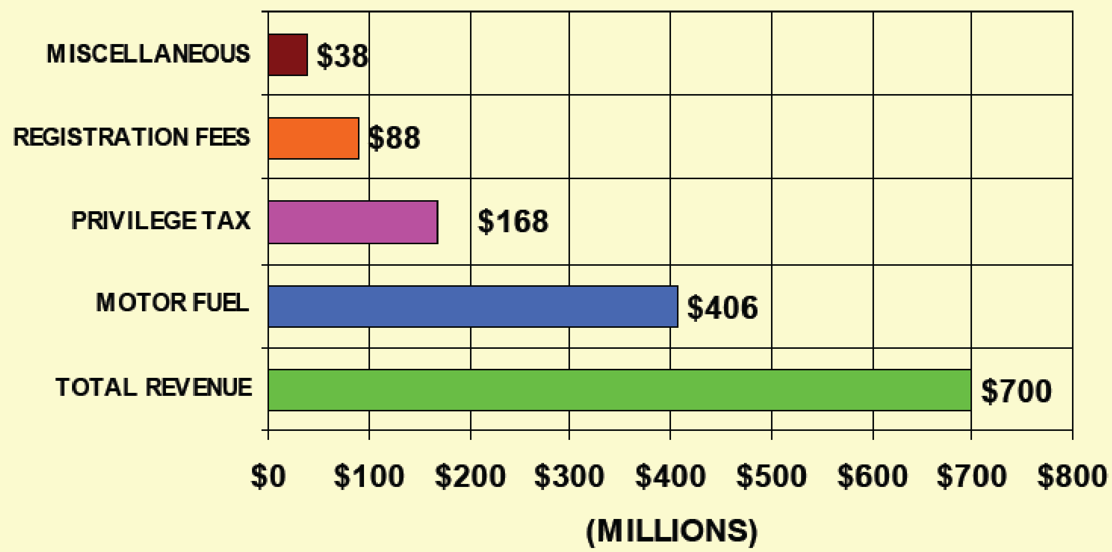
V. HIGHWAY FUNDING

The activities of WVDOH are funded almost exclusively from the Road Fund, which receives its funding from state revenue collections and federal reimbursement. The state revenue component of the Road Fund is derived from motor fuel taxes, registration fees, privilege tax, and miscellaneous income levied and generated at the State level. The federal component is derived from federal-aid reimbursements available to the State through national federal-aid highway legislation. Federal-aid highway funds are generated by motor fuel taxes and fees levied at the national level and deposited in the Highway Trust Fund. In order to help highway departments plan and schedule projects, Congress typically passes legislation authorizing the expenditure of federal-aid funds over a multi-year period and specifying how those funds are to be distributed among the states. The current multi-year federal reauthorization legislation is SAFETEA-LU, which was signed into law on August 10, 2005. SAFETEA-LU covers FFYs 2005 through 2009 and replaces the prior multi-year legislation, the Transportation Equity Act for the 21st Century (TEA-21), that expired in September 2003. In the interim, Congress enacted a series of short extensions to keep federal highway funds flowing to the states.

STATE ROAD FUND (STATE REVENUE):

The State Road Fund collected $700 million in State revenue in FY 2007 (see Figure # 5). Those revenues can be divided into four basic categories: Motor Fuel Taxes, Registration Fees, Privilege Tax, and Miscellaneous Revenue.

FIGURE # 5
STATE ROAD FUND REVENUE
(State Components) FY 2008



While the Motor Fuel Tax serves as the primary revenue generator for the State Road, it has come under intense scrutiny in the wake of high retail fuel prices, which currently exceed $4 per gallon. The Motor Fuel Tax rate was 27¢ per gallon in calendar year (CY) 2006 and increased to 31.5¢ per gallon for CY 2007 and subsequently to 32.2¢ in CY 2008 due to a continuing rise in the variable rate component of the State’s Motor Fuel Tax. In response to the run-up’s in retail fuel prices in 2007 and 2008, the Legislature forestalled a subsequent increase in the variable rate by freezing that portion of the Motor Fuel Tax at its current rate of 11.7¢ for CY 2009. The recent action taken by the Legislature represents the second time during a five year period where the variable rate portion of the tax has been frozen. The flat rate portion of the Motor Fuel Tax is set to remain at its current rate of 20.5¢ until July 31, 2013 at which time without legislative action will revert to 15.5¢ per gallon.

