Putting the Trust Back in the New Jersey Transportation Trust Fund

Executive Summary

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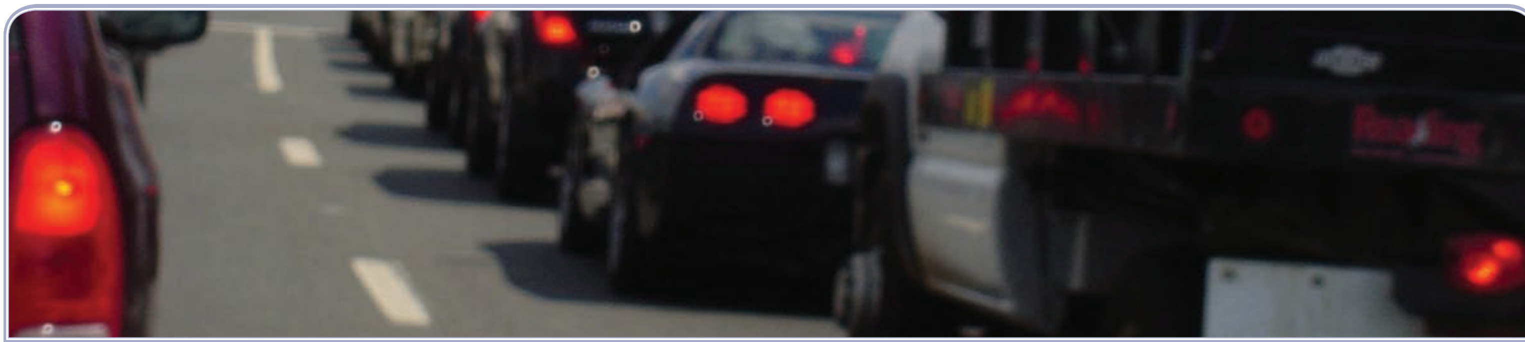


The Day of Reckoning

New Jersey's Transportation Trust Fund is going broke. While property tax relief and funding for education are the fiscal issues that have dominated public debate in recent months, New Jersey's most pressing financial problem is transportation funding.

By June 30, 2006, New Jersey will have depleted almost all of the revenue sources it now uses to pay the costs of maintaining and building its road and mass transit systems. Nearly every penny paid in state gas taxes and other constitutionally dedicated taxes and fees will be needed to cover debt from past transportation spending. This marks the demise of a stable and sufficient source of transportation capital - the Transportation Trust Fund - that a prior generation of public leaders fought to create in 1985.

After July 1, 2006, New Jersey will be in an unprecedented and extremely troubling position: except for emergency repairs, the state will be unable to fill a single pothole, improve an intersection or train station, let alone plan and build a new Trans-Hudson Express Tunnel or replace the most dangerous bridges across the state, unless it is done with new state revenue.

If the problem isn't remedied quickly, billions in federal funds, which make up about half of the annual transportation capital program, may be lost due to the state's failure to supply matching funds.

Though such a crisis seems wildly implausible in a state with the second highest per capita income in the nation and annual government revenues of billions of dollars, things are in fact even worse. In addition to NJ TRANSIT and the New Jersey Department of Transportation (NJ DOT) facing a capital construction and maintenance shutdown, their operating budgets have annual structural shortfalls that now total hundreds of millions of dollars. A combination of factors over the last few years, including increased bonding, insufficient revenue collection and increased investments to meet travel needs has made the situation even more dire than predicted two years ago by a Blue Ribbon Transportation Commission established by the Governor. The simple fact is that New Jersey must fix the Transportation Trust Fund now.

> **"Today's successful global economy requires a comprehensive, multi-modal, global transportation grid. If New Jersey fails to invest in its component of that transportation grid, it will cease to be a competitive player in the global economy."**
>
> *– Dr. James W. Hughes and Dr. Joseph Seneca, Rutgers University*

Quality of Life

This issue is critical for all New Jersey residents.

Everyone has a daily experience with the state's transportation system, be it on the roads, on train platforms, in bus shelters, or crossing bridges. It impacts the safety of children traveling to and from school, the security of cities and towns served by transit and connected by roads, and the day-to-day speed and ease of life in the region. Traffic delays are already costing New Jerseyans 261 million hours in lost time and billions of dollars in economic losses every year. Potholes, congested highways, delayed trains, infrequent buses, and closed bridges may seem like mere inconveniences in the short term, but in the long term can add up to economic disaster.

Without funding for operations and the capital program, the transportation system – highways and transit – will shrink just as it is needed to accommodate growth. If the Transportation Trust Fund is not sufficiently reformed and adequately funded by July 1, 2006, New Jersey residents and employers can expect to feel the impact on a daily basis.

