



Funding of the Montana Transportation System

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Introduction

The Montana transportation system is funded from state fuel taxes, state vehicle fees, and federal funds. The majority of the funding comes from federal grants. Generally state funds must be spent within the biennium in which they are appropriated, while federal funding is available over a longer time horizon depending on the use of the funds. Most federal highway grant funds require a state match and match rates vary depending on the type of expenditure.

A majority of state fuel taxes are deposited to the state highway revenue account (HRA) with a small percentage allocated to snowmobile, motor boat, and off-road vehicle account. Annual expenditures from the HRA have exceeded annual revenues since state fiscal year (SFY) 2012 by an average of \$11.6 million, drawing down the account reserves.¹ At the beginning of the 2017 biennium, the HRA working capital balance was projected to be negative by \$20.8 million at the end of SFY 2017. The Montana Department of Transportation (MDT) began reducing expenditures in order to ensure that the HRA ending balance would be positive at the close of the 2017 biennium. The fiscal imbalance in the HRA account will continue unless expenditure reductions are permanent or revenues are increased.

State Funding for Transportation Infrastructure

Montana imposes fuel taxes and gross vehicle weight fees to support the construction, maintenance, and operation of the state transportation system, with some funding available for local government use. Fuel tax rates are 27 cents per gallon on gasoline, 27 3/4 cents per gallon on special fuel (predominantly diesel fuel), and 4 cents per gallon on aviation fuel (15-70-403, MCA). The most recent changes to fuel tax rates were:

- Gasoline tax rate was raised from 24 cents to 27 cents per gallon effective July 1, 1994
- Special fuel tax rate was raised from 27 cents to 27 3/4 cents per gallon effective July 1, 1995
- Aviation fuel tax rate was raised from 3 cents to 4 cents per gallon effective July 1, 1999

Constitutional Restrictions

Article VIII Section 6 of the Montana Constitution governs the use of revenue from taxes on gasoline and special fuel and revenue from gross vehicle weight fees. After deduction of refunds and adjustments, the revenue from such taxes and fees shall be used only for:

1. Payment of obligations incurred for construction, reconstruction, repair, operation, and maintenance of public highways, streets, roads, and bridges;
2. Payment of county, city, and town obligations on streets, roads, and bridges; and
3. Enforcement of highway safety, driver education, tourist promotion, and administrative collection costs.

However, this section of the Constitution also allows use of these revenues for other purposes if it is approved by a 3/5 vote of members of each house of the state legislature.

Highway Revenue Account – Restricted Highway Funding

State statute requires constitutionally restricted funds from gas and special fuel taxes and weight fees to be deposited in the HRA, which supports:

- "Planning functions required in the federal funding law
- Maintenance of the federal-aid highway system to FHWA (federal highway) standards
- Adequate management and oversight of federal-aid construction projects
- A minimum construction program supported by 100% state funds
- Matching funds for federal-aid construction funds, . . .; and

- Adequate working capital to pay operating expenses with 100% state funds until federal reimbursement is provided"²

Although the majority of the funds in the HRA are appropriated through the general appropriations act (HB 2) each legislative session, state statute establishes several appropriations (statutory appropriations) that continue year after year unless the statute is amended by the legislature. Three state agencies receive HB 2 appropriations from the account, including MDT, the Department of Justice (DOJ), and the Department of Fish, Wildlife, and Parks (FWP).

Statutory Appropriations

The most significant of the statutory appropriations from the HRA is \$16.7 million allocated each state fiscal year to cities and counties (15-70-101(1), MCA). About \$6.3 million is divided among counties based on rural road mileage, rural population, and land area. About \$10.4 million is allocated among incorporated cities and towns based on population and street and alley mileage. The second largest statutory appropriation from the account supports negotiated settlements with Indian tribes. The amount can vary depending on the various negotiated settlements and was \$5.1 million in SFY 2016.

