STATE TRANSPORTATION BONDING AND BUILD MICHIGAN III

"IS THIS THE END OF 'PAY-AS-YOU-GO' TRANSPORTATION FINANCING?"

by

Craig Thiel
Fiscal Analyst

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THE SENATE FISCAL AGENCY

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Gary S. Olson, Director
Senate Fiscal Agency
P.O. Box 30036
Lansing, Michigan 48909-7536
Telephone (517) 373-2767; TDD (517) 373-0543
Internet Home Page http://www.senate.state.mi.us/sfa/

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TABLE OF CONTENTS

INTRODUCTION

The State of Michigan began its "Build Michigan" transportation campaign in 1992. At the time, Build Michigan was promoted as a mechanism to begin new construction projects while delaying transportation tax increases. It was believed that long-term borrowing was preferable to raising taxes in a struggling economy and that bond proceeds would provide sufficient transportation revenues until the economy could support a permanent revenue increase. A 1992 overview of the program stated: "By the time additional funds are required in 1995, the economy, stimulated by Build Michigan, will be better able to support an increase in revenue to continue the program."[1] Taking advantage of low interest rates, the State Transportation Commission issued approximately $200 million in bonds for State road and bridge projects, $30 million in bonds for local critical bridge projects, and $35 million in bonds for public transit. The State also refinanced approximately $200 million in higher rate bonds to realize savings in future debt service payments.

The second phase of Governor Engler's Build Michigan plan was signed into law in the summer of 1997 and included a permanent transportation revenue increase. Buoyed by a strong economy and considerable political support, the transportation-funding portion of the Build Michigan II program raised the gasoline tax, commercial truck registration fees, and fees on overweight trucks. The final version of the Build Michigan II program also included supplemental appropriations for State and local road and bridge repair and some administrative changes related to the use of the Michigan Transportation Fund. The transportation funding increases associated with Build Michigan II benefitted both the State and local road agencies. In total, Build Michigan II generated approximately $236 million in new transportation revenues annually.

During the 2000 State of the State address on January 19, 2000, Governor Engler announced the third phase of his transportation infrastructure package, Build Michigan III. At that time, the program was described as a $1 billion investment plan over five years for State and local road projects. The plan, as originally described, included a one-time $100 million General Fund/General Purpose appropriation and $900 million in bond proceeds and would be linked to passage of the Public Act (PA) 51 of 1951 "reform package", which would include recommendations from the Transportation Funding Study Committee. In the end, many of the original components of the "reform package" were removed and the only substantive change was the elimination of the PA 51 formula sunset. Similarly, the size and financing components of the Build Michigan III program also were modified substantially from their original design.

A major component of Governor Engler's Build Michigan III program relies on the use of long-term borrowing to meet transportation infrastructure needs. At this time, it is estimated that Build Michigan III will include $800 million in bond proceeds to finance State and local road projects. By using bonding as a financing tool, the State can realize a sizable short-term increase in transportation revenue without having to raise transportation user-related taxes. The significant revenue generated from the issuance of long-term debt can be used to finance new projects and/or expedite existing construction. Bonding recognizes that transportation user-related taxes are insufficient to meet annual transportation needs. Bonding also allows the State to take advantage of current favorable interest rates, its relatively low debt-to-revenue ratio, and its excellent bond ratings. This article provides an overview of State Trunkline Fund bonding in the

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[1] Build Michigan. Governor John Engler's Vision for the Future of Michigan's Transportation System, February 1992.

context of the Build Michigan III program.

TRANSPORTATION BONDING

Article IX, Section 9 of Michigan's Constitution authorizes the Legislature to provide for long-term transportation-related borrowing. Unlike general obligation bonds, which are supported by State General Fund/General Purpose revenues and backed by the full faith and credit of the State, transportation bonds are considered revenue-dedicated bonds. State transportation debt requires repayment from constitutionally dedicated transportation revenues (e.g., fuel taxes and vehicle registration taxes).

Section 18b of Public Act 51 of 1951 authorizes the State Transportation Commission to issue State Trunkline Fund bonds.[2] The amount of State Trunkline Fund bonding is limited by the amount of constitutionally dedicated revenue available for debt service payments.[3] Specifically, State statute limits debt service payments to 50% of the total amount of money received from taxes constitutionally dedicated for transportation purposes and deposited into the State Trunkline Fund (STF) in the preceding fiscal year. As a matter of practice, the Michigan Department of Transportation's (MDOT's) *Bonding Guidelines* require a ratio of restricted revenue to annual debt service of at least four to one. In fiscal year (FY) 1998-99, $730.4 million in constitutionally dedicated revenue was deposited in the STF. Therefore, debt service payments could total $365.2 million in FY 1999-2000. Total STF debt service payments are estimated at $57.7 million for FY 1999-2000, well below the ceiling allowed under PA 51.

Table 1 shows the amount of constitutionally dedicated revenue deposited in the State Trunkline Fund and the associated debt service requirements for STF bonds over the past 10 fiscal years. During this time, debt service payments as a percentage of dedicated revenue, have ranged from a high of 11.8% in FY 1995-96 to a low of 7.2% in 1992-93. Relative to the statutory debt service ceiling provided in PA 51 (50% of dedicated revenue), debt service as a percentage of revenue has been very low during this period. Similarly, the revenue-to-debt ratio over the past 10 years has been well above MDOT's four-to-one factor. In fact, the revenue-to-debt ratio decreased from 14 to one in FY 1989-90 to 13 to one in FY 1998-99.

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[2] Section 18b also authorizes bonding for public transportation purposes (Comprehensive Transportation Fund bonds).

[3] The limit on State Trunkline Fund bonding applies to bonds issued for Economic Development Fund, State Trunkline Fund, Critical Bridge, and Blue Water Bridge purposes.

