Oregon
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TO: Senate Interim Committee on Business, Transportation and Economic Development

FROM: Matthew L. Garrett, ODOT Director
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SUBJECT: ODOT's Funding Picture and Implications for the Transportation System

Introduction

Over the last decade, the Oregon Legislature and Congress have provided record levels of funding for transportation programs, allowing a significant surge of investment in all transportation modes. However, due to a variety of factors ODOT is now facing significant long-term funding challenges. ODOT's construction program has started to drop off. By 2015 the program will be cut in half from current levels—at a level below where it was before the legislature passed the first Oregon Transportation Investment Act (OTIA) program.

ODOT's funding challenges will have a number of important impacts on the state. With our construction program dropping precipitously, we are developing new strategies to slow the deterioration of the highway system as best we can. We are also working to right-size the agency's staff, reducing our headcount by five percent by 2015 as one action to better align expenditures to revenue; the bulk of these reductions will fall on ODOT's project delivery arm, which will shrink by about 30 percent as the construction program shrinks. We will seek efficiencies and reduce services while minimizing the impact on the safety of the traveling public and the state's economic health.

Funding Challenges

There are a number of factors that contribute to ODOT's long-term funding challenges.

Debt service: The Oregon Transportation Investment Act (OTIA) and Jobs and Transportation Act (JTA) programs frontloaded resources, authorizing $2.9 billion in bond proceeds that allowed ODOT to build projects much faster than under a "pay-as-you-go" funding approach. However, bonding billions of dollars requires paying significant debt service. By 2015 when all the JTA bonds are sold, ODOT expects to pay over $210 million a year out of the State Highway Fund for debt service. The vast majority of the additional revenue ODOT received from the OTIA and JTA programs will go to debt service or to other purposes specified by the legislature.

Falling State Highway Fund revenue: The State Highway Fund has also seen a significant decline in revenue. Future revenues would have dropped off significantly had it not been for the Jobs and Transportation Act. ODOT's December 2008 forecast projected bringing in $7.4 billion in gross State Highway Fund revenue from 2008 through 2015; the latest revenue projection shows that without the Jobs and Transportation Act, the State Highway Fund would only bring in $6.9 billion—meaning half a billion dollars (about seven percent) of expected revenues over this period evaporated due to the economic downturn and reduced driving in the face of high gas prices. Luckily, the JTA more than offset the loss of projected revenue.

However, since most of ODOT's share of JTA resources was bonded or otherwise committed by the legislature, ODOT will not have any significant non-dedicated resources in the long-term compared to its original projections from 2008.

Growing agency operations costs: Most of the costs of operating ODOT—particularly the costs of basic highway maintenance as well as most of the agency's personnel costs—can only be covered by State Highway Fund resources; federal funds generally have to be spent on capital construction projects. Even with a workforce that isn't growing, agency operations costs have grown faster than revenue, largely because of higher health care and PERS costs. Agency expenses are now higher than the State Highway Fund resources available to pay for them. Because ODOT's project delivery program will be smaller, we won't need as many project delivery staff.

ODOT's State Highway Fund resources are now essentially fully committed to debt service, the costs of running the agency, and maintaining highways, leaving virtually no state funding for new capital projects in the Statewide Transportation Improvement Program (STIP) (other than the JTA projects and matching funds for federal resources). That leaves federal funding as the exclusive funding source for construction projects. However, there are significant fiscal challenges facing the federal Highway Trust Fund.

Federal funding at risk: The federal surface transportation program invests well over half a billion dollars in Oregon highway and transit projects each year. However, because the federal fuels tax has not been raised since 1993, the funding level for the federal highway and transit programs is about $15 billion more per year than the Highway Trust Fund is taking in.

When the Trust Fund's balances are exhausted sometime in 2012 or 2013, Congress will be forced to either find additional revenue or cut funding for highway and transit projects significantly. Given the current fiscal and political situation, transferring additional general fund resources into the Highway Trust Fund (which has already been done three times totaling nearly $35 billion) could be difficult, and increasing the fuels tax in the face of high gas prices is not considered particularly feasible.

If Congress does not find additional resources for the transportation program, highway program funding will have to be cut by about one third, and transit program funding will have to be cut by about 40 percent. This would result in Oregon's annual federal highway program funding falling $150-175 million.