- Commuters will have to leave for work earlier in the morning to compensate for less reliable trains and traffic;
- Drivers will face more backups on the highways, as construction is slowed or stopped and lanes stay closed longer;
- Delays will get even longer in the future as DOT does more emergency resurfacing instead of real maintenance work;
- Delivery trucks, buses and cars will move slower as speed limits are lowered on the highways and roads, weight limits imposed on bridges, and trains slowed down, to ensure safety of the system;
- All the bottlenecks that exist today and more will clog the roads due to delayed maintenance;
- More riders will be standing on trains;
- On-time performance of trains and buses will dip to 1970s levels;
- Those with limited mobility, including the young and the elderly, will have less access to shopping and social and recreational activities due to transit crowding and decreased frequency.

It's the Economy, New Jersey!

It is difficult to overemphasize the extent to which transportation drives New Jersey's economy. The state's status as a premiere consumer, job and residential market is unthinkable without a robust and constantly improving transportation system. The goods movement industry alone employs 400,000 workers, and freight transport and distribution continue to grow as sources of employment and wealth in the state, increasing New Jersey's economic reliance on its transportation infrastructure even further.

Every increment of economic advancement demands an equivalent increment of transportation services advancement. A global economy requires a comprehensive global transportation grid. If New Jersey is not an efficient component of that transportation grid, it will not continue to be a competitive component of the global economy. A faltering transportation system, like that now faced by New Jersey, will have bleak economic consequences on a very large scale.

Economic growth relies on transportation. Over 1,250,000 new residents and 750,000 new jobs are forecast to come to New Jersey in the next 25 years. With sufficient funding for smart growth transportation projects, the added population and jobs position New Jersey for its next generation of prosperity; without the growth, New Jersey could face economic stagnation or decline. But this growth is not foreordained. It will go elsewhere if the daily tasks of getting around or receiving a shipment become too difficult and unreliable. The current crisis, if not properly resolved, will set in motion a period of disinvestment in which already-strained transportation infrastructure steadily deteriorates and deters the investment of private capital, altering the location decisions of New Jersey's future workers and employers.

How Did This Happen?

Too Many Demands, Too Few Resources and Insufficient Accountability.

Even though the state collects millions of dollars in gas taxes each year, the transportation system is out of money. Over the last 20 years, costs have risen along with the demand for public mobility and the needs of an aging infrastructure. In response, the size of the state-supported transportation capital program has tripled while revenue has failed to keep pace. State government adopted a borrow-and-spend approach, diverting revenues from the General Fund and borrowing against them rather than adding new revenues or adjusting spending: in 2000, the Transportation Trust Fund was made viable through constitutional dedication of two existing revenue streams from the State General Fund. In the short term, borrowing was cheaper and politically palatable and, through its leverage, enabled transportation spending to meet increasing needs. But the State General Fund is now in a chronic deficit condition and it is unlikely to be tapped much, if at all, in 2006. As debt service accumulated over the years without any corresponding increase in revenues, the Transportation Trust Fund became buried under a mountain of debt and is now bonded out.

This year (2005), the Trust Fund's capital generating capacity was stretched to June 30, 2006, through refinancing and GARVEE bonds, further tying up today's gas and other constitutionally-dedicated taxes for future debt service and adding substantially to the amount of outstanding bonds. (See graph.) The State has not sufficiently raised the revenue needed to pay for this past borrowing or to sustain investment going forward. Federal funding, now representing approximately 48% of the $2.6 billion annual capital program, is expected to grow modestly, if at all. As a result, New Jersey will have to pay for the next generation of infrastructure repair and improvement, including the match of available federal funds, with new revenues that the Legislature and Governor will have to identify and raise.