The variable rate portion of the Motor Fuel Tax is set at 5% of the Statewide average wholesale price per gallon, but may not be less than 4.85¢ per gallon. The rate is calculated by the Department of Revenue yearly and any adjustment in the rate is effective on January 1 of the next year. In January 2008, for the fifth time since it was instituted in 1983, the variable rate component exceeded the minimum rate and was set at 11.7¢ per gallon. The variable rate of 11.7¢ per gallon represents an increase of

0.7¢ over the CY 2007 rate. As the result of the two components, the total Motor Fuel Tax rate increased from 31.5¢ per gallon in CY 2007 to 32.2¢ per gallon on January 1, 2008. During FY 2008, the Motor Fuel Tax generated $404.2 million in revenue.

For the purposes of this document, Registration Fees encompass not only vehicle registration fees but also driver licenses, permit, and litter control fees. Vehicle registration fees are based on a vehicle's classification and are renewed annually or on a multi-year basis. Driver licenses and learners permit fees are imposed to verify that a person is qualified to operate a motor vehicle. In FY 2008, registration Fees generated $88.3 million in revenue.

The Privilege Tax, imposed when the certificate of title is issued, was first enacted in 1935 at a rate of 2% of the vehicle value. The rate was increased to 5% in 1971 and has remained unchanged since that time. In FY 2008, Privilege Taxes generated $169.5 million in revenue.

Miscellaneous Revenue sources typically include revenue from interest on investments, map sales, permits, etc and have historically been small in comparison to the other revenue sources. However, due to several legislative changes Miscellaneous Revenue now accounts for a larger share of State Road Fund monies. The most significant change is a legislatively mandated yearly transfer of revenue from the State's General Fund to the State Road Fund, which is intended to offset costs incurred by the WVDOH when its contractors pay State Sales Tax on construction materials. The amount of the transfer will vary yearly depending on the size and scope of the Agency's construction program, but will add several million dollars to the State Road Fund annually. In FY 2008, the transfer of funds associated with the rebated sales tax equaled $12.7 million. This change along with other funding transfers required in the short term by the Legislature caused the amount of Miscellaneous Revenue collected to increase by $25.8 million from FY 2007 to FY 2008. In FY 2008, Miscellaneous Revenue generated $38.4 million in revenue for the Road Fund.

STATE ROAD FUND (FEDERAL-AID REIMBURSEMENT):

The federal government has long recognized the need for an efficient and effective national highway network. To help satisfy this need, the federal government authorizes the expenditure of federal funds for various activities that it has deemed to be of national importance. Rather than trying to own, operate, and maintain highway infrastructure across the nation, the federal government makes funds available to state and local governments having jurisdiction over important transportation facilities to accomplish these tasks. The activities and/or the network of roads and bridges in which the federal government will participate in their renovation, improvement, and construction are termed "federal-aid-eligible".

The federal government primarily uses the national highway functional classification system of roadways discussed earlier as the basis for determining which facilities are eligible for federal aid. Due to the national focus on these roadways, except under special circumstances, roads that are functionally classified as Rural Minor Collector, Rural Local Service, or Urban Local Service are not eligible for federal aid. Throughout the State, only 28.6% (10,368 miles) of the public highway mileage is eligible for federal aid. The remaining 71.4% (25,944 miles) of public highway mileage must be funded entirely by the governmental entity having jurisdiction over those highways. In the case of West Virginia, where WVDOH has statutory responsibility for nearly all roads, all maintenance, improvement, and construction initiatives are funded with 100% State revenues. In addition to the previously listed classifications, the federal government also prohibits use of federal-aid funds for specific activities. This is of paramount importance because federal funds may not be used to pay for the top three mandated priorities of WVDOH (i.e., debt service, administrative support, and routine maintenance expenditures). As a result, not only are the majority of roadways under WVDOH jurisdiction not eligible for federal assistance, but neither are its top three mandated priorities.

As mentioned previously, Congress typically authorizes a specific total amount of federal-aid highway funds for a multi-year period and mandates the amount of funding that will be available in a given year. In order to assure that specific types of highway needs are addressed, Congress identifies various highway programs and then sets eligibility criteria, matching fund requirements (most federal funds must be matched on an 80/20 federal to state ratio), and the funding levels of each. The federal legislation that makes these funds available to the states is two-fold in nature. First, when multi-year authorizing legislation (like SAFETEA-LU or TEA-21) is in place, formulas are set that dictate how a large portion of those funds will be apportioned among the states on a yearly basis over the life of the legislation, which in turn allows transportation agencies to set some long-range priorities. Second, each year a significant amount of discretionary or “special” funds, which become available as part of the authorizing legislation, are appropriated for use and allocated based upon wording contained in the legislation for that specific year. The exact amount of “special” funds that will be available is impossible to predict. These yearly allotments tend to come in the form of line items for specific projects (i.e., the funds can be used only for the initiative described in the legislation).