Table 1

State Trunkline Fund Constitutionally Dedicated Revenue and Debt Service
FY 1989-90 to FY 1998-99
(in millions)

Fiscal Year Ending September 30

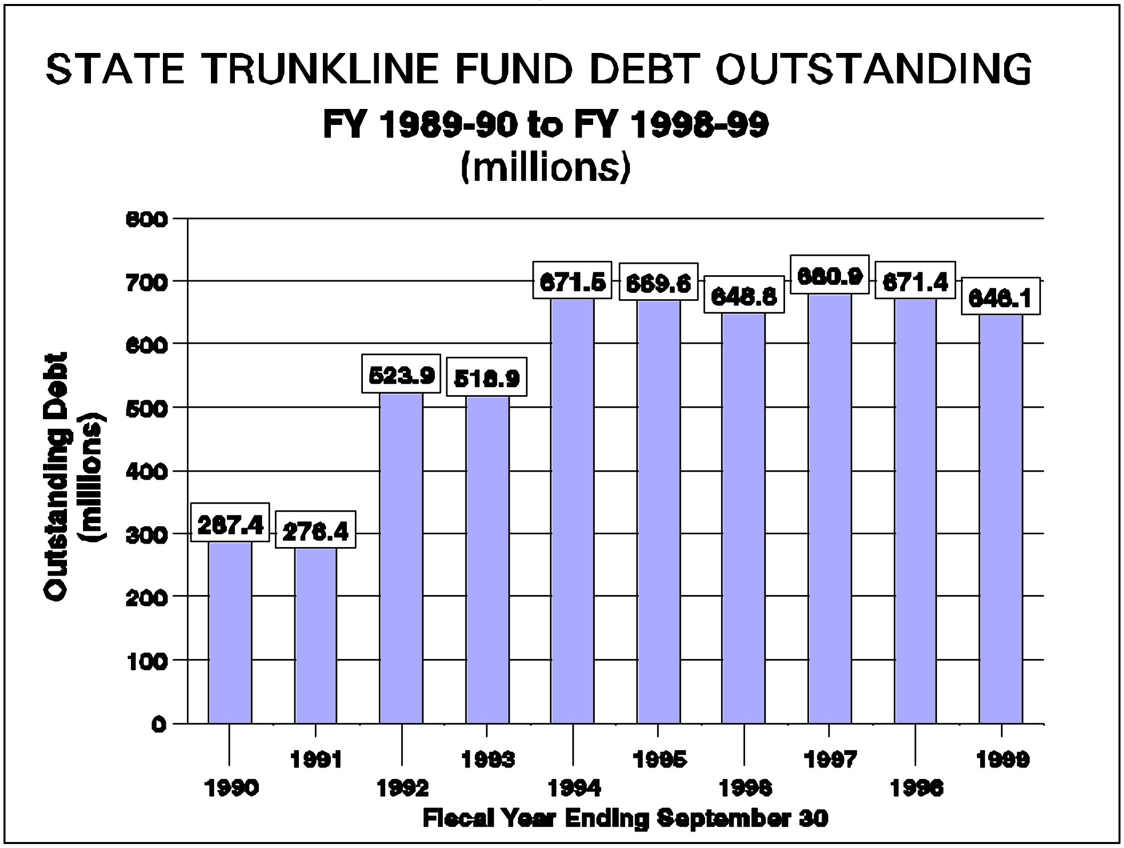
	1990	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**
Dedicated Revenue to STF	$398.4	$398.1	$409.2	$442.5	$464.8	$481.7	$492.5	$529.1	$699.9	$730.4
Debt Service	29.6	31.8	29.4	31.9	34.5	42.5	58.2	59.7	61.4	57.8
Debt Service as a % of Revenue	7.4%	8.0%	7.2%	7.2%	7.4%	8.8%	11.8%	11.3%	8.8%	7.9%
Revenue to Debt Service Ratio	14 to 1	13 to 1	14 to 1	14 to 1	14 to 1	11 to 1	9 to 1	9 to 1	11 to 1	13 to 1

Source: State of Michigan Comprehensive Annual Financial Report

The amount of State Trunkline Fund debt outstanding has more than doubled over the last 10 years, indicating an increase in the use bonding to finance State transportation projects in Michigan. During the same period, however, the amount of dedicated revenue to service the debt has grown by 83%, indicating an increased ability to support additional debt. Figure 1 illustrates STF debt outstanding since FY 1989-90. As of September 30, 1999, there was $646.1 million in outstanding STF debt.

The marked increase from 1991 to 1992 shown in Figure 1 is primarily the result of $253.6 million in new and refunding bonds associated with the first phase of the Build Michigan program. Then, in 1994, the State issued $150.0 million in new bonds for capital preventive maintenance projects and to match Federal aid. In 1996, the State issued $54.5 million in new bonds for the completion of the Blue Water Bridge ($35.0 million) and for certain advance right-of-way purchases ($19.5 million). Outstanding debt has remained relatively constant since FY 1993-94. Table 2 summarizes the State Trunkline Fund bonds (new and refunding bonds) issued since 1989.

Figure 1



Source: State of Michigan Comprehensive Annual Financial Report

Table 2

State Trunkline Fund Bonds Issued (new and refunding bonds)					
			Maturities		
Year Issued	Bond Purpose(s)	Amount (millions)	First Year	Last Year	Avg. Interest Rate
1989	State Trunkline and Economic Development Fund	$135.8	1994	2017	6.97
1992	State Trunkline and Critical Bridge	$353.2	1999	2021	6.16
1994	State Trunkline	$241.0	1994	2007	5.53
1996	State Trunkline and Blue Water Bridge	$54.5	1997	2009	5.71
1998	State Trunkline	$377.9	2005	2026	5.09

SOURCE: State of Michigan Comprehensive Annual Financial Report

The increase in debt outstanding over this 10-year period is also a function of the sale of refunding bonds to take advantage of favorable interest rates. Refinancing high-interest bonds with low-interest bonds can reduce annual debt service payments. The State has realized significant savings by issuing refunding bonds. Most recently, the State issued over $377.0 million in STF refunding bonds in 1998 to lower its debt service costs on prior bonds, saving approximately $12 million in annual debt service costs.

