Building a Quality Arizona: Statewide Intrastate Mobility Reconnaissance Study

Working Paper #5:
Issue Paper – Finance

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The *Building a Quality Arizona: Statewide Intrastate Mobility Reconnaissance Study* was initiated by the Arizona Council of Governments (COG)/Metropolitan Planning Organization (MPO) Association, in cooperation with the Arizona Business Coalition, the Arizona Department of Transportation (ADOT), the State Legislature, and the Governor's Office, focusing on Arizona's growth and transportation challenges. The purpose of the *Statewide Intrastate Mobility Reconnaissance Study* is to develop a long-range vision, driven by sustainable community and economic development, that links land use, the economy, and transportation infrastructure in the state of Arizona.

In an effort to learn about strategic issues confronting Arizona, the bqAZ team visited each COG/MPO, as well as other key stakeholders and state departments. These day-long workshops brought together local experts in community development, economic development, transportation, and finance to gain an understanding of the existing conditions, issues, ideas, and possibilities.

The findings of these visits are summarized in *Working Paper #1: Data Collection Summary*. The topic of this multi-disciplinary focus group is identifying acceptable strategies for funding improvements to the current and future high-capacity state transportation network. It emphasizes revenue sources, not innovative finance mechanisms (such as bonds) to leverage these sources. This paper and the supplemental documents will form a common knowledge base for our discussion.

INTRODUCTION

A safe and efficient surface transportation system is vital to Arizona's future. The system's foundation is a network of high-capacity freeways and arterials which accommodate regional, inter-regional and interstate travel. In many parts of the state, the system is already congested or inadequately maintained due to a lack of transportation funds.

The current system will need to be expanded to accommodate 7 million new residents – a doubling of today's population – by the year 2055[1]. Although the time horizon seems very distant, we need to remember that (1) new capacity will need to be phased in over time, (2) major improvement projects typically have extremely long lead time (e.g. planning, design, right-of-way acquisition, construction), and (3) adequate funding does not currently exist.

On average, each new household requires $10,000 to $20,000 in arterial and freeway capacity. Initial construction represents only about one-third the life cycle cost of new facilities, so the present value of total costs are about $30,000 to $60,000 per household. Our current revenue sources simply will not fill the bill. We need to decide soon which facilities are needed, how the projects will be funded, and who will pay the capital and maintenance costs.

SUMMARY OF CURRENT REVENUE SOURCES

Transportation funding is available from federal, state, and local revenues and from private sources. Motor vehicle fuel taxes dominate federal and state revenues. Sales taxes, user fees and development impact fees generate most of the regional and local revenues. Private revenues include development exactions and money spent on construction of public roadways as part of land development. Arizona's revenues are restricted by

[1] Arizona Department of Economic Security, Research Administration, Population Statistics Unit, Population projected by Demographic Cohort-Component Population Model. Approved by Arizona Department of Economic Security Director, March 31, 2006.

statute and the state Constitution. They are used almost exclusively for roadway purposes. Virtually all of the local road and collector streets, and some arterials segments, are provided with new land development.