Allocations from Gasoline Tax

Statute also establishes several additional allocations from gasoline taxes (60-3-201, MCA). After payments of refunds and any bond obligations (60-3-201, MCA), gasoline tax allocations are made as follows:

- 9/10 of 1% for the state parks account
- 15/28 of 1% for the snowmobile account
- 1/8 of 1% for the off-highway vehicle account
- 1/25 of 1% for the aeronautics revenue fund
- Remainder for operation and maintenance of highways, the collection of the fuel taxes, and enforcement of the Montana highway code under Article VIII Section 6 of the Constitution

Generally these allocations are restricted to the purposes of the allocation. The legislature must establish appropriations each legislative session from each of these accounts in order for funds to be expended. FWP administers the funds appropriated for state parks and snowmobiles and most of the funds appropriated for off-highway vehicles, while MDT administers funds appropriated for aeronautics and a small amount of off-highway funds.

NonRestricted Highway Funding

There are also several sources of state revenue that are not restricted and may be appropriated by a simple majority vote of each house of the legislature. These sources generated, on average, \$9.5 million annually over the most recent 10 years and include:

- Special weight and trip permit fees
- Fees in lieu of taxes
- International Registration Plan (IRP) registration fees
- Various minor sources not governed by the constitutional restrictions

These funds are deposited to a state special revenue account. In SFY 2016 the two most significant expenditures from this fund source were for MDT maintenance and rail, transit, and planning functions.

Special Fuel and Gasoline Tax Allocations

Special fuel and gasoline taxes are remitted to the state treasury on a monthly basis by the distributor. MDT deposits these monies into the various funds as prescribed by state statute. With exception of

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refunds, these deposits cannot be expended until appropriated by the legislature (general appropriations act and statutory appropriations).

Figure 1 shows the distribution of state taxes on special fuel and gasoline to the various state special revenue funds (accounts). The information is shown by state fiscal year from 2000 to 2016. There may be multiple funds used to facilitate appropriate accounting and to comply with statutory requirements. For example, there are three different snowmobile funds but they have been consolidated in this document as one fund. If the heading line in Figure 1 shows “Funds”, it indicates that multiple funds have been consolidated. As shown at the bottom of Figure 1, 98.9% of the special fuel and gasoline tax revenue (after refunds) has been allocated to the HRA over the 17 year period. The remainder is distributed to the other funds listed. After statutory appropriations are made from the HRA, the remainder of the funds shown in Figure 1 were available for appropriation in the general appropriations act each biennium by the legislature.

Figure 1

Distribution of State Taxes on Special Fuel and Gasoline By State Fiscal Year							
State FY	Noxious Weed Funds	Off Highway Funds	Snowmobile Funds	MotorBoat Fund	Highway Revenue Fund	Aeronautics Fund	Total Funds
2000	\$13,032.41	\$156,389.07	\$690,718.43	\$1,172,917.98	\$182,498,230.78	\$52,129.68	\$184,583,418.35
2001	12,781.89	154,517.14	672,047.41	1,150,250.59	177,635,336.45	51,863.04	179,676,796.52
2002	13,137.96	156,323.32	690,984.39	1,181,093.96	185,407,777.17	52,552.40	187,501,869.20
2003	13,120.41	157,472.82	695,492.32	1,180,857.30	187,005,540.45	52,481.19	189,104,964.49
2004	13,299.28	159,485.43	704,391.35	1,196,224.34	191,539,159.47	53,165.99	193,665,725.86
2005	12,509.60	150,623.58	665,042.36	1,126,371.13	185,813,971.99	50,038.26	187,818,556.92
2006	12,924.46	155,196.14	685,407.27	1,163,307.13	197,176,387.55	51,698.00	199,244,920.55
2007	13,499.56	161,637.98	714,053.85	1,214,604.62	201,022,342.79	53,998.26	203,180,137.06
2008	12,739.46	153,255.21	676,755.48	1,147,235.54	196,839,942.84	50,969.45	198,880,897.98
2009	13,747.08	164,015.30	724,760.40	1,236,671.88	204,453,462.11	54,999.94	206,647,656.71
2010	7,089.66	165,439.78	709,025.67	1,191,161.91	194,538,421.72	52,940.54	196,664,079.28
2011	7,112.83	165,967.66	711,267.68	1,194,966.62	199,822,458.57	53,109.62	201,954,882.98
2012	7,120.24	166,138.98	704,903.94	1,196,200.62	202,133,420.40	53,164.48	204,260,948.66
2013	7,213.21	168,308.19	714,107.57	1,211,818.91	205,583,999.97	53,858.61	207,739,306.46
2014	7,275.83	169,770.12	720,310.24	1,222,344.79	206,251,300.77	54,326.44	208,425,328.19
2015	6,385.39	179,024.43	754,053.92	1,279,427.40	216,749,817.00	56,863.82	219,025,571.96
2016	7,706.05	181,120.64	766,629.66	1,300,956.35	215,642,354.25	57,820.55	217,956,587.50
Totals	\$180,695.32	\$2,764,685.79	\$11,999,951.94	\$20,366,411.07	\$3,350,113,924.28	\$905,980.27	\$3,386,331,648.67
% of Total	0.0053%	0.0816%	0.3544%	0.6014%	98.9305%	0.0268%	