Compared with other states, Michigan ranks below the national average in terms of state highway debt outstanding per capita. Table 3 summarizes state highway debt per capita among the 50 states. According to data compiled by the Federal Highway Administration for 1998, the national average debt outstanding per capita was $186.70. Michigan ranked 29th at $68.80 per capita. Delaware ranked first at $1,112.50 per capita, while 11 states did not have any state highway debt outstanding. The issuance of bonds for Build Michigan III will surely increase Michigan's ranking among the states.

Debt service payments for STF bonds are satisfied from restricted transportation revenues. Annual debt service payments (principal, interest, and fees) for all outstanding STF bonds through FY 2004-05 are $47.2 million per year. Table 4 lists the scheduled debt service on all outstanding STF bonds by purpose. The debt service obligations on outstanding State Trunkline Fund bonds are satisfied by annual appropriations from the Blue Water Bridge Fund, the Michigan Transportation Fund, and the State Trunkline Fund.

Annual appropriations from the Blue Water Bridge Fund support the debt service requirements on STF bonds issued in 1996 for completion of the second span of the Blue Water Bridge in Port Huron. The Blue Water Bridge Fund, a subfund of the State Trunkline Fund, primarily receives revenue from bridge tolls and rental agreements.

Annual appropriations from the Michigan Transportation Fund support the annual debt service requirements on STF bonds issued in 1992 for the Critical Bridge Program.[4] Appropriations from the Transportation Economic Development Fund, which is accounted for in the STF, support debt service on STF bonds issued in 1989 for economic development projects.[5]

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[4] Public Act 51 allocates at least $3.0 million from the Michigan Transportation Fund annually to the Critical Bridge Fund for debt service.

[5] Public Act 51 of 1951 allocates $36,775,000 from the Michigan Transportation Fund annually to the Transportation Economic Development Fund, with the first priority for debt service on bonds issued to fund Transportation Economic Development Fund projects.

Table 3

STATE OBLIGATIONS FOR HIGHWAYS -- 1998			
	OBLIGATIONS OUTSTANDING END OF YEAR	POPULATION 1998 EST.	DEBT OUTSTANDING PER CAPITA
Delaware	$827,744,000	744,066	$1,112.5
Connecticut	3,070,899,000	3,272,563	938.4
Massachusetts	5,243,438,000	6,144,407	853.4
New Jersey	6,073,905,000	8,095,542	750.3
New York	7,740,253,000	18,159,175	426.2
Oklahoma	1,331,005,000	3,339,478	398.6
Kansas	1,041,065,000	2,638,667	394.5
Utah	813,600,000	2,100,562	387.3
Rhode Island	366,609,000	987,704	371.2
Kentucky	1,363,992,000	3,934,310	346.7
Florida	4,476,480,000	14,908,230	300.3
New Hampshire	334,794,000	1,185,823	282.3
Arizona	1,231,926,000	4,667,277	263.9
Hawaii	301,973,000	1,190,472	253.7
Maine	288,515,000	1,247,554	231.3
Pennsylvania	2,251,857,000	12,002,329	187.6
U.S. Average			**186.7**
Illinois	2,214,543,000	12,069,774	183.5
Washington	1,004,260,000	5,687,832	176.6
Virginia	1,175,739,000	6,789,225	173.2
Georgia	1,278,696,000	7,636,522	167.4
Wisconsin	856,544,000	5,222,124	164.0
West Virginia	244,755,000	1,811,688	135.1
Indiana	754,185,000	5,907,617	127.7
Ohio	1,336,215,000	11,237,752	118.9
Maryland	516,115,000	5,130,072	100.6
Louisiana	352,090,000	4,362,758	80.7
New Mexico	127,315,000	1,733,535	73.4
Montana	63,375,000	879,533	72.1
Michigan	**675,247,000**	**9,820,231**	**68.8**
Texas	965,130,000	19,712,389	49.0
Vermont	21,933,000	590,579	37.1
South Carolina	137,365,000	3,839,578	35.8
North Carolina	250,000,000	7,545,828	33.1
Minnesota	94,435,000	4,726,411	20.0
Nevada	17,700,000	1,743,772	10.2
Alabama	22,185,000	4,351,037	5.1
Oregon	5,840,000	3,282,055	1.8
Mississippi	3,945,000	2,751,335	1.4
California	43,525,000	32,682,794	1.3
Alaska	649,000	615,205	1.1
Tennessee	0	5,432,679	0.0
Missouri	0	5,437,562	0.0
South Dakota	0	730,789	0.0
North Dakota	0	637,808	0.0
Idaho	0	1,230,923	0.0
Nebraska	0	1,660,772	0.0
Colorado	0	3,968,967	0.0
Arkansas	0	2,538,202	0.0
Iowa	0	2,861,025	0.0
Wyoming	0	480,045	0.0

NOTE: Includes indebtedness from all state bond issues, including toll facilities and state issues for local roads.