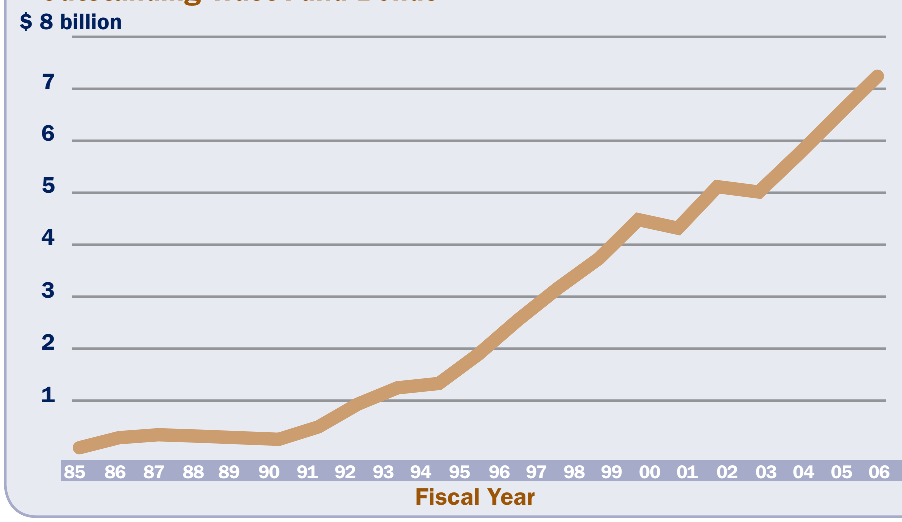
Both NJ TRANSIT and NJ DOT have severe operating deficits that blur the lines between capital and operating. NJ TRANSIT has been using over $300 million in capital funds (a capital-to-operating transfer) to fill its structural deficit each year, partly due to an 11-year freeze on fare increases and stagnant General Fund appropriations. NJ DOT has received annual General Fund appropriations well below its needs and has cut back on routine maintenance and basic operations. From a budgeting point of view, the true operating cost of the system is obscured by the use of capital funds; fare-setting, legislative appropriations and other policies that should be based on true operating costs get skewed by the practice. Finally the public trust has been lost by using Trust Fund monies for other than intended purposes. It is necessary to address the operating gap, and, because operations cannot be funded with borrowed money, it makes the overall picture much more expensive.[1]

There is no silver bullet or easy fix. NJ TRANSIT fare increases would narrow the operating gap, but eliminating NJ TRANSIT's $300 million plus deficits through fare increases alone is economically impossible and unwise. Funds from the Federal transportation bill now before Congress have already been factored into capital and operating budgets, but the gap remains substantial.

A few cents more on the gas tax would only delay and worsen the day of reckoning. For example, even at a capacity-depleting status quo program level, and given anticipated federal and other resources, a 6-cent gas tax increase would only last three years. By 2009, the Transportation Trust Fund would again be bonded out and substantial yearly gas tax increases would be necessary to keep it afloat. Hundreds of millions of dollars per year would continue to be diverted to fill operating budget gaps, and without reform, the public would still not know how much is collected from their taxes and how it is being spent.

To avoid any relapse into this borrow-and-spend pattern, and another transportation funding crisis in just a few years – to restore "Trust" to the Transportation Trust Fund – the Governor and Legislature will need to enact fundamental changes. Public distrust of government in this area is justified, and changes are necessary if the public is going to be asked to make sacrifices. New Jersey cannot have a functional, sustainable transportation system while borrowing beyond its means, avoiding fiscally prudent tax increases, and denying the need for fare or toll increases. New Jersey needs real, lasting solutions that will require contributions by many sectors. The Governor and Legislature have a responsibility to acknowledge the State's transportation funding crisis, reform the way financing takes place, and enact appropriate solutions.

Outstanding Trust Fund Bonds



1 The Blue Ribbon Transportation Commission report did not suggest solutions for the operating deficits. Had it done so, its recommended revenue increases would have been much larger.

Guidelines to Keep New Jersey Moving

A number of important lessons have been learned over time from the work preceding the initial establishment of the Transportation Trust Fund and from the more recent efforts of the Blue Ribbon Transportation Commission. In short, the main lessons are that stability and sufficiency of new revenues and reform are essential. The following planning guidelines and fiscal principles that underlie the measures this report recommends were arrived at by carefully analyzing the political and financial history of the Transportation Trust Fund:

- The Trust Fund Authority should not require a major overhaul again for at least 25 years.
- The operations structural deficit, particularly at NJ TRANSIT, must be addressed, or it will undermine the capital budget. Public funding for operations needs should be significantly expanded in the short term and continued for the long term.
- A diversity of revenue sources should be used, not just the gas tax, to ensure adequate revenue levels and distribute the burden of paying for the transportation system more widely across the state.
- The NJ TRANSIT rider must be part of the solution. NJ TRANSIT fare increases should be predictable and related to normal growth in expenditures.
- Wherever feasible, transportation users who impose higher environmental, social, and economic costs should pay a higher share of the transportation costs.

Needs

Over the last 15 years, New Jersey saw increasing demands put on its aging roads, bridges and rails as well as the continuing need to replace and expand its transit fleet. Over the next 15 to 20 years, more can be expected; New Jersey's labor force is expected to grow so greatly that NJ TRANSIT will face a 20% increase in travel demand by 2020. This growth needs to be absorbed in a state with a dense, old, and very heavily used transportation system. New Jersey has more miles of highway per square mile than any other state, and they are more heavily used than any other, even more than Florida or California. The transit system, pieced together from the vestiges of 19th century railroads and the third largest bus network in the nation, is used by over 750,000 people every day.