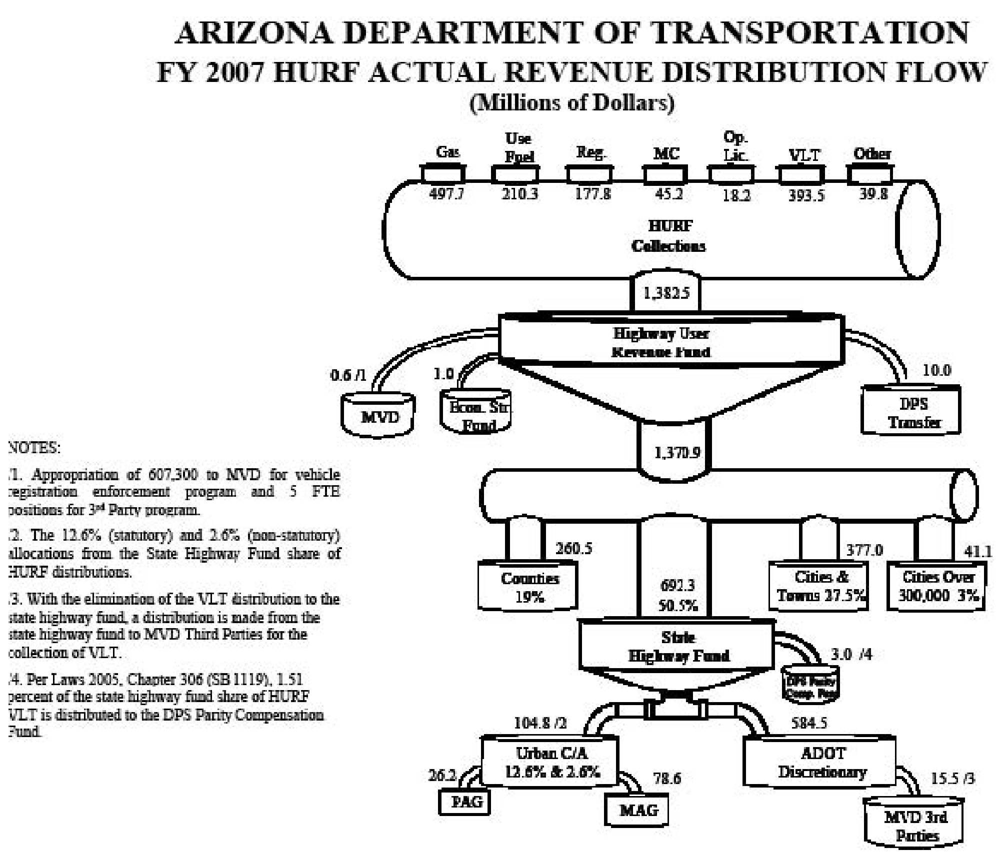
Federal Revenues

Federal revenues are distributed by formula from the federal Highway Trust Fund. Arizona fares well and gets back about 96¢ from every dollar collected in the state. Last year, Arizona received about $602 million in federal allocations. A portion of the federal gas tax is allocated to mass transit to buy new buses, build "new start" projects such as the Metro light rail within the Phoenix Metropolitan Area, and to maintain transit systems.

Highway Users Revenue Fund (HURF)

Arizona's HURF is crucial to ADOT, counties and municipalities statewide. HURF provides over $1 billion per year, which is comprised mainly of the fuel taxes and a portion of the state's vehicle license tax (VLT.) Figure 1 summarizes HURF collections and distributions. The funds are allocated by a complex distribution method that reflects a jurisdiction's population and fuel sales, among other factors. ADOT receives over half of all HURF receipts, but 15.2% of ADOT's portion is re-allocated for controlled access corridors in the MAG and PAG regions.

