MEMORANDUM

DATE: May 5, 2008

TO: House Committee on Appropriations

FROM: William E. Hamilton

RE: State Transportation Borrowing and Debt Service – **2008 Update**

Authority for Transportation Bond Program

Article IX, Section 9 of Michigan's 1963 Constitution mandates that revenue from specific taxes on motor fuels and vehicle registrations be used exclusively for transportation purposes. The section also states that, "*The legislature may authorize the incurrence of indebtedness and the issuance of obligations pledging the taxes allocated or authorized to be allocated under this section, which obligations shall not be construed to be evidence of state indebtedness under this constitution.*" This language gives constitutional authorization for debt secured by constitutionally-restricted transportation revenue, and indicates that transportation notes and bonds issued under the authority of this section are not general obligations of the state of Michigan.

Statutory authority for borrowing secured by constitutionally-restricted transportation revenue is found in Public Act 51 of 1951. Act 51 authorizes the State Transportation Commission to issue notes or bonds by pledging as payment constitutionally-restricted transportation revenue. Act 51 also authorizes the State Transportation Commission to issue notes or bonds in anticipation of federal revenue, and authorizes the refunding of previously issued bonds.

Section 18b of Act 51 requires that the State Transportation Commission, prior to issuing notes or bonds, adopt a resolution providing a pledge of payment of the notes or bonds from constitutionally-restricted transportation revenue. Section 18b also requires that the resolution contain a brief statement describing the projects for which the notes or bonds are to be issued, including estimated cost of the projects, or a description of the notes or bonds to be paid or refunded from the proceeds.

Section 18k of Act 51 requires that the State Transportation Commission provide to the House and Senate appropriations committees the list of projects for which notes or bonds are to be issued at least 30 days before the notes or bonds are issued. If the State Transportation Commission determines that the projects for which bonds were issued should change, Section 18b(4) requires that the Commission adopt the change by resolution, and that notice of intention to adopt the resolution be given to the House and Senate Appropriations Committees. Although Act 51 includes these notification provisions, the act does not require legislative authorization for the State Transportation Commission to issue notes or bonds, and does not give the appropriations committees or legislature as a whole authority to approve or reject the proposed project list.

Proceeds from the sales of notes or bonds can be used only for projects included in the note or bond resolution project list. However, the proceeds are not earmarked for any particular project or projects on the list. Some of the projects on the list may be constructed using other state-restricted or federal aid revenue sources. For example, the 125 projects shown in the list associated with the 2004 State Trunkline Fund bond issue simply represents the pool of projects for which the bond proceeds may be used.

State Transportation Commission authorization for note or bond sales is typically a two-step process. The Commission first authorizes the Michigan Department of Transportation to circulate a preliminary official note or bond statement, including the list of projects. In a subsequent resolution, after the 30-day notification period, the Commission will authorize the department to issue the notes or bonds up to the amount authorized in the resolution. The department will time the actual sale of the debt issue based on anticipated cash flow needs and on market conditions.

Debt Limits
Act 51 limits transportation-related debt service to 50% of the previous year's constitutionally-restricted transportation revenue. Or to state this another way, transportation revenue pledged to secure bonds or notes must be at least twice the amount of the related transportation debt service.[1] Current debt service is below these statutory limits. At September 30, 2007, available revenue was 7.1 times the amount needed to cover State Trunkline Fund (STF) debt service, and 7.2 times the amount needed to cover Comprehensive Transportation Fund (CTF) debt service.

State Transportation Commission policy is more restrictive than statute; it requires a 4-to-1 revenue to debt service coverage ratio.

Issues in Transportation Bonding
Outstanding STF debt doubled between September 30, 2000 and September 30, 2001 – from $633.2 million to $1.328 billion. Of this increase, $308.2 million related to the sale in July 2001 of Build Michigan III bonds. At the same time, the department sold $400.0 million in short-term federal grant anticipation notes (GARVEEs).[2] Since 2001, the department made the following additional STF bond and note sales: $200.0 million in GARVEE notes (September 2002), $185.7 million *Preserve First* bonds (September 2004), $244.5 million in STF bonds (July 2006), and $485.1 million (Jobs Today) GARVEE bonds. At September 30, 2007 total outstanding STF debt was $2.1 billion, including $485.1 million in GARVEE bonds, and $32.0 million in GARVEE notes.

The department anticipates selling from $118 million to $130 million in additional Jobs Today bonds. The department also has preliminary authorization for the sale of $150 million in STF or GARVEE bonds as part of the Governor's 2008 transportation *Economic Stimulus* program. Actual sale of these bonds will be based on department project cash flow needs and market conditions.