Source: Statewide Accounting, Budgeting, and Human Resource System

State Transportation Budget

MDT was appropriated \$1.3 billion total funds for the 2017 biennium in the general appropriations act, with about 62% supported by federal funds and the balance from the HRA. This amount does not include appropriations for pay plan nor long range building functions.

Federal Highway Funds

The major portion of MDT funding is from federal sources. States receive funds for infrastructure and operation of transportation systems through federal highway legislation. Federal funds are generated from gasoline and diesel fuel taxes and in recent years have been supplemented from other federal tax sources as well. Current federal fuel tax rates are:

- 18.4 cents per gallon on gasoline
- 24.4 cents per gallon of diesel fuel

Federal highway funding is usually authorized through multi-year "federal authorization bills that specify the allocation formulas and standards for use of federal highway funds".³ Each state is guaranteed funding equal to at least 95.0% of the estimated amount of federal fuel taxes paid by its residents.

Federal Highway Grant

Montana receives an apportionment of federal highway funding in an annual grant. The apportionment is a share of federal highway funding that is typically authorized over several years. The most recent federal act - Fixing America's Surface Transportation or FAST Act - authorizes \$39.7 billion in federal fiscal year (FFY) 2016 gradually increasing to \$43.4 billion in FFY 2020. Although these amounts are approved in the FAST Act, Congress has appropriated funds for all but the final year.⁴

Figure 2 shows the initial \$422.0 million apportionment of federal highway grant funds to Montana for FFY 2017 by major component. The majority of funds are allocated to the National Highway Performance and Surface Transportation Block Grant programs, which are the primary funding sources for construction and maintenance of highways. These two programs were reduced by about \$9.2 million since Montana was penalized for not adopting certain federal requirements related to the primary seat belt law. The penalty funds must be reallocated and spent for safety projects meeting federal guidelines.

Figure 2

FFY 2017 Federal Transportation Funding for Montana								
Grant/ Penalty/ Preliminary Total	National Highway Performance Program	Surface Transportation Block Grant Program	Highway Safety Improvement Program	Railway- Highway Crossings Program	Congestion & Mitigation Air Quality Improvement	Metropolitan Planning	Highway Freight Program/ Other	Apportioned Total*
Initial Grant	\$244,721,938	\$122,185,653	\$24,882,649	\$1,972,354	\$15,060,896	\$1,814,847	\$11,399,888	\$422,038,225
Transfer to Safety Preliminary Grant*	<u>6,118,048</u>	<u>3,054,641</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>(9,172,689)</u>	<u>0</u>
Grant*	\$250,839,986	\$125,240,294	\$24,882,649	\$1,972,354	\$15,060,896	\$1,814,847	\$2,227,199	\$422,038,225
% of Total	59.4%	29.7%	5.9%	0.5%	3.6%	0.4%	0.5%	100.0%

Source: U.S. Department of Transportation, Federal Highway Administration, "Apportionment of Federal-Aid Highway Program Funds for Fiscal Year (FY) 2017", October 3, 2016.