Figure 1



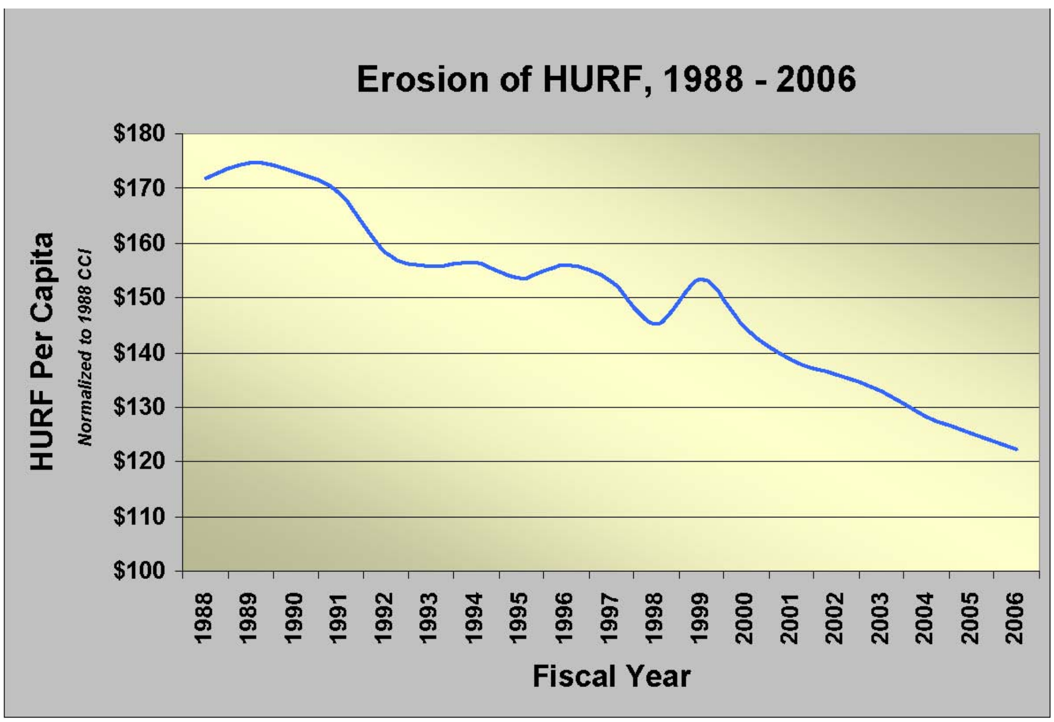
Fuel taxes are levied as cents-per-gallon in Arizona. Some states impose a sales tax on fuel sales instead of, or in addition to, the cents-per-gallon tax. The federal government and the state of Arizona collect taxes on the sales of gasoline at the rate of 18.3¢ per gallon and 18¢ per gallon respectively. They also collect taxes on diesel fuels and the federal government collects taxes on the sales of alternative fuels, but at lower rates.

Arizona's tax rate has not increased since 1991. Several states index the tax rate to inflation, but Arizona cannot. If adjusted for inflation since 1991, the rate would be about 10¢ higher today, or 28¢ per gallon. Tax rates in other states range from a low of 8¢ in Alaska to a high of 32.9¢ in Wisconsin. Revenues from fuel sales are relatively predictable and reliable because there is little change in the volume of sales despite price fluctuations, (I.e., consumer demand for gasoline is inelastic with respect to price.)

At current fuel prices, a typical Arizona motorist driving 15,000 miles per year pays about $108 in state gasoline tax and $110 in federal gasoline tax. They pay on average $190 in vehicle license tax, of which $86 flows into HURF. These taxes add up to about 2.6¢ per vehicle mile. This is only a small fraction of the average 52¢ per mile to own and operate a vehicle[2].

Although VLT revenues increase with Arizona's economy, the gas tax is falling behind. Figure 2 shows that, on an inflation-adjusted per-person basis, HURF is declining alarmingly.

Figure 2



ADOT relies on federal funds for construction and maintenance. Figure 3 shows the amount of federal money in ADOT's budget. The federal share is declining in comparison to other sources. At the regional and local level, the flexible funding programs help build and maintain major routes. Figure 4 shows the relevance of federal money to the PAG region.

[2] Based on AAA's "Your Driving Costs", 2007 edition.