ODOT saw the Highway Trust Fund's fiscal situation looming on the horizon when the 2010-2013 STIP was being developed, so we assumed a reduction of about 20 percent in federal highway formula funding and downsized the STIP. Funding for the Bridge and Preservation programs have been cut, and the Modernization program has been reduced to the minimum required under state law. In 2014-15, ODOT will have no additional funding for Modernization projects. However, if Congress finds no additional resources for the Highway Trust Fund and is forced to impose a full one-third cut, ODOT will need to cut the STIP by another $70 million per year, forcing projects already in the STIP to be eliminated or delayed.

Construction cost increases: Over the last decade, construction costs have surged, with costs increasing 120 percent—more than doubling—from 2001 (when the first OTIA package was passed) through 2008. While construction costs have decreased since the onset of the recession, in 2010 costs remained nearly 70 percent higher than they were in 2001. As a result, each dollar ODOT spends buys much less construction activity than it did a decade ago. When adjusted for cost increases, ODOT's construction program will be much smaller by 2015 than it was in 2001, with fewer bridges repaired and replaced, less paving taking place, and few projects funded that will improve the system.

Fuel efficient vehicles: Lest you think things will get better in the future when the economy recovers, consider the future of the transportation system's main funding source: the gas tax.

The gas tax provides about 45 percent of the State Highway Fund's ongoing revenues, and the federal gas tax provides a significant majority of the resources flowing into the federal Highway Trust Fund. However, gas tax receipts have been flat or declining for half a decade, and this may be a continuing trend. Nationwide gasoline use peaked in 2006—before the recession and high gas prices reduced driving—and many experts project it will stay flat into the future as fuel efficiency increases and non-gasoline vehicles gain market share.

Fuel efficiency of new cars has increased by 16 percent since 2004. That was before the federal government increased the Corporate Average Fuel Economy standards in 2009 and again this summer. Fuel efficiency standards for new vehicles are now scheduled to rise to 54.5 mpg by 2025, at which point the gas tax will no longer be a viable funding source.

Lack of adequate and dedicated funding for non-highway modes: Bicycle/pedestrian spending is at a record level, and a significant amount of state and federal money is going into public transportation. Port and rail projects are seeing significant investments, due in part to investments in *Connect*Oregon.

However, because of limits on the use of the State Highway Fund and federal transportation resources, these investments have been episodic, and Oregon has no way to sustain these investments in the long-term. There is no adequate, long-term, dedicated source of funding for non-highway modes, and most of the funding sources ODOT has used are shrinking. For example, *Connect*Oregon has been constrained by the state budget situation, and non-highway modes are highly reliant on federal funds that are at significant risk of being cut.

<u>Implications to ODOT and the Transportation System</u>

Faced with these funding challenges, ODOT will be focusing on its base mission of maintaining and preserving the highway system, investing scarce resources strategically to minimize the deterioration of the system. We're also taking steps to deliver services more efficiently, including realigning and consolidating facilities.

Right-Sizing ODOT

With revenue falling off and much of ODOT's State Highway Fund revenue going to debt service on bonds, we no longer have adequate Highway Fund revenue to pay for all of our employees. To help bring expenses back into line with revenues, I have put forward a plan to reduce the agency's workforce by two percent in 2013 and by five percent by 2015 to match our funding levels. This equates to about 225 positions throughout the agency. To ease the down-sizing, staff reductions will be done through attrition, with plans in place to eliminate positions as they are voluntarily vacated. Each division administrator within ODOT has put together a plan to reduce expenditures and their workforce to manage reductions as vacancies occur.

Because ODOT's first priority must be to operate and maintain our highways to protect the safety of the traveling public, we work to minimize the impact of right-sizing on our maintenance forces; much of our effort to reduce maintenance costs will come through efficiencies that allow us to eliminate equipment and facilities. The brunt of the reductions will fall on our project delivery arm, which oversees the design and construction of projects. With ODOT's construction program expected to fall significantly, ODOT's project delivery arm will see its size reduced by 150-200 positions—a reduction of about 30 percent, corresponding with the reduction in the size of our construction program.

New strategies to slow deterioration of highways

With the significant state and federal investments of recent years, Oregon's highway system is in pretty good shape. However, with expectations for reduced funding now and into the foreseeable future, the highway system is expected to deteriorate. Arresting this deterioration will require new strategies to ensure that scarce resources are invested as effectively as possible.