The department has indicated that there are several reasons for recent bonding programs. Bonding allows the department to advance projects which would be more costly to build in the future due to construction price inflation. By advancing projects, the economic benefits of improved transportation facilities are realized sooner. The recent transportation bond program has taken advantage of historically low interest rates. Finally, by advancing construction projects, bonding is a stimulus to the state economy.

Although current debt service is well within statutory limits, there is concern that increasing future debt service obligations could affect the department's ability to sustain its road and bridge program. Bonding has helped the department "frontload" the road and bridge reconstruction program, and helped the department reach its pavement performance goal of 90% state trunkline pavement in "good" condition by 2007. However, the department indicates that "existing investment level will not sustain that condition." Anticipated reductions in the state trunkline road and bridge reconstruction program starting in FY 2007-08 are due, in part, to increased debt service claims on STF revenue, as well as flat transportation revenues.[3]

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[1] In accordance with State Transportation Commission policy adopted August 26, 1999, the department adopted capital financing guidelines. Those guidelines require that restricted revenue must be at least four times annual debt service. The guidelines also require that bonding be used only for capital projects, infrastructure and equipment, and require the department to take every effort to ensure that the average life of bonds not exceed the average life of the capital financed projects.
[2] At the time the department issued the GARVEE notes, it anticipated that the state would receive additional federal aid through reauthorization of the federal aid program, the Transportation Equity Act for the 21st Century (TEA-21). Congress did not pass a long-term reauthorization until August 2005 – two years after the anticipated reauthorization. The reauthorized program is titled the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU). In 2005, the department issued STF bonds to refinance $400.0 million in short-term GARVEE notes.
[3] Source: Five-year program presentation at November 11, 2006 State Transportation Commission meeting. According to this presentation, the state trunkline road and bridge construction and maintenance program would be $1.6 billion in FY 2006-07, and would decline to $1.3 billion in FY 2007-08, and would level off at $1.2 billion in fiscal years 2008-09 through 2010-11.

Current Debt Service and Interest Rates
As STF debt began to increase starting in 2001, debt serviced also increased, from $47.2 million in FY 2000-01 to $187.6 million in FY 2005-06, and $158.5 million in FY 2006-07. Total STF debt service will be $188.1 million in FY 2007-08, $158.5 million in FY 2008-09, and will be approximately $192 million per year through 2019.[4]

With the exception of a 1989 bond issue, which will be retired in 2009, the average interest rate on STF bonds ranges from 4.13% to 5.72%. Of the eight bond series issued by the department since 2000, all but one has an average interest rate of 5.00% or less.

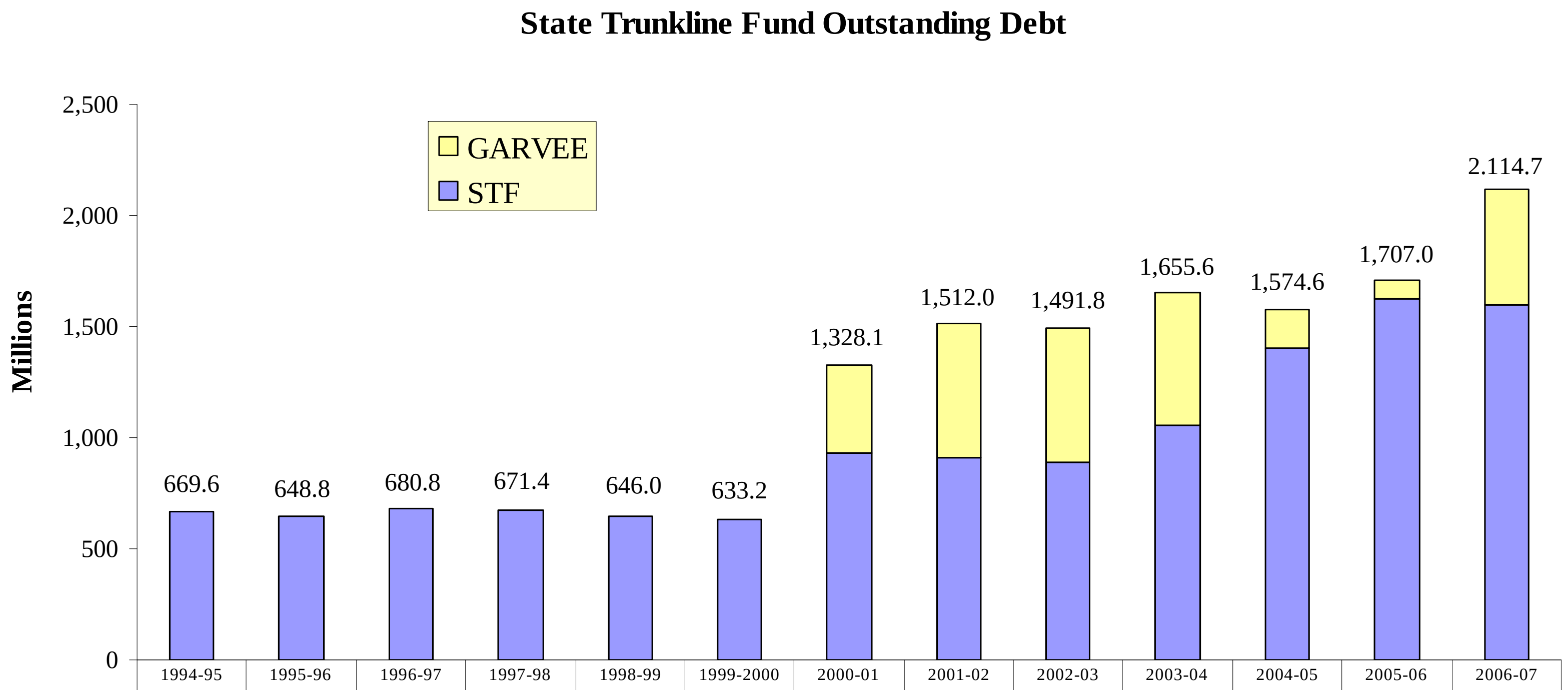
The department, in accordance with State Transportation Commission policy, looks to refund (i.e. refinance) debt when it can achieve a present value savings of 3% or more. At its January 31, 2008 meeting, the State Transportation Commission authorized the department to pursue refunding opportunities for any outstanding bonds if market conditions are appropriation.