Figure 3

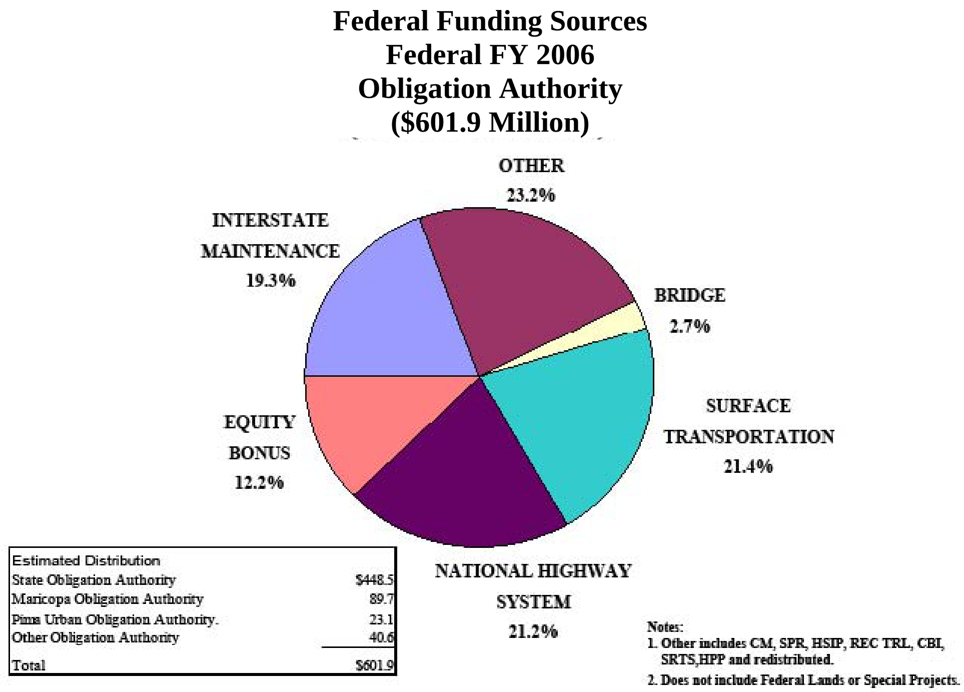
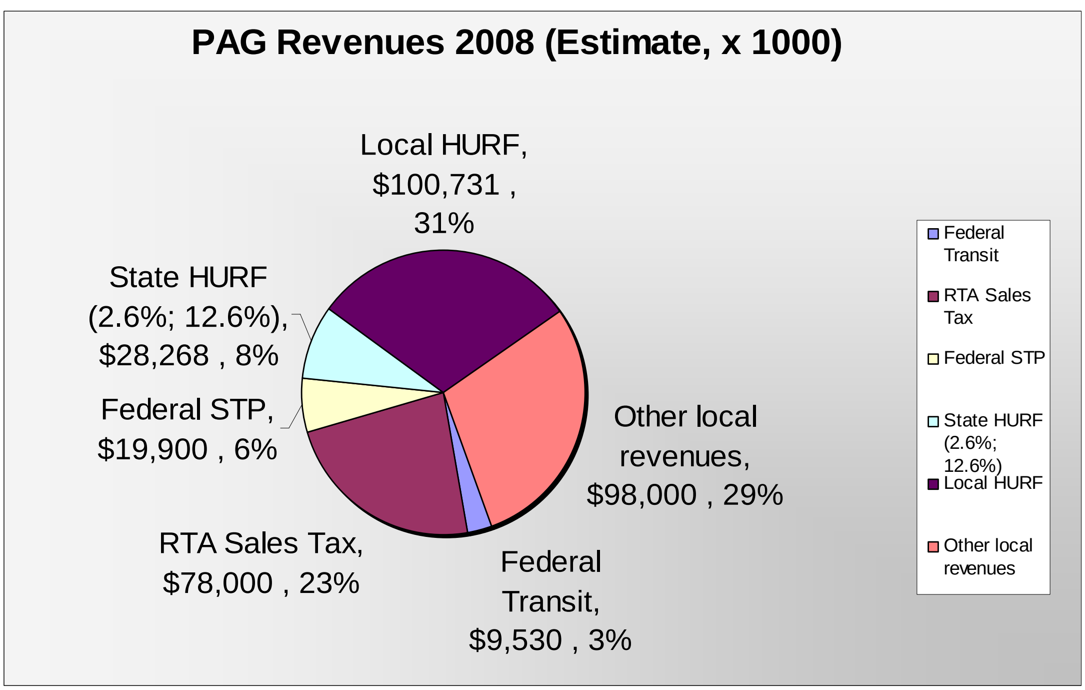