In addition to the apportionments and allocations described above, obligation limitation also must be factored. Obligation limitations are caps placed on federal-aid highway funding to control highway program spending in response to economic and budgetary conditions. In short, obligation limitations have the impact of generally reducing a state’s federal-aid apportionments and allocations. While it is possible for Obligation Authority (OA) to be greater than apportionment or appropriation amounts, historically it has been about 90% of those levels. While some apportionments get obligation authority that can only be used for projects that meet those requirements, much of the obligation authority the Agency receives comes in block form that can be applied to multiple apportionment categories. This mechanism provides states with the flexibility to apply more or less of their obligation authority to a specific federal program in a given year, as long as it does not exceed the unobligated balance available of that program. For the purposes of this document, the assumed 90% obligation level will be applied uniformly to all federal programs.

When the federal-aid component of the Road Fund is examined, it should be noted that the federal funds are in fact reimbursements. The federal government does not provide funds directly to the states for expenditure. Instead, in each year covered by the authorizing legislation, the states are allowed to obligate federal highway funds that will be available to them for highway initiatives based upon the amount of OA provided. The obligations serve as commitments for the federal government to reimburse a State for the federal share of the highway initiatives' eligible costs. As indicated previously, most programs are matched by a state on an 80% federal/20% state share basis. When expenditures are incurred on a project that is eligible and has been authorized, they are initially paid for by the state and then reimbursement is requested from the Federal Highway Administration (FHWA). Once a request is made, it typically takes ten days for the FHWA to reimburse the State. This information is important because, while the amount of funds that can be obligated by the state in a given year can be predicted with some degree of certainty when a multi-year federal highway authorization is in place, the timing of when the required matching funds will be needed to cover expenditures cannot be predicted as easily. In FY 2008, federal-aid reimbursements to the WVDOH totaled $357.2 million.

OBLIGATIONS vs. EXPENDITURES:

At first glance, the difference between obligations and expenditures may not appear significant. In fact, if sufficient cash reserves are available to WVDOH to provide the necessary matching funds, the difference between the two will have little effect on WVDOH operations. If the State is allowed to obligate $100 million in federal funds on an 80/20 matching basis, it is evident that $20 million in State funds will be needed to match those funds at some point. The danger lies in promoting a plan of highway initiatives that may place a strain on available State funds. As an example of this danger, consider the following scenario: WVDOH wishes to construct a section of new four-lane highway that is eligible for federal aid. The project has an estimated cost of $100 million and will take four years to complete, with a project development and cost breakdown as shown in Table # 2.

TABLE # 2
PROJECT FINANCING EXAMPLE

DEVELOPMENT PHASE	TIME TO COMPLETE	TOTAL COST	FEDERAL SHARE	STATE SHARE
ENGINEERING	1 YEAR	$10 MILLION	$8 MILLION	$2 MILLION
RIGHT OF WAY	1 YEAR	$5 MILLION	$4 MILLION	$1 MILLION
CONSTRUCTION	2 YEARS	$85 MILLION	$34 MILLION/YR	$8.5 MILLION/YR
TOTAL	**4 YEARS**	**$100 MILLION**	**$80 MILLION**	**$20 MILLION**

While only $20 million in State funds is required to complete the project, the amount of funds required during the more expensive construction phase is significantly higher than during the initial two phases of development. Without proper planning, the fluctuations in required State funds could easily result in funding shortfalls.

Since inherent uncertainty permeates every aspect of WVDOH's operations, from revenue projections to weather-related emergencies to estimating costs and schedules, no degree of planning will ever fully account for these events. To mitigate these uncertainties and ensure that it has enough funds on hand to meet changing conditions; WVDOH needs to keep a cash balance of approximately $80 to $100 million to avoid any shortfalls in meeting its financial obligations.

While matching all available federal-aid highway funds is an important goal of WVDOH, it ranks only fourth in order of priority behind debt service, administrative support, and routine maintenance. It is the disparity between the desire to undertake improvement projects and the need to fund mandated priorities adequately in conjunction with projected revenue declines that has required WVDOH to track more closely every aspect of its expenditures. In order for WVDOH to develop and follow a realistic STIP, it will be necessary not only to project the amount of future federal-aid funds (apportioned and discretionary) that will be made available during that time period but also to:

- Project State revenue available to WVDOH;
- Project future costs of debt service, administrative support and routine maintenance;
- Project future costs of mandated set-asides;
- Identify and track the status of all active highway improvement projects (i.e., phase of development, federal eligibility, capital cost, expenditure schedule, and construction schedule); and
- Determine the impact that expected revenues and expenditures will have on the cash position of WVDOH and make adjustments accordingly to avoid shortfalls.