Transportation Debt and Debt Service History
The tables and charts on the following pages show the history of state transportation debt and debt service from FY 1994-95 through FY 2008-09. The outstanding note and bond amounts through FY 2006-07 are taken from the department's annual financial reports or from the state Comprehensive Annual Financial Report (CAFR). The debt service amounts through FY 2006-07 are based on actual debt service payments as recorded in the state's accounting system. Debt service amounts for FY 2007-08 and FY 2008-09 reflect budgeted amounts based on anticipated debt service schedules.

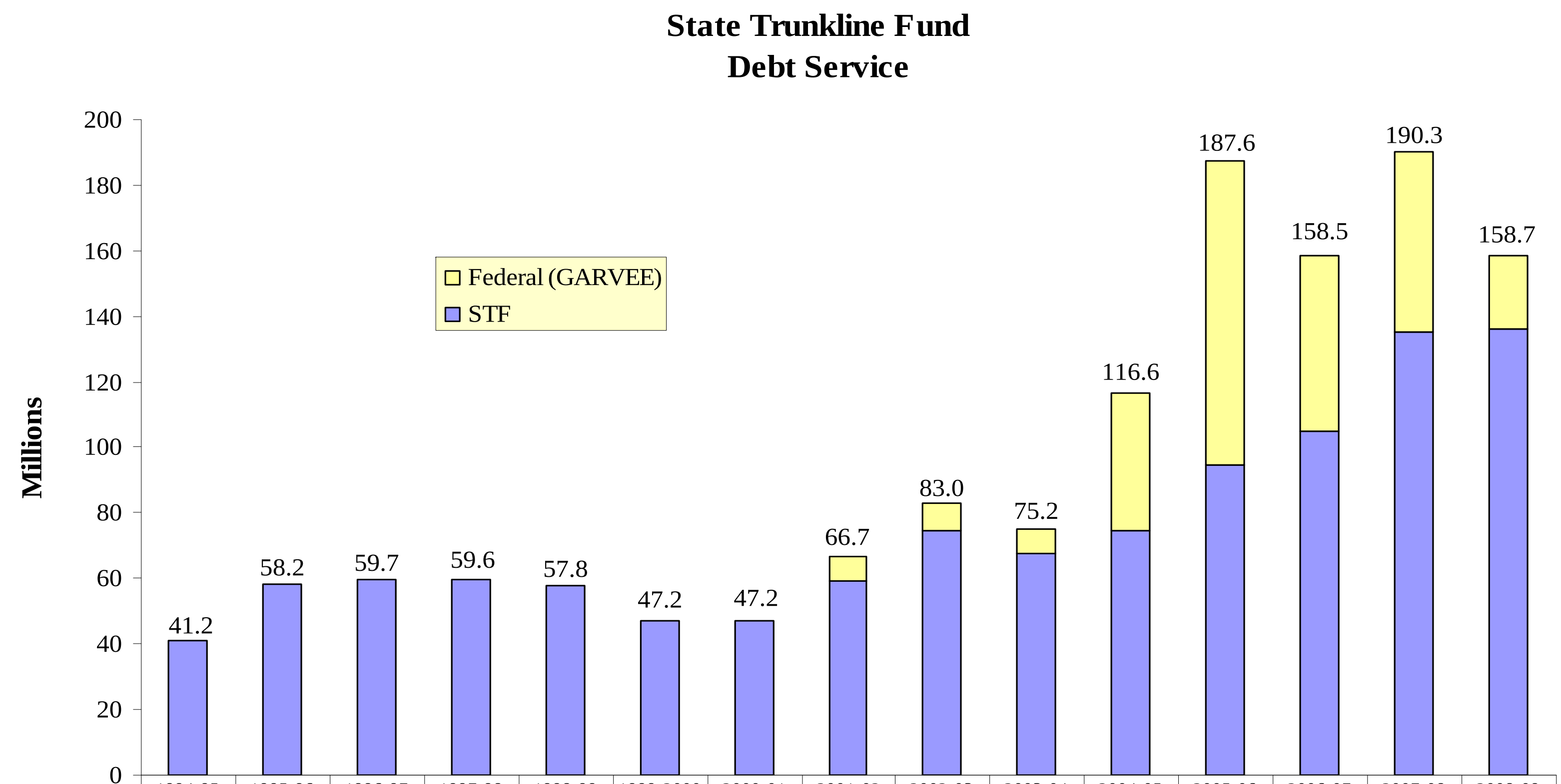
[4] This anticipated debt service is based on MDOT debt service schedules updated in December 2007.