Figure 4



Regional and Local Revenues

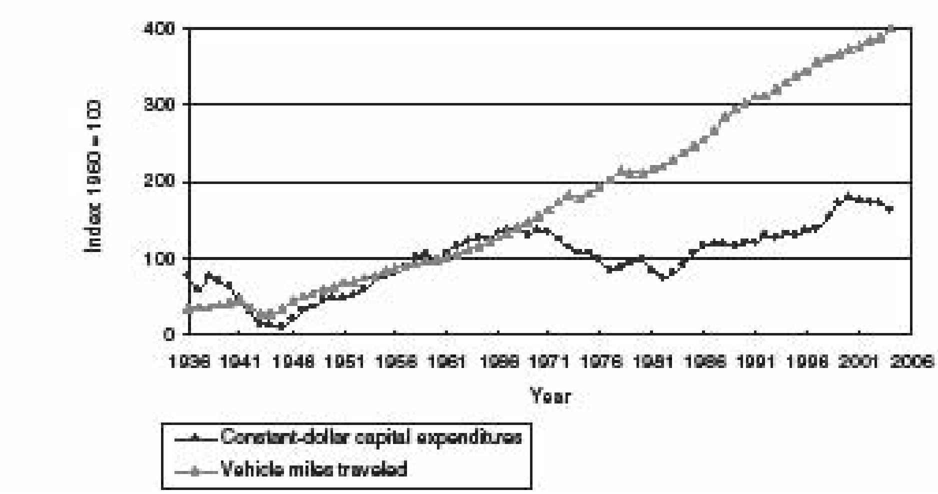
Because federal and state revenues are not meeting all our needs, regional agencies and local government have implemented new taxes and fees. There are three main strategies in Arizona – general sales taxes, construction sales taxes, and development impact fees. Only a few jurisdictions rely on general funds because of the competition from other services such as public safety, health, and welfare programs. All Arizona counties have a sales tax in addition to the Arizona 5.2% tax. These revenues supplement federal and state disbursements, and have fewer strings attached.

- A typical ½¢ sales tax for transportation generates about $260 per family per year in Maricopa County[3], slightly less in Pima County.
- A 2% construction sales tax generates about $3,900 on a typical $300,000 home[4]. This can be in addition to impact fees.
- Development impact fees for roads are common, range from $100 to $7,000 per home, and vary for non-residential uses[5].
- Improvement districts and Community Facilities Districts can be used to provide infrastructure directly related to development. District revenues are used on a case-by-case basis to repay bond debt.

Transportation Revenue Options

As Figure 5 depicts, there is a disparity between revenues and travel demand. At the federal and state levels, there are no current options for expanding the revenue base other than increasing tax rates above current levels. This is under consideration in Congress but not at the State Legislature. Experts in the field of transportation finance are not optimistic that fuel taxes will be raised meaningfully anytime soon. There currently are no options at the regional or MPO level. Arizona counties can impose a transportation property tax, but none have done so. Counties can impose impact fees but cannot impose additional sales taxes of any kind. At the municipal level, additional sales taxes, impact fees, and property taxes are current options.

Figure 5



Highway capital expenditures and vehicle miles traveled, 1936-2004. (Sources: FHWA various years, Tables HF-10, VM-1.) Price index is private nonresidential structures (BEA 2005, 188-189).

[3] Based on RARF gross receipts of $392 million, 3.8 million residents and 2.5 people per household.
[4] Based on a 2% construction tax, $300,000, and a statutory 65% taxation base limitation.
[5] See "National Impact Fee Survey: 2007" at www.impactfees.com

Additional legislation is needed for local option gas taxes, additional regional sales taxes, real property transaction taxes, employment taxes, congestion fees, and similar strategies. Toll roads are not particularly viable under current legislation.

On the demand side of the equation, travel reduction strategies are already being implemented throughout the state, and alternate modes are being widely considered.

Here are a few questions for participants to ponder before our session:

- Who creates the demand for new roadway capacity? Who should pay for new capacity?
- How should we prioritize the following:
    - System maintenance and rehabilitation,
    - Resolving today's congestion, and
    - Accommodating new growth.
- Is mass transit an important component of Arizona's transportation system? If so, how important is it and how should it be funded?
- Are sales taxes for transportation good public policy?
- Are vehicle fuel taxes good public policy?
- Are local option taxes and fees good public policy?
- Should the state and federal government be the primary funders of the freeway and arterial systems?
- What should be the future role of toll roads and privatization in Arizona?
- Is "saying no to growth" a viable solution to the transportation funding dilemma?