SOURCE: U.S. Department of Transportation, FHWA; U.S. Census Bureau; SFA Calculations

Table 4

Debt Service on Outstanding State Trunkline Fund Bonds By Purpose
FY 1999-2000 through FY 2026-27
(in millions)

	Fiscal Years Ending September 30								
Bond Purpose	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007 to 2027**	**Total**
State Trunkline	$35.9	$35.9	$35.9	$35.9	$32.3	$32.3	$32.4	$605.1	$845.7
Economic Development	6.6	6.6	6.6	6.6	10.2	10.2	9.4	122.3	178.5
Critical Bridge	2.4	2.4	2.4	2.4	2.4	2.4	2.4	46.7	63.5
Blue Water Bridge	2.3	2.3	2.3	2.3	2.3	2.3	2.4	46.2	62.4
TOTAL	**47.2**	**47.2**	**47.2**	**47.2**	**47.2**	**47.2**	**46.6**	**820.3**	**1,150.1**

Source: Michigan Department of Transportation

Annual debt service payments on STF bonds issued for State road and bridge projects are satisfied by annual appropriations from the State Trunkline Fund. Public Act 51 provides an annual allocation from the Michigan Transportation Fund (MTF) to the State Trunkline Fund of $43 million for debt service costs on State of Michigan projects. This earmarked funding resulted from the Build Michigan II revenue enhancement program in 1997. During FY 1999-2000, debt service on STF bonds for State projects totaled $35.9 million, approximately $7.1 million below the $43 million annually allocated from the Michigan Transportation Fund. The remaining $7.1 million in MTF revenue deposited in the STF is available for other State road and bridge projects. Table 5 lists the required principal and interest payments on outstanding STF bonds.

Table 5

Debt Service on Outstanding State Trunkline Fund Bonds FY 1999-2000 through FY 2026-27 (in thousands)			
Fiscal Year Ending 9/30	**Principal**	**Interest**	**Total**
2000	$17,745	$29,464	$47,209
2001	18,670	28,530	47,200
2002	19,690	27,512	47,202
2003	20,780	26,422	47,202
2004	18,050	29,158	47,208
2005	18,801	28,403	47,204
2006	12,809	33,812	46,621
2007	14,279	33,886	48,165
2008	14,288	33,879	48,167
2009	14,325	33,838	48,163
2010	17,096	31,065	48,161
2011	17,453	30,712	48,165
2012	17,907	30,266	48,173
2013	18,396	29,765	48,161
2014	29,375	18,788	48,163
2015	30,975	17,190	48,165
2016	32,660	15,505	48,165
2017	34,470	13,692	48,162
2018	36,420	11,742	48,162
2019	38,480	9,683	48,163
2020	40,530	7,633	48,163
2021	42,570	5,600	48,170
2022	44,745	3,419	48,164
2023	12,170	1,975	14,145
2024	12,800	1,350	14,150
2025	13,455	694	14,149
2026	3,485	270	3,755
2027	3,665	92	3,757
Total	**$616,089**	**$534,345**	**$1,150,434**

Source: Michigan Department of Transportation

BUILD MICHIGAN III

On January 19, 2000, Governor Engler announced the third phase of his transportation infrastructure package, Build Michigan III.[6] Unlike the Build Michigan II program, which relied primarily on a four-cent increase in the gasoline tax to raise State transportation revenues, Build Michigan III was designed to increase transportation funding through a combination of one-time General Fund/General Purpose appropriations and long-term borrowing. While the Build Michigan II program provided a permanent increase in annual transportation revenues for road construction, maintenance, and repair, the Build Michigan III program will provide, more or less, a one-time revenue increase for specific projects. Build Michigan III was originally described as a $1 billion investment plan over five years for State and local road projects to relieve congestion, reduce traffic delays, improve safety, and promote economic development. Based on the projects selected to date, it appears that a major focus of the Build Michigan III program is to address the transportation infrastructure needs of a number of economic development initiatives throughout the State. Because of the emphasis on economic development, the MDOT worked closely with the Michigan Economic Development Corporation to identify and select projects for the Build Michigan III program.

Appendix A lists all of the projects, including estimated project costs, under the initial Build Michigan III bond resolution.[7] The list includes both State and local projects, although all projects were selected by the State. Projects range in nature from major freeway design to construction of passing lanes to reduce congestion. One of the projects is included in the MDOT's *Five Year Plan* and currently in the construction phase (e.g., to expedite construction of M-6 in Kent/Ottawa Counties) while the rest are new as a result of the Build Michigan III program.

As originally designed, the Administration's plan included a one-time $100 million General Fund/General Purpose appropriation and $900 million in bond proceeds. As part of the plan, annual debt service payments on the bonds would be satisfied by a $35 million annual appropriation from the Budget Stabilization Fund, $8 million from diesel fuel tax reforms, and $5 million from the Transportation Economic Development Fund. Since its initial unveiling in January 2000, the scope of the Build Michigan III bonding program has been reduced to $800 million. Also, after considerable debate, the final version of the Build Michigan III financing plan enacted by the Legislature contained few of the components of the original plan.

The Build Michigan III program also was linked to passage of the Public Act 51 of 1951 "reform package". This legislative package was intended to include recommendations from the Transportation Funding Study Committee, which had met for over one year to review "transportation funding options, transportation investment priorities, and potential strategies for maximizing returns on transportation investments".[8] The various proposed PA 51 changes garnered considerable legislative attention, ultimately resulting in a very limited final package compared with earlier versions. The only substantive changes contained in the final PA 51

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[6] "Lessons From the 20th Century, Leadership for the 21st Century", 2000 State of the State Address, January 19, 2000.

[7] Approved by the State Transportation Commission, October 26,2000.

[8] Public Act 308 of 1998.

reforms dealt with eliminating the PA 51 formula sunset and the railroad grade crossing program sunset.[9] Both the PA 51 formula and the railroad grade crossing program were scheduled to expire on September 30, 2000.

BUDGET STABILIZATION FUND

Similar to the previous Build Michigan program, Build Michigan III provides a one-time appropriation from the Countercyclical Budget and Economic Stabilization Fund (BSF) for transportation purposes. While Build Michigan II divided a one-time $69 million appropriation among the State and local road agencies for resurfacing and repairing existing roads based on the traditional PA 51 formula, Build Michigan III provides a one-time $100 million appropriation to the State Trunkline Fund, primarily for State projects.[10] In addition to the one-time appropriation from the BSF, the financing plan for Build Michigan III bonds includes an annual transfer of $35 million from the BSF to the STF to cover part of the debt service costs.