State Trunkline Fund

State Trunkline Fund bonds and notes are used to provide funds for state trunkline road and bridge construction or reconstruction projects. For purposes of the table and chart, STF bonds include bonds issued for Transportation Economic Development Fund (TEDF) projects, the Blue Water Bridge (second span), and Critical Bridge Program projects – as well as state trunkline construction projects. The TEDF, Blue Water Bridge, and Critical Bridge Program bonds are considered "STF" because they are secured by STF revenue. The tables and charts also include GARVEE notes and bonds.



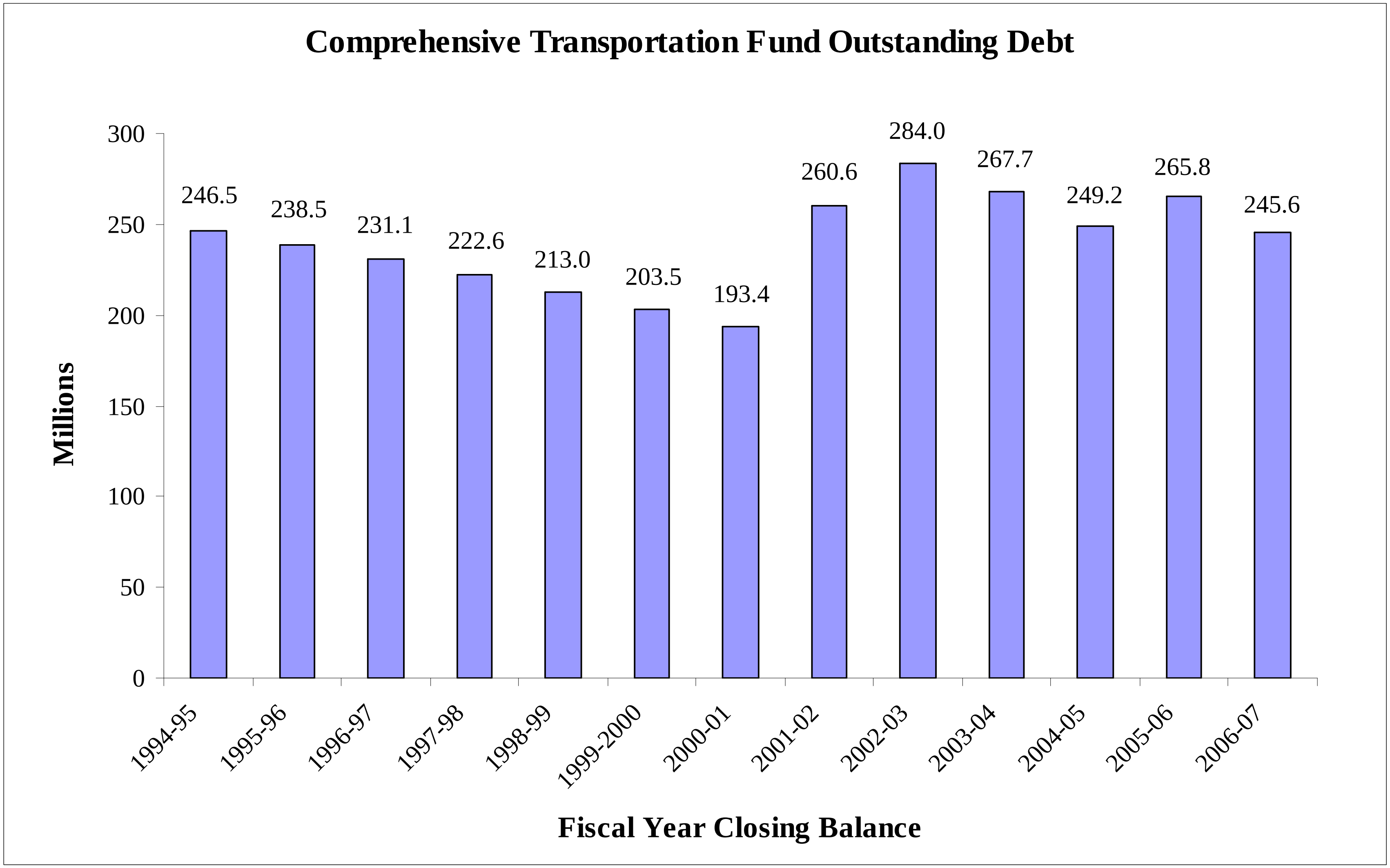
	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
GARVEE							400,000,000	600,000,000	600,000,000	600,000,000	172,000,000	84,000,000	517,115,000
STF	669,583,000	648,798,000	680,778,000	671,432,000	645,990,000	633,219,000	928,052,000	911,967,000	891,770,000	1,055,645,000	1,402,600,000	1,623,000,000	1,597,572,751