*Total grant amounts shown do not include post apportionment set asides and reductions due to sequestration.

The actual amount of federal funds that Montana may be eligible to spend may be lower or higher than the initial apportionment depending on Congressional action. As of October 31, Montana had been notified that it may obligate (spend) \$69.8 million of the \$422.0 million apportionment.

Multiyear Expenditure Authority and Reallocation

A state does not receive cash from its federal highway grant until it makes an allowable expenditure and submits a request for reimbursement. A state has several years to spend funds from its annual federal highway grant, with time limitations dependent on the type of activity that is funded. For instance, a state has 10 years to obligate funds for a highway construction project and complete the preliminary engineering. A state then has another 20 years to complete other project tasks such as acquiring the right of way. Although it is not a routine occurrence for states to lose federal highway funding for long term projects that are not progressing, there is increasing federal scrutiny on inactive projects.⁵ In SFY 2017,

Montana is managing \$152.2 million for projects funded from federal grant authority carried forward from previous years.

States that are not able to fully spend federal highway grant funds revert federal authority that is then redistributed to other states. Historically, Montana has received between \$10.0 million to \$15.0 million annually in redistributions of other states' unused federal grant authority. However, the most recent redistribution was closer to \$30.0 million.⁶ A state has one month to obligate the redistributed authority, which is often accomplished by reassigning active projects from one of its annual state grants to the redistributed authority.

State Match Requirement

Each of the major sub grant categories shown in Figure 2 has federal guidelines governing how the funds may be spent and may include several sub categories further delineating the use of funds and whether the state must participate in the cost. Although some types of expenditures, such as projects on Indian reservations and some safety projects, are eligible for 100% federal funding, the majority of projects funded from the federal highway grant must be partially supported with state funds as well. The required amount of state participation (match rate) is based on a formula that takes into account population and miles of federal highway system. Although there are different match rates for subcategories within federal highway grant funding, such as the 8.76% state match rate for work on certain interstate highway projects, the majority of federal funds require a 13.42% state match.⁷

State Maintenance of Effort

In addition to providing matching funds for certain expenditures, a state also must spend a designated amount of state funds on eligible activities each year (MOE) in order to receive federal highway grant funding. The MOE is calculated annually based on a federal formula. The Montana MOE has ranged from \$17.0 to \$20.0 million.⁸

Timing of State Funding Compared to Federal Funding

Generally, MDT has two years (one biennium) to spend its state funded HRA appropriation. The legislature has authorized biennial appropriations for MDT, meaning that appropriation authority can be moved between the two fiscal years in a biennium. Unspent authority from the first year can be re-established and spent in the second year of the biennium. Conversely, if expenditures run higher the first year of the biennium authority can be transferred from the second year to the first year to cover the overage. Since MDT has multiple years to spend federal grant authority, state funds appropriated in the 2017 biennium may be used to match federal grant funds received over several state fiscal years.

Estimated Working Capital Balance - HRA

Figure 3 shows the estimated working capital balance for the HRA at the beginning of the 2017 biennium compared to the estimated balance at the end of the biennium. A working capital fund balance is defined as all assets less inventories minus all liabilities. Since inventories are not considered a liquid asset (available cash), they are excluded from the balance calculation. At the end of SFY 2016, total inventories were \$20.6 million.