Public Act 189 of 2000 amended the Management and Budget Act to appropriate and transfer up to $100 million from the BSF to the State Trunkline Fund in FY 1999-2000 for the Build Michigan III program. PA 189 actually provides for two separate one-time transfers to the STF. First, PA 189 contains a one-time transfer of $37.1 million, equal to the FY 1999-2000 General Fund/ General Purpose (GF/GP) pay-in to the BSF.[11] This transfer took place with the enactment of PA 189 in July 2000.

The second transfer to the STF consists of an amount equal to the unreserved GF/GP year-end balance that otherwise would be carried forward into FY 2000-01, but not to exceed $62.9 million. It is estimated that this transfer will occur sometime in January 2001, during book-closing for FY 1999-2000, when the unreserved General Fund year-end balance is known. Combined, the maximum amounts allowed under these two transfers total $100 million. The amendments to the Management and Budget Act only transfer funding from the BSF to the STF; they do not provide spending authorization for Build Michigan III.

Public Act 291 of 2000, an omnibus FY 1999-2000 supplemental appropriation, provides for up to a $100 million appropriation from the State Trunkline Fund for the Build Michigan III program. The $37.1 million portion of the $100 million was appropriated with the enactment of PA 291, as this funding had been transferred to the STF in July 2000. The $62.9 million piece of the $100 million STF appropriation will not be available until the BSF transfer occurs, sometime in January 2001. Pursuant to language in PA 291, the $100 million appropriation will be reduced by the same amount by which the year-end balance transfer from the BSF to the STF is less than $62.9 million. It is worth noting that the original Build Michigan III plan called for a $100 million GF/GP appropriation. Public Act 291 effectively provides a $100 million GF/GP appropriation, as the one-time BSF funds transferred to the STF amount to the GF/GP funding that would have been carried forward into FY 2000-01.

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[9] Public Act 188 of 2000.

[10] Public Act 110 of 1997 distributed the $69 million in the following manner: State Trunkline (39.1%) $26,979,000; County Road Commissions (39.1%) $26,979,000; and Cities and Villages (21.8%) $15,042,000.

[11] As required under Section 352 of the Management and Budget Act.

LONG-TERM BORROWING

Historically, the State of Michigan has funded the vast majority of its transportation projects on a "pay-as-you-go" basis, paying for construction, maintenance, and administration as revenue became available from user-related taxes and Federal sources. In order to supplement tax revenue, the State, from time-to-time, also has used long-term borrowing to finance transportation projects. Most often, borrowing is used in lieu of increasing user-related taxes (e.g. motor fuel and vehicle registration taxes) when tax increases are politically unpopular or when interest rates are favorable. Borrowing provides increased short-term funding, but does not address the issue of increased funding for long-term transportation needs. Whereas tax hikes can provide permanent revenue increases, borrowing can provide one-time infusions of revenue available for specific transportation projects. After the proceeds from borrowing are used, annual debt service payments continue until all the bonds have been paid off. Debt service payments effectively reduce the funds available for annual transportation expenditures.

The statutory authority for the State Transportation Commission to issue long-term debt for the Build Michigan III program already exists under the current provisions of PA 51 of 1951. Furthermore, there exists significant room under the debt service ceiling to issue additional State Trunkline Fund bonds. As noted above, PA 51 caps the amount of outstanding STF debt through a limitation on the debt service (50% of constitutionally dedicated revenue). In FY 1998-99, only 7.9% of the dedicated revenue was spent on debt service payments, well below the 50% ceiling.

State Trunkline Fund

The Build Michigan III program will take advantage of the current favorable interest rate climate and Michigan's excellent bond rating. Approximately $800 million in STF bond proceeds will be made available over the next five years for transportation projects throughout the State. It is likely that the State Transportation Commission will issue a combination of traditional STF bonds and Transportation Economic Development Fund bonds to generate the $800 million for Build Michigan III.

Some of the Build Michigan III State projects will require a local match. The local matching funds are in addition to the $800 million in STF bond proceeds. The local match requirements for State projects financed from traditional STF bonds will be different from the match requirements for those projects funded with Transportation Economic Development Fund bonds. Furthermore, the specific local match for each project will depend on the population(s) of the city(ies) and/or village(s) where the project is taking place.[12]

The actual annual debt service payments associated with borrowing $800 million will not be known until the bonds are sold. Annual debt service requirements will be contingent on the interest rate, term, issuance costs, and repayment schedule of each separate bond issue, assuming multiple issues. Assuming issuance of the entire $800 million at once, an interest rate of 5.5%, and a 15-year term, annual debt service payments (principal and interest) would be

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[12] Section 1c of PA 51 of 1951 requires incorporated cities and villages to share in the opening, widening, and improving of State trunkline highways based on the population of a given city or village. The local match ranges from 12.5% for cities and villages of 50,000 or more in population to zero for cities and villages of less than 25,000 in population.

approximately $79.7 million. Total debt service payments over the 15-year term of the bonds would be $1,195.5 million ($800 million principal and $395.5 million interest).

Assuming that the entire $800 million is issued, the addition of the Build Michigan III bond requirements will increase annual STF debt service payments (including Economic Development, Critical Bridge, and Blue Water Bridge) from $47.2 million to $126.9 million in FY 2000-01. While it is unlikely that the State will borrow the entire amount at one time, these figures provide an estimate of the required total and annual debt servicing once all the bonds are issued. The State will, more than likely, issue bonds over a three- to five-year period to meet the cash flow needs of the Build Michigan III program.