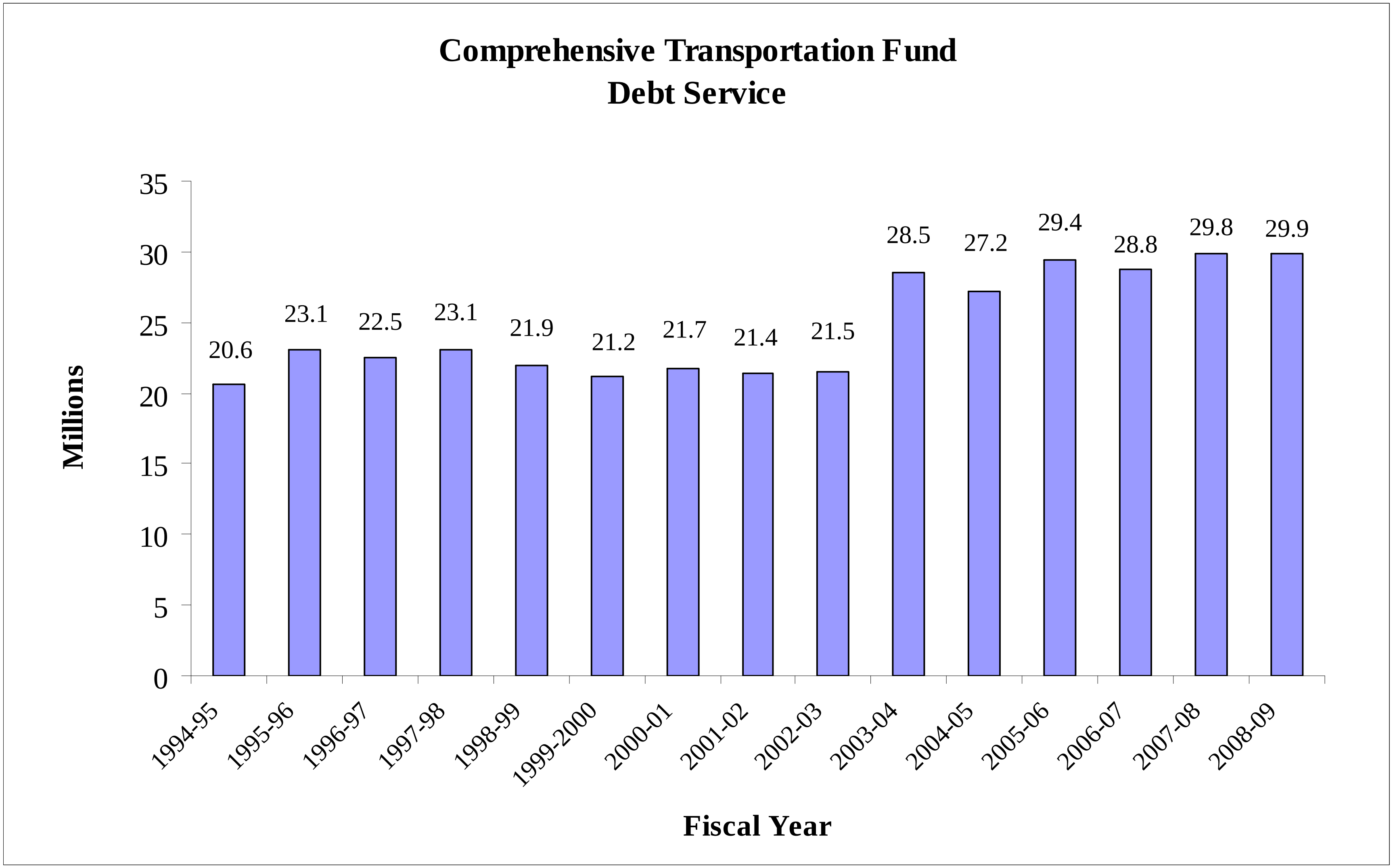


	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
Federal (GARVEE)								7,331,174	8,188,877	7,373,848	42,101,793	92,970,510	53,666,746	55,080,000	22,783,300
STF	41,208,728	58,185,515	59,737,132	59,577,357	57,750,999	47,209,099	47,200,259	59,361,635	74,774,663	67,811,662	74,523,958	94,608,773	104,799,64	135,215,70	135,897,80

Comprehensive Transportation Fund

Comprehensive Transportation Fund bonds are used to fund public transportation capital projects, including the purchase of buses for transit agencies, construction of bus transit bus intermodal terminals, and rail freight construction projects. CTF bond proceeds have also been used to support certain airport improvement projects.




Comprehensive Transportation Fund
Debt Service
Millions
35
30
25
20
15
10
5
0
20.6
23.1
22.5
23.1
21.9
21.2
21.7
21.4
21.5
28.5
27.2
29.4
28.8
29.8
29.9
1994-95
1995-96
1996-97
1997-98
1998-99
1999-2000
2000-01
2001-02
2002-03
2003-04
2004-05
2005-06
2006-07
2007-08
2008-09
Fiscal Year

Transportation Bond Program
Summary of Recent Bond Issues

1989 - $135,779,506 in STF Bonds
Used primarily to finance a number of state and local economic development (TEDF) projects. Approximately 38% of the funds were used for state trunkline projects - 59% if one includes projects which involved the upgrading of local roads and jurisdictional transfers to the state. Included among the listed projects were the Haggerty Road extension in Oakland County, Davison Freeway reconstruction in Detroit, and upgrading the Capital Loop in Lansing.

The original 1989 bond statement shows $100 million for TEDF projects. The January 18, 1996 reprogramming letter shows $120.5 million in TEDF projects.