Bridges

The $1.3 billion OTIA III program strategically addressed bridge needs on freight routes that are key to Oregon's economy but left billions of dollars of additional bridge needs unmet. What's more, the OTIA III State Bridge Program was a one-time infusion of bonded funding and did not provide long-term sustainable funding to preserve and replace bridges. Now that the surge of investments under OTIA III is winding down, funding for bridge repair and replacement has fallen, and bridge conditions will significantly deteriorate over the next several decades.

About half of the OTIA III State Bridge Program was paid for with new revenue. The remainder came from a portion of the funding that would have gone into the STIP's Bridge Program. About $25 million a year from the Bridge Program has now been dedicated to repaying the OTIA III bonds, and federal bridge funding is at significant risk of being cut. As a result, bridge program funding levels for 2012-15 are the lowest since the mid-1990s, dropping from $90 million in 2009 to about $55 million by 2015.

The largest portion of state highway bridges were built prior to 1970, particularly during the Interstate era of the 1950s and 1960s. As a result, between 2030 and 2060 ODOT will be hit by a massive wave of bridges that will reach the end of their design life and will require replacement or substantial repair. In the 2030s and 2040s, ODOT will need $5-6 billion per decade to deal with this wave of replacements and repairs—about 10 times the amount currently being invested. At current funding levels, by 2050 only 25 percent of state highway bridges will be non-distressed. Even at higher funding levels, the portion of distressed bridges on the state highway system will jump significantly.

Recognizing that we are unlikely to have the funding to meet all bridge needs, ODOT is exploring cost-effective bridge preservation strategies that will hold high priority parts of the system together as best we can. These strategies include:

- Giving priority to maintaining the highest priority freight corridors to ensure efficient movement of goods.
- Investing in high value coastal, historic and major river crossings by protecting them to extend their lifespan before replacement becomes necessary.
- Developing a bridge preventive maintenance program to extend the service life of decks and other components.
- Using practical design strategies to narrow the scope of bridge projects and fund only basic bridge rehabilitations and rare replacements with bridge funds.

Pavement Conditions

Though little of the state highway system's pavement is in poor condition today, much is on the cusp of falling into poor condition. Consequently, the gap between pavement needs and available funding will cause pavement conditions to significantly deteriorate over the next decade. The possible reduction in federal funds will reduce the amount of paving ODOT can do each year, and inflation has significantly reduced purchasing power.

Overall, pavement conditions are currently at 86 percent fair or better condition is eight points above ODOT's Key Performance Measure target (78 percent). To sustain these current conditions in the long run would require paving 780 lane miles each year. Hitting ODOT's performance target for pavement conditions would require paving 690 lane miles each year—an interval of 15-20 years between resurfacing. However, funding levels for ODOT's Pavement Preservation Program for 2012-2015 are lower than they have been since the 1990s, allowing for paving just 355 miles per year—a 47-year resurfacing interval. Under current funding levels, by 2019, the portion of Oregon's Interstate highways with pavement rated fair or better is projected to slip from 97 percent to 74 percent.

Unfortunately, these deteriorating conditions could cost the state more in the long run. With pavement, the old adage about an "ounce of prevention being worth a pound of cure" definitely applies. Neglected pavement that has deteriorated to poor condition usually requires expensive reconstruction. ODOT estimates that it costs eight- to 12-times as much to reconstruct pavement in poor condition as it does to do preventive maintenance or minor rehabilitation on pavement while it is still in good condition.

Given these realities, ODOT is implementing a number of pavement strategies.

- Focus a larger share of pavement spending on the Interstate, where deteriorating conditions will have a greater impact.

- Implement more low-cost paving only and chip-seal-type treatments.
- Focus preservation dollars on pavements only.
- Look at adding statewide highways under 5000 daily vehicles to the low-volume roads program.

ODOT is hopeful that these strategies will help arrest some of the deterioration, particularly on the Interstate. Under our new strategy, Interstate pavement conditions would stay above 85 percent fair or better through 2019.

Conclusion

Transportation investments made by the Oregon Legislature and Congress have paid off with a stronger transportation system that can more safely and efficiently move people and freight. However, long-term funding challenges will leave ODOT struggling to preserve and improve the transportation system, requiring us to right-size the agency and develop new strategies to slow the deterioration of our highways.

Attachment: ODOT Capital Program graphic

ODOT Capital Program