Although the exact timing and actual amount(s) of borrowing for the Build Michigan III program are unknown, legislative notification is required prior to all transportation bonding. Section 18k of PA 51 of 1951 requires the State Transportation Commission to authorize the issuance of notes or bonds by resolution. Thirty days before the issuance of notes or bonds, the Commission is required to provide the Appropriations Committees of the Senate and the House of Representatives with a list of the projects for which the notes or bonds are to be issued. As a general rule, if neither committee responds by the end of the 30-day notice period, the MDOT will proceed with the sale of the bonds. A similar 30-day notice is required when the State Transportation Commission plans to amend the project list originally submitted to the Legislature. In addition to the PA 51 reporting requirements, PA 291 of 2000 required the MDOT to report, by October 31, 2000, to the Legislature on all Build Michigan III projects to be funded with State transportation revenues.[13]

Annual debt service payments on bonds issued for the Build Michigan III program will be satisfied by restricted revenue appropriated in the annual MDOT budget. The source(s) of debt service financing will be contingent on the combination of State Trunkline Fund bonds and Transportation Economic Development Fund bonds issued.

Public Act 189 of 2000 provides an annual transfer of $35.0 million from the Budget Stabilization Fund to the State Trunkline Fund to cover partially the required annual debt service on Build Michigan III bonds. The transfer from the BSF to the STF will last 15 years, from FY 2000-01 to FY 2015-16. The $35 million figure was intended to approximate one-half of the annual interest earnings of the BSF. It is worth noting that PA 189 does not limit the BSF funding to debt service payments on Build Michigan III bonds, although this was the legislative intent. The earmark of BSF revenue to the State Trunkline Fund will cover less than one half of the estimated annual $79.7 million required for Build Michigan III bonds.

<u>Transportation Economic Development Fund</u>

In addition to issuing traditional State Trunkline Fund bonds, the State Transportation Commission can provide revenue for the Build Michigan III program through the bonding authority under the Transportation Economic Development Fund (TEDF).[14] The TEDF was created to assist in the funding of highway, road, and street projects necessary to support economic growth. The TEDF provides a mechanism for the State, local road agencies, and businesses to

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[13] Public Act 291, an FY 1999-2000 supplemental appropriation bill, appropriated up to $100 million for the Build Michigan III program.

[14] Section 11, PA 231 of 1987, as amended.

respond to the transportation infrastructure needs resulting from economic development. Since a major focus of the Build Michigan III program is economic development, it is possible that TEDF bonds will be used to provide financing for select local economic development projects; however, the amount of TEDF borrowing that will occur is unknown at this time.

All Build Michigan III projects to be funded with TEDF bond proceeds (for State or local road agencies) would have to qualify for funding under Category A of the TEDF. Category A is intended to improve or build new roads, streets, and highways that are necessary to establish, retain, and expand specific industries in Michigan. The targeted industries eligible for Category A grants include agriculture or food processing, tourism, forestry, high technology research, manufacturing, mining, and office centers of 50,000 square feet or more. Category A grant applications are received year-round and jointly reviewed by the Director of the Michigan Department of Transportation and the Chief Executive Officer of the Michigan Economic Development Corporation.[15] Grants are made throughout the year in order to assist road agencies in meeting the needs of business firms. In most cases, selected Category A projects require a match of at least 20% of total costs. The local projects listed in Appendix A will be financed from TEDF bond proceeds and the local match funds.

The TEDF receives annual revenue from the Michigan Transportation Fund and from the 1987 increase in certain driver license fees.[16] Under the statutory formula, the first priority for expenditure of TEDF revenue is debt service payments on existing bonds and administrative costs. These costs effectively come "off the top" of the TEDF prior to any statutory allocations.[17] Should the State Transportation Commission decide to issue TEDF bonds to provide revenue for specific Build Michigan III projects, then the total statutory distributions to Categories A, C, and D will be reduced by the amount of associated debt service costs. Based on the TEDF formula, the additional debt service costs would be borne entirely by Category A (50%), Category C (25%), and Category D (25%) grant recipients.[18]

Assuming that the State Transportation Commission decides to issue $100 million in TEDF bonds for Build Michigan III, the associated annual debt service will total just under $10 million. Assuming $10 million in additional annual borrowing costs, the amount of TEDF revenue annually available for Category A, C, and D grants will be reduced by $5 million, $2.5 million, and $2.5 million, respectively. The original financing plan for Build Michigan III debt service included $5 million from the TEDF Category A. Currently, $6.6 million is spent annually to cover the

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[15] Executive Orders 1999-1 and 1999-2 transferred the administrative duties for the TEDF from the State Transportation Commission to the Director of MDOT and the President and CEO of the Michigan Economic Development Corporation.

[16] Public Act 51 annually allocates $36,775,000 from the MTF to the TEDF, with the first priority being debt service, and $3,500,000 earmarked for Category A grants.

[17] Category A - Target Industries; Category C - Urban Congestion Relief; Category D - Rural Counties; Category E - Forest Roads; and Category F - Cities in Rural Counties.

[18] Category B, State Trunkline Service, was eliminated by PA 149 of 1993. Projects previously funded under Category B are now the responsibility of the Michigan Department of Transportation.

borrowing costs on $100 million in bonds issued in 1989 for Category A and B projects to stimulate economic development in the State at that time.

As noted above, total annual debt service on $800 million in STF bonds would approximate $79.7 million. Based on the funding sources identified to date, approximately $45 million is available to satisfy these annual payments ($35 million in BSF revenue transferred to the STF and approximately $10 million from the TEDF). Presumably, the remainder of the funding necessary to cover annual debt service payments will have to come from other sources.

One possible source of funding might be the nearly $7.0 million from the annual transfer of MTF revenue to the STF to satisfy debt service. Currently, this funding is used for other STF-supported transportation activities. The Transportation Economic Development Fund could cover more than the estimated $10 million of annual debt service costs should the State Transportation Commission decide to issue more than $100 million in TEDF bonds for Build Michigan III projects. The additional TEDF debt would increase the amount of "earmarked" funding for annual Build Michigan III debt requirements and reduce the amount of funding that would have to come from other sources. The additional TEDF debt service would be borne by Category A, C, and D grant recipients in the same proportions mentioned above.