In addition to the funds used for TEDF projects, approximately $30 million from the original bond proceeds were used for state trunkline right-of-way projects.

1992 - $253,618,067 in STF Bonds for "Build Michigan I"
Primarily used to match federal funds for state trunkline projects. In addition, approximately $30.0 million of the bond proceeds were used for local Critical Bridge projects. At the same time, the department issued $37.7 million in CTF obligation bonds.

Note that the total Build Michigan I bond issue was $353.2 million, of which $253.6 million was "new money".
The balance of the bond proceeds were used to refund existing debt.

1994 - $150,000,000 in STF Bonds
Used entirely for state trunkline projects.

1996 - $55,000,000 in STF Bonds
$35.0 million was used to finance, in part, Blue Water Bridge construction (second span) and $20.0 million was used for advance purchase of right of way.[5]

1998 - Refunding Bonds
The department issued $377.9 million STF and $38.6 million CTF to refinance previously issued bonds.

2001 - $308,200,000 in STF Bonds for "Build Michigan III"
These bonds, issued in July 2001, were intended to be the first phase of the Build Michigan III bond program. The proceeds were used to finance a number of state highway reconstruction, capacity improvement, and local economic development projects. The department originally anticipated issuing additional Build Michigan III bonds; the State Transportation Commission had authorized up to $900.0 million in borrowing under the Build Michigan III program. However, no additional bonds were issued under this program.[6] The project list related to this bond issue was last amended by the State Transportation Commission in September 2006.