Figure 3

Highway Revenue Account Figures in Millions		
Anticipated Revenue	2017 Biennium	% of Total
Beginning Fund Balance	\$41.9	
Special Fuel & Gasoline Tax	421.1	73.4%
Gross Vehicle Weight Fee	54.4	9.5%
Federal Indirect Recovery	83.5	14.6%
Other Revenue	14.6	2.6%
Distributors Fee	(4.0)	
Total Anticipated Revenue + Balance	\$611.5	
Authorized Appropriations		
Department of Transportation	\$506.2	80.1%
Department of Justice	79.4	12.6%
Fish, Wildlife & Parks	2.3	0.4%
Statutory Appropriations	44.4	7.0%
Total Authorized Appropriations	\$632.3	
Initial Estimated Working Capital Fund Balance.	(\$20.8)	
MDT Cost Reductions/Reversions	48.5	
Year End Estimated Working Capital Balance	\$27.70	

Source: Legislative Fiscal Division

Figure 3 shows that total revenues plus carryforward balance anticipated for the 2017 biennium are \$611.5 million and total appropriations are \$632.3 million for a projected negative ending balance of \$20.8 million. MDT has taken actions to reduce expenditures from the account, which are discussed in greater detail later in the report, and has projected that the account balance will be a positive \$27.7 million by the end of SFY 2017.

As shown in Figure 3, MDT has the largest HRA appropriation of \$506.2 million or 80.1% of the total. DOJ and FWP also have appropriations from this fund, 12.6% and 0.4% of the total,

respectively.

Statutory appropriations are about 7% of the total. As noted previously, the two most significant are a \$16.7 million fixed amount allocated to counties and cities and the negotiated settlement with Tribes, which was \$5.1 million in SFY 2016. Together these two statutory appropriations accounted for \$43.6 million of the total \$44.4 million shown in Figure 3.

MDT Budget

MDT builds its biennial budget using many of the same assumptions that other state agencies use for expenditures such as personal services and operating costs to support its employees. However, it has two unique components: the maintenance program and the highway construction program. Together these two programs comprise 86.8% of the MDT appropriation from HB 2.

The construction program received \$902.6 million or 67.2% of the total MDT 2017 biennium appropriation in HB 2. The majority of the appropriation - 83.2% - is from federal grants.

The maintenance program is budgeted about \$262.9 million over the 2017 biennium from HB 2, supported largely by state funds and about \$16.4 million in federal funds. This program performs such activities as winter maintenance, pavement repair, painting and striping roadways, and noxious weed control. The state maintenance of effort (MOE) is included in the maintenance program budget.

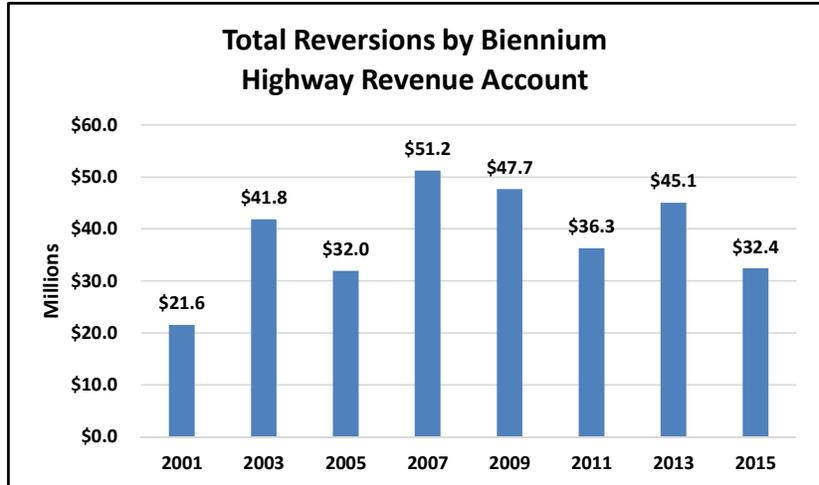
Budget Assumptions

MDT prepares its biennial budget request for construction and maintenance functions using assumptions that have provided more appropriation authority than it generally needs during a biennium. MDT requests sufficient authority to complete all planned highway construction projects within the timelines assumed for the biennium and to fund necessary road maintenance under the worst possible weather conditions. The legislature has based its appropriations on these assumptions as well.