The remaining funding will have to come from a redirection of revenue from other STF-supported programs. State Trunkline Fund revenue currently allocated to State road and bridge construction, maintenance, and administration, will, more than likely, have to be redirected to cover debt service on Build Michigan III bonds. An area in the budget where the MDOT has a high degree of flexibility and discretion in the use of STF revenue is the STF-supported portion of the annual State road and bridge program. The FY 2000-01 budget apportions approximately $296.3 million to the program for annual road and bridge construction. Assuming that a portion of the bond proceeds is used to expedite currently planned transportation projects, the advantage of diverting road and bridge program funding to debt service is that some of the projects that would have been funded through the annual program will be funded through the bond proceeds. Therefore, the scope of the annual program is decreased and requires fewer resources in the short term.

It is also possible that STF-supported annual administrative expenses could be shifted to cover part of the borrowing costs of Build Michigan III. A significant redistribution of STF funding from administration to debt service, however, is unlikely as most administrative costs are personnel-related and more or less fixed.

CONCLUSION

The Build Michigan III program raises a number of questions. Are current transportation revenues sufficient to maintain existing roads and at the same time improve and expand the State transportation system? If current user-related taxes (e.g., motor fuel and vehicle registration taxes) do not generate adequate resources to support the system, then what other financing mechanisms are available and should be used? If long-term borrowing is used to finance transportation projects, what is the appropriate mix of capital financing and ongoing revenues? One could argue that the simple fact that the State borrows to fund any transportation projects indicates that the “pay-as-you-go” method of transportation financing generates insufficient resources to meet the needs of the State’s transportation system. Others might contend that borrowing is required, from time to time, to meet specific transportation demands, particularly large-scale projects. While this report does not attempt to provide a needs analysis of transportation funding in Michigan, it does focus on State efforts to supplement ongoing revenues with the proceeds of long-term borrowing to finance transportation projects.

Despite a relatively strong economy in recent years, the Build Michigan III program recognizes that current user-related transportation taxes are insufficient to address the transportation needs arising from economic development throughout the State. Governor Engler's planned Build Michigan III program will use the proceeds from $800 million in State Trunkline Fund bonds over the next five years to finance a wide variety of State and local road projects. Although long-term borrowing will provide the State with a significant amount of revenue to address a list of identified projects, it also will tie up some existing annual transportation resources to meet required debt payments. The additional annual debt requirements effectively will decrease the amount of resources available to the Legislature for various discretionary transportation purposes.

Given the State's strong credit rating and the current interest rate climate, long-term borrowing can be an attractive method to finance a significant number of transportation projects over a short time frame. Furthermore, there is considerable room under the debt service cap to allow the State Transportation Commission to issue additional State Trunkline Fund bonds for highway purposes. Bonding, however, does not provide a permanent increase in annual transportation revenues. Given the degree of State highway borrowing over the past 10 years, State policy-makers must decide whether the needs of the State transportation system can be met through frequent large-scale borrowing, such as what is proposed under Build Michigan III, or whether another permanent revenue increase is required.

APPENDIX A

BUILD MICHIGAN III PROJECTS

County	Project	Estimated Project Cost	Estimated Local Share	Estimated Bond Amount
Kent/Ottawa	Accelerate completion of M-6 (South Beltline) in west Michigan	$150,000,000		$150,000,000
State Projects: Design Investment for Major Freeway Improvement				
Wayne	I-94, from I-96 to Connor, widen and reconstruct	66,000,000	8,250,000	57,750,000
Oakland	I-75, from I-696 to M-59, widen	28,000,000	2,598,531	25,401,469
Washtenaw	US-23, from M-14 to I-96, widen	17,000,000		17,000,000
Ottawa	New US-31 freeway from I-196 to I-96	28,000,000		28,000,000
Kalamazoo	I-94, US-131 to Sprinkle Rd., widen	11,000,000	435,337	10,564,663
State Projects: Economic Development Congestion/Choke Point				
Bay/Saginaw	M-84, widen and reconstruct	25,200,000		25,200,000
Huron	Construct passing lane on M-53 between Wadsworth and Popple Roads	2,074,000		2,074,000
Lapeer	Construct passing lane on M-53 from (M-90) Burnside Rd. to (M-90) North Branch Rd.	2,000,000		2,000,000
Lapeer	Construct passing lane on M-24 north of M-90	2,000,000		2,000,000
Isabella	Construct passing lane on M-20 east of Coldwater Rd. 1 mile	2,000,000		2,000,000
Ionia	Construct passing lane on M-66 from Nichols Rd. to David Highway	1,200,000		1,200,000
Mecosta	Construct passing lane on M-66 from 16 Mile Rd. north 1.5 miles	1,600,000		1,600,000
Macomb	Improvements to M-53 (Van Dyke), I-696 to 14-Mile	19,600,000	2,450,000	17,150,000
Oakland	Improvements to I-75 and Square Lake Road in Pontiac	2,850,000		2,850,000
Oakland/Macomb	M-59, Crooks to Ryan, widen (choke point)	30,000,000	3,136,125	26,863,875
Wayne	I-375 east riverfront access improvement	18,000,000	1,845,000	16,155,000
Wayne	Improvements to the I-94/Schaeffer Road area in Dearborn	50,000,000	5,125,000	44,875,000
Crawford	Construct passing lane on M-32 west of Johannesburg	2,000,000		2,000,000
Grand Traverse	Construct Passing lane on M-37 from Vance Rd. to US-31	1,400,000		1,400,000

