issued $575 million in bonds. Using this bond revenue in addition to other revenue sources allowed over 50% (356 miles) of the Interstate System in Arkansas to be improved with a total cost of $1.6 billion. Upon completion of the 1999 IRP, Arkansas' Interstates went from being some of the worst roads in the country to some of the best. Needs on the Interstate System still exist and are continuing to increase.

At the time of the first bond issuance letting, Arkansas had 542 miles of Interstate Highways. Since that time the Department has added 114 miles to the system bringing the total mileage to 656 miles. The two routes that were added are Interstate 530 (formerly Highway 65 from Interstate 30 to Pine Bluff) and Interstate 540 from Interstate 40 to northwest Arkansas.

When Interstate 530 was added to the system, 10.6 miles were considered poor and 25.3 miles were considered fair. Likewise, of the 67 miles of

Interstate 540 that were added to the system, 7.35 miles were in poor condition by 2010.

2. Vehicle Miles Traveled Tax

The VMT tax is not recommended for consideration at this time because of uncertainties over collection methods and technologies, privacy issues and absence of federal standards. However, it is the consensus of opinion in the transportation profession and among the committee that because of shifts to hybrid, electric and alternative fueled vehicles in the future, a direct mileage charge for the light duty fleet will be necessary to maintain the transportation system. Average fleet fuel efficiency is projected to accelerate rapidly after 2020 and a national policy on VMT taxes is expected prior to that time.

From a long-term revenue perspective, it is recommended that AHTD begin planning for transitioning to a VMT tax by 2020 in order to be prepared to move quickly once national standards are established. Absent federal preparation for a VMT tax, the committee recommends that AHTD work with the Texas DOT and other states that are actively working on VMT tax standards independent of federal action.

Work Group Action:

The Work Group endorsed this recommendation.

3. Public Private Partnership/Tolling

Based on extensive analysis by AHTD, tolling existing and certain proposed new roadways is not currently viable. It is noted that future changes in federal policy regarding tolling existing freeways could make tolling a useful tool for some improvements to major facilities. Tolling and the use of public private partnerships to finance improvements should be regularly assessed by AHTD as to their usefulness as a partial funding mechanism for appropriate projects, including major roadways on new location and capacity additions to existing freeways.

Work Group Action:

The Work Group endorsed this recommendation.