Figure 4 shows MDT reversions (unexpended authority) of HRA appropriations for each biennium from 2001 to 2015. For example, MDT reverted \$45.1 million of HRA authority in the 2013 biennium and \$32.4 million in the 2015 biennium. The average reversion for the time period shown in Figure 4 is \$38.5 million.

In comparison, the cost reductions and reversions anticipated by MDT for the 2017 biennium as shown in Figure 3 are \$48.5 million or \$10.0 million greater than the historic biennial average.

Figure 4



2017 Biennium Cost Saving Measures

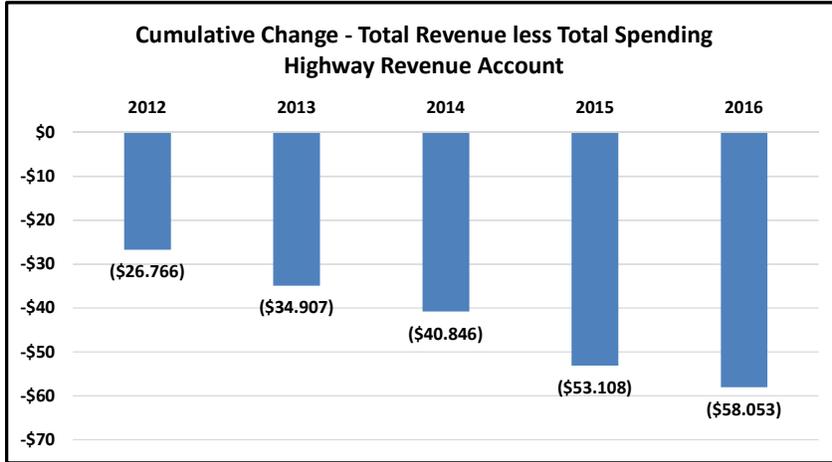
MDT took actions to reduce expenditures, including delaying some of the projects funded from HB 10 (information technology system appropriations) and HB 5 (long range building appropriations).⁹ MDT also focused on identifying and using the portion of federal highway grant funds that require no match or the lowest state match.

DOJ is unable to substantially reduce its expenditures from the HRA. Statute requires state agencies to spend other funds before spending general fund (17-2-108, MCA). DOJ receives both HRA and general fund for its functions, therefore it is statutorily required to spend HRA appropriations prior to spending general fund.

HRA Balance

As noted previously, there has been an ongoing fiscal imbalance in the HRA beginning in SFY 2012. Annual expenditures from the account have exceeded revenues despite the MDT reversions of HRA. This ongoing imbalance has depleted account reserves. Figure 5 shows the cumulative change in annual revenues compared to annual expenditures from the account.

Figure 5



For instance, in SFY 2012, expenditures exceeded annual revenue by \$26.7 million. The five year average annual deficit was \$11.6 million over this period.

There will be an ongoing fiscal imbalance in the HRA without permanent reductions in spending, an increase in revenue, or both. Some of the MDT expenditure reductions

were for one-time appropriations and are not ongoing. In addition, some of the reductions were related to upgrades of information technology system and maintenance of secondary roadways, which cannot be indefinitely postponed.