APPENDIX A

BUILD MICHIGAN III PROJECTS

County	Project	Estimated Project Cost	Estimated Local Share	Estimated Bond Amount
Grand Traverse/ Kalkaska	Construct passing lane on US-131 between M-113 and M-72	4,100,000		4,100,000
Kalkaska	Construct passing lane on M-72 between US-131 and Crawford County line	4,800,000		4,800,000
Allegan	Construct passing lane on M-40 from Allegan to Holland	1,500,000		1,500,000
Berrien	New US-31 connector, Napier to I-94	80,000,000		80,000,000
Berrien	M-63 at Klock Road, replace interchange with at-grade intersection	8,000,000		8,000,000
Kalamazoo	US-131, Schoolcraft, rail relocation/grade separation	20,000,000		20,000,000
Kalamazoo	Construct passing lane on M-43 from Kalamazoo to South Haven	1,500,000		1,500,000
Dickinson	US-2, Washington to Michigan Ave. in Iron Mountain, widen	10,000,000		10,000,000
Dickinson	Construct passing lane on M-95 south of the Marquette County line	1,725,000		1,725,000
Mackinac	Construct passing lane on US-2 just beyond Naubinway	1,080,000		1,080,000
Mackinac	Construct passing lane on US-2 east and west of Borgstrom Rd.	1,511,000		1,511,000
Marquette	Construct passing lane on M-553 from Fairground Hills to M-94	1,858,000		1,858,000
Iron	Construct passing lane on US-2 south of County Rd. 424	1,565,000		1,565,000
Iron	Construct passing lane on M-69 east of Crystal Falls	1,865,000		1,865,000
Schoolcraft	Construct passing lane on M-28 just west of Seney	1,900,000		1,900,000
Schoolcraft	Construct passing lane on US-2 just east of M-77	2,100,000		2,100,000
Clinton/Shiawassee	Construct passing lane M-21 between St. Johns and Owosso	4,000,000		4,000,000
Eaton	Millett Rd bridges over I-96 and I-96 bridges over Canal Rd. in Delta Twp.	15,000,000		15,000,000
Jackson/Lenawee	US-127 widen shoulders and bridges between M-50 south to Vicary Rd.	6,000,000		6,000,000
Livingston	M-59, Michigan to US-23, widen to boulevard	60,000,000		60,000,000

APPENDIX A

BUILD MICHIGAN III PROJECTS

County	Project	Estimated Project Cost	Estimated Local Share	Estimated Bond Amount
Livingston	Interchange improvements at I-96 and Pleasant Valley Rd. and improvements to intersections along M-59	20,000,000		20,000,000
Washtenaw	Construct passing lane on US-12 between Clinton and Saline	4,000,000		4,000,000
	State Projects Subtotal	**$712,428,000**	**$23,839,993**	**$688,588,007**
Local Projects: Economic Development Congestion/Choke Point				
Genesee	Improvements to local roads in Flint	7,624,500	1,624,500	6,000,000
Kent	Widen and upgrade 68th Ave. in Gaines Twp.	2,680,000	680,000	2,000,000
Kent	Grand Rapids Airport Access and 36th Street extension	10,000,000	2,000,000	8,000,000
Muskegon	Construct Shoreline Drive connector from US-31BR in Muskegon	12,000,000	2,400,000	9,600,000
Macomb	Widen 32 Mile Rd. from 3 to 5 lanes between Powell and M-53	5,650,000	2,650,000	3,000,000
Macomb	Improve access roads in Warren near GM Technical Center	12,500,000	2,500,000	10,000,000
Oakland	Widen and add turn lanes on Grand River Avenue in Novi	10,655,000	5,655,000	5,000,000
Oakland	Improvements to local roads near Milford	2,500,000	500,000	2,000,000
Oakland	Improve intersection and relocate Williams Lake Road at M-59	12,000,000	2,400,000	9,600,000
Oakland	Construct local road to new M-59/Adams Road interchange	16,000,000	10,000,000	6,000,000
Oakland	Improve Centerpoint Parkway, Bradford St. and Opdyke Rd. in Pontiac	22,500,000	4,500,000	18,000,000
Oakland	Local widenings and improvements in Pontiac	14,561,319	3,561,319	11,000,000
Wayne	Local improvements for auto industry in Dearborn	15,817,165	5,817,165	10,000,000
Wayne	Improvements to local streets surrounding the Renaissance Center	40,000,000	15,000,000	25,000,000
Wayne	South airport access improvements	31,000,000	6,200,000	24,800,000
Wayne	Improvements to support development at Pinnacle Park	5,000,000	1,000,000	4,000,000
Grand Traverse	Hartman/Hammond corridor, US-31 to Three Mile Road, construct Boardman River bridge	15,000,000	3,000,000	12,000,000
Grand Traverse	Improve Three Mile Rd. in Traverse City	3,125,000	625,000	2,500,000

APPENDIX A

BUILD MICHIGAN III PROJECTS

County	Project	Estimated Project Cost	Estimated Local Share	Estimated Bond Amount
Wexford	Construct new road for industrial park in Cadillac	1,218,500	418,500	800,000
Alger	Widen and reconstruct (H-58) access to Pictured Rock National Lakeshore	5,200,000	4,200,000	1,000,000
Clinton	Reconstruct and widen Walker Rd. to provide all-season access to industrial park	416,000	172,000	244,000
Eaton	Improvements to local roads in Eaton County	15,000,000	3,000,000	12,000,000
Washtenaw	Improve Bemis, Platte & Willis Roads in York Twp.	6,250,000	1,250,000	5,000,000
Washtenaw	Improve Wagner and Liberty Roads	2,800,000	560,000	2,240,000
	Local Projects Subtotal	**$269,497,484**	**$79,713,484**	**$189,784,000**
	Build Michigan III Totals	**$981,925,484**	**$103,553,477**	**$878,372,007**

Source: Michigan Department of Transportation, as of October 26, 2000