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[5] Under this program, the department purchased right of way in advance of the completion of early preliminary engineering and environmental clearance. The department subsequently discontinued the use of the advance purchase of right of way account. Use of advance purchase of right of way makes the entire project ineligible for federal aid. Cost savings achieved in purchasing right of way prior to final highway alignment are offset by the loss of federal project participation.

[6] Debt service for the Build Michigan III bond program was to have come, in part, from an annual $35 million appropriation from the Budget Stabilization Fund (BSF) for a sixteen-year period beginning in FY 2000-01 and ending in FY 2015-16. The $35 million BSF transfer was made for the first two fiscal years, but was suspended in FY 2002-03 because of reduction in GF/GP revenue and the depletion of the BSF. In addition, $8.0 million per year was to have come from a proposed increase in the diesel motor fuel taxes. The proposed diesel tax increase was not enacted.

2001 - $400,000,000 in GARVEE Notes
These notes, issued in July 2001, were issued to accelerate previously programmed state trunkline projects ("Build Michigan II"). These are considered short term notes (less than 10 year maturity). The state pledged anticipated revenue from the federal aid highway program to secure repayment of these notes. This was the first series of bonds issued under this program.

2001 - Refunding Bonds
In July 2001, at the same time the department issued the Build Michigan III bonds and GARVEE notes, it refinanced $27.8 million in CTF bonds.

2002 - $82,310,000 in CTF Bonds
On July 19, 2002 the State Transportation Commission authorized the sale of up to $160.0 million in CTF bonds. Bonds were issued in August 2002 for a number of public transit capital projects, including rail freight track rehabilitation projects, local public transportation bus and facility projects, intermodal terminal projects, and rail passenger projects. The State Transportation Commission-approved bond project list identifies $88.5 million in various CTF projects, plus $60.0 million for various ASAP airport safety and security projects.[7] However, none of the proceeds were used for ASAP projects, and no additional CTF bonds were issued under this authorization. As described further below, the department issued bonds for the ASAP program in 2003 under a separate authorization from the State Transportation Commission. The approved project list was last revised by the State Transportation Commission at its September 27, 2007 meeting.

2002 - $200,000,000 in GARVEE Notes
On September 19, 2002 the department issued an additional $200.0 million in short-term federal-aid grant anticipation notes intended to accelerate previously programmed state trunkline projects ("Build Michigan II"). This was the second series of notes issued under this program bringing total GARVEE borrowing to $600.0 million. **In 2005 the department converted a large part of the short-term GARVEE notes into longer-term STF bonds (see below). The final payment on the remaining short-term notes, $32.1 million, will be made in FY 2007-08.**

2002 - Refunding Bonds
In May 2002, the department sold $89.6 million in CTF refunding bonds. The total proceeds (including premium) refinanced $95.6 million in CTF bonds. In August 2002, the department sold $97.9 million in STF refunding bonds. The total proceeds (including premium) totaled $104.5 million.

2003 - $35,020,000 in CTF Bonds
In April 2003, the State Transportation Commission authorized the sale of up to $38.0 million in CTF bonds. The approved bond list was identical to the one approved in 2002 – $88.5 million in various CTF bond projects and $60.0 million for ASAP airport improvement projects. The department sold $35.0 million in CTF bonds in July 2003, ($36.4 million net proceeds). The department identified $24.0 million from the bond proceeds as related to the ASAP program. In 2006, the department sold additional CTF bonds under a separate authorization, of which $36.0 million was identified as for the ASAP program. See below for additional description.

The authorized project list related to this bond issue was last revised in September 27, 2007.

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[7] ASAP represents the “Airport Safety and Protection Plan,” a bond program funding airport safety and security projects. The bond project list identified $60.0 million in ASAP bond program funds. Total ASAP project costs, including federal, local, and other state revenue, total approximately $1.1 billion.

Although ASAP debt service is shown as State Aeronautics Fund (SAF) in the transportation appropriations acts, the bonds are guaranteed with CTF revenue; the State Transportation Commission has no constitutional or statutory authority to issue bonds secured with SAF revenue. The SAF revenue for the debt service reimbursement was guaranteed through an earmark of certain Airport Parking Tax revenue made in Public Act 680 of 2002 (HB 4454) and Public Act 135 of 2006 (HB 5154).