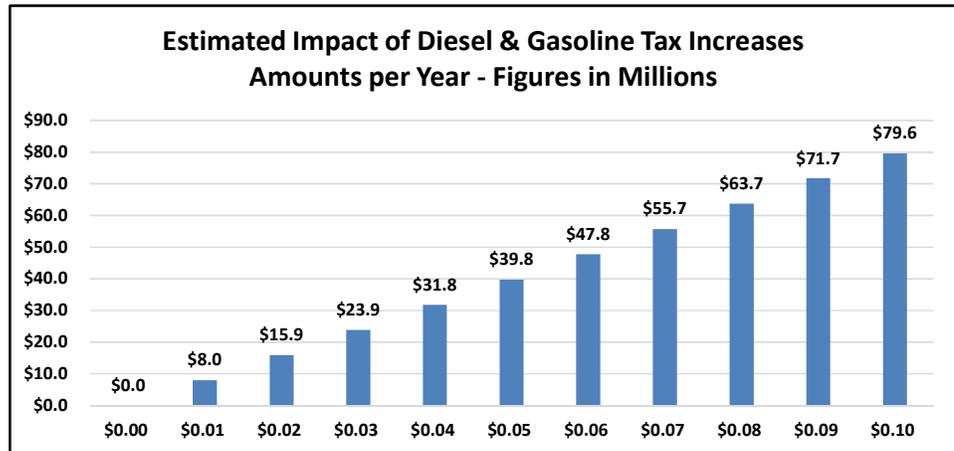
Revenue Impact of a Fuel Tax Increase

Figure 6 shows an estimate of revenue if fuel taxes were increased. Each additional penny would add about \$5.3 million in the gasoline tax and about \$2.7 million in diesel tax for a total of \$8.0 million each year. The estimates

Figure 6

assume consumption would not decline with a higher tax rate (inelastic demand).

As noted previously, one way to address the HRA fiscal imbalance would be to raise fuel taxes. Two ways to evaluate the level of increase needed to align HRA revenues and expenditures are:



the initial estimated shortfall in the 2017 biennium - \$20.8 million, and the average annual shortfall since FY 2012 - \$11.6 million. Fuel taxes would need to be raised 2 6/10 cents under the first scenario and 1 1/2 cents under the second scenario. However, neither of these scenarios anticipates revenue for increased expenditures such as additional state matching funds for federal grant funds nor to cover the cost of inflation in construction costs or MDT operating costs such as pay increases. The estimates also assume that fuel consumption will remain constant.

Summary

The Montana transportation system is funded from state and federal funds, with federal funding providing the most significant share. State funds, primarily from taxes on gasoline and special fuel, provide the majority of state funding.

State revenue from special fuel and gasoline taxes has increased on average about 1.0% per year since SFY 2000. During this timeframe, Montana fuel tax rates have not been modified. Beginning in SFY 2012, expenditures from the HRA increased faster than revenue growth thereby drawing down reserves, resulting in a projected working capital deficit of \$20.8 million by the end of SFY 2017. MDT is taking actions to reduce expenditures, with the goal of ending the biennium with a positive balance of \$27.7 million in the account.

The annual shortfall between HRA revenues and expenditures has averaged about \$11.6 million from SFY 2012 through SFY 2016. The HRA faces an ongoing fiscal imbalance unless actions are taken to permanently reduce expenditures from or increase revenues to the fund. Each 1 cent per gallon increase in fuel taxes provides about \$8.0 million per year assuming fuel purchases would not decline due to higher prices. It would take an increase of about 1 1/2 cents to 2 6/10 per gallon on gasoline and special fuel to offset the projected FY 2017 deficit or the average annual deficit in the HRA account.

¹ All accounting and expenditure data is drawn from the Montana Statewide Accounting, Budgeting, and Human Resources System (SABHRS) unless otherwise specified.

² Montana Legislative Fiscal Division. 2015 Biennium Legislative Fiscal Report. Montana Legislative Fiscal Division. June 2013, Vol. 4, p. C-76, downloaded from the following link: <http://leg.mt.gov/fbp.asp>.

³ Cathy Duncan. Fiscal Brochure: Montana Highway Funding. Montana Legislative Fiscal Division. 2016, p. 2, downloaded from the following link: http://leg.mt.gov/content/Publications/fiscal/leg_reference/Brochures/Highway-Funding-2016.pdf.

⁴ Larry Flynn, Administrator, Administration Division, Montana Department of Transportation, personal conversation, October 13, 2016.

⁵ *Ibid.*

⁶ *Ibid.*

⁷ *Ibid.*

⁸ *Ibid.*

⁹ *Ibid.*