2004 - $185,710,000 in STF (*Preserve First*) Bonds
At its October 30, 2003 meeting, the State Transportation Commission approved a preliminary resolution regarding the sale of up to $480.0 million in new STF bonds. The Commission gave final approval for the issuance of these bonds on July 29, 2004. Although not part of the official bond statement, these are sometimes referred to as Preserve First bonds. The bond list identified a total of 125 projects with a total estimated cost of $633.6 million. There were also three capacity improvement projects on the list: M-24 in Lapeer County, I-96 at 36th Street in Kent County, and M-42 in Wexford County.

In September 2004, the department issued $185.7 million in bonds, ($201.2 million including premium to issue date) as part of the authorized bond sale. An additional sale under this authorization was made in July 2006.

The State Transportation Commission revised the associated project list at its July 27, 2006 meeting to include certain local projects as part of the $80 million *Local Jobs Today* grant program. The use of STF bond proceeds for local road agency grants was authorized by Public Act 141 of 2006 (House Bill 6003) which amended Act 51 of 1951. The project list related to this bond issue was last amended by the State Transportation Commission at its March 27, 2008 meeting.

2004 - STF Refunding Bonds
In April 2004, the department sold $103.5 million in STF refunding bonds. The total proceeds (including premium) totaled $113.2 million.

2005 - $378,250,000 STF Bonds to Refund GARVEE Notes
On June 30, 2005 the State Transportation Commission authorized the department to restructure up to $400.0 million in short-term GARVEE notes with STF bonds. In August 2005 the department issued $378.2 million in STF bonds. From the proceeds of this sale, which totaled $402.1 million including issue premium, $400.0 million was used to refund GARVEE notes.

2005 - Refunding Bonds
In 2005, the department completed two other bond refunding issues: In April 2005, the department issued $62.2 million in CTF refunding bonds ($70.0 million total proceeds), and $223.0 million in STF refunding bonds ($250.0 million total proceeds).

2006 - $53,685.000 in CTF Bonds
On March 30, 2006, the State Transportation Commission authorized the sale of up to $100 million in CTF bonds. As part of this sale, the department identified $36.0 million as the second and final part of the $60.0 million ASAP bond program. The first $24.0 million in ASAP bonding had been authorized in 2003. The actual bond sale was completed in June 2006. The sale proceeds, including issue premium, totaled $55.0 million. The additional bond proceeds above the $24.0 million for the ASAP program were used to refund prior CTF issues.

2006 - $244,525,000 in STF (*Preserve First*) Bonds
In July 2006, the department issued $244.5 million in STF bonds (proceeds totaled $261.5 million). This represented the second and final part of the $480.0 million bond issue (*Preserve First*) first authorized in 2004. The project list associated with this bond issue, and the subsequent revisions, are the same as for the original 2004 STF (*Preserve First*) bond issue described above.

2006/2007 - $485,115,000 (Jobs Today) GARVEE Bonds
In January 2006, the State Transportation Commission approved a preliminary resolution for the sale of up to $630.0 million in STF bonds or GARVEE bonds as part of the *Jobs Today* program. The project list totaled $796.7 million.

The authorization was subsequently amended to include up to $192.0 million for a local federal-aid loan program, part of the *Local Jobs Today* program. Under this program, the department loaned money to local road agencies to allow for the construction of local federal-aid projects in 2006 and 2007 which would otherwise be postponed. The local road agencies will repay the loans from future federal aid. This financing method is also called "advance construct." The department anticipates that all loans made to local road agencies under this program will be repaid by 2010.

The project list related to this bond issue was last amended by the State Transportation Commission at its March 27, 2008 meeting.

Note that there were two parts of the *Local Jobs Today* program: the local advance-construct loan program using the STF or GARVEE bond proceeds to be issued under this 2006 authorization; and the $80 million local federal-aid grant program authorized under the revised project list for the 2004 STF (*Preserve First*) bonds.

In September 2007, the department sold $485.1 million in GARVEE bonds under this authorization. The total proceeds from the sale, including premium, totaled $503.8 million.

The department anticipates selling from $118 million to $130 million in additional Jobs Today bonds. Actual sale of these bonds will be based on department project cash flow needs and market conditions.

2008 - $150,000,000 STF (Economic Stimulus) Bonds
At its March, 2008 meeting, the State Transportation Commission approved a preliminary resolution regarding the sale of up to $150.0 million in new STF or GARVEE bonds. This proposed bond issue is related to the Governor's *Economic Stimulus* program which would advance $150.0 million projects originally slated from construction in 2009 into the 2008 construction season. The department indicates that the decision to proceed with the actual bond sale will depend on market conditions and cash flow needs.