Some of the 10-year needs are listed here. The Transportation Trust Fund has typically provided for about half the cost of these programs and projects.

Roads: Less than half of the highway pavement in New Jersey is rated "acceptable," below the national average as well as the ratings for New York, Pennsylvania, Connecticut and Delaware. The Blue Ribbon Transportation Commission two years ago concluded that, absent substantial new investment, the current 47% acceptable rate will wither to 10% within a decade. The need at that time was identified as one billion dollars a year for 10 years.

Bridges: The average age for New Jersey bridges is 47 years and 40% of all bridges are more than 50 years old, the point when major rehabilitation or total replacement typically is in order. When the Blue Ribbon Transportation Commission completed its work in 2003, 87% of the state's bridges were rated as in "acceptable" structural condition; two years later, NJ DOT reports that inventory has dropped to 83%. Even if funding is maintained at the current rate of $300 million per year, the number of acceptable bridges will continue to decline to 81% within a decade. Without further investment, the number will fall to 73% over that same time, according to NJ DOT. The Blue Ribbon Transportation Commission identified the bridge need number at $7 billion over 10 years.

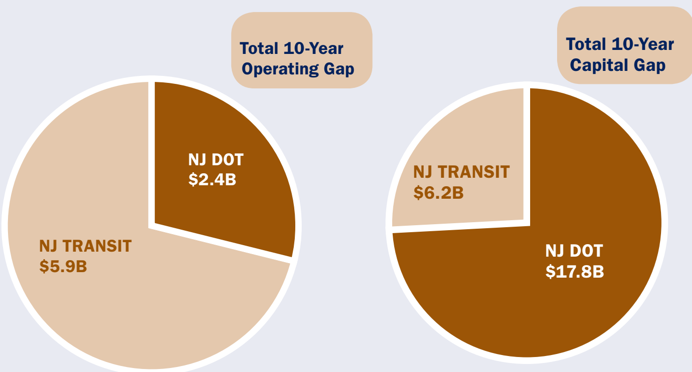
Municipalities: Largely funded by the Transportation Trust Fund, the Local Aid program has made many local road improvements possible. Local Aid applications now far outstrip funding. For example, in FY 05 NJ DOT was able to approve less than half of the 829 municipal aid funding applications it received and award less than one third of the $198.5 million in funding requested. The Safe Streets to School program drew 227 applications for $37.7 million in funding; NJ DOT could award only $4 million for 45 proposals. Without renewal of the Transportation Trust Fund, county and municipal governments will have to rely on local property taxes to undertake such projects or abandon them altogether. These projects are estimated to cost $3.7 billion over ten years.

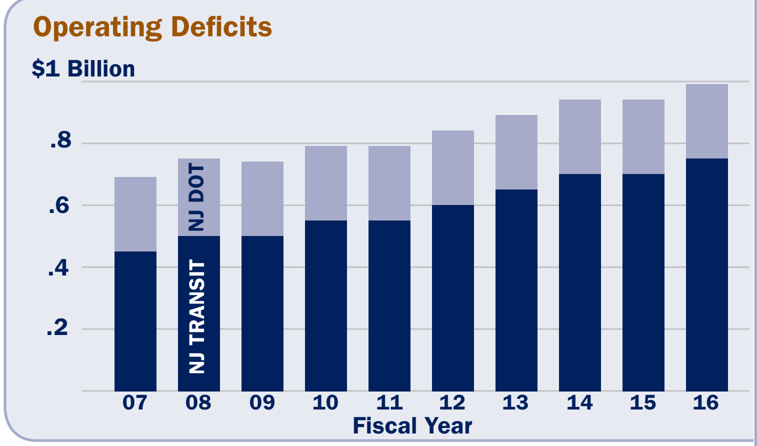
Transit: Over the next ten years, NJ TRANSIT will need over $6 billion to bring its system to a state of good repair and maintain it at that level. This includes replacing 13 miles of track each year, working on a backlog of bridges and other structures that need repair or replacement, updating the signaling system, modernizing the bus and rail fleet, and rehabilitating stations. An additional $9 billion is needed to increase and expand core system capacity. Much of this will come from the federal government and other sources, but only if the Transportation Trust Fund can provide matching funds.

Operations: As noted above, both NJ TRANSIT and NJ DOT have severe operating deficits. The NJ TRANSIT practice of using capital funds to fill the gap has weakened its ability to meet its capital objectives. NJ DOT's operating budget shortfalls have serious consequences for routine maintenance and basic operations. For example, the drainage system for roads and bridges should be cleaned once annually, but, given DOT's low operating budget, only 10% of the system is cleaned annually, usually when severe flooding occurs. The failure to perform adequate preventative maintenance has a multiplier impact on capital infrastructure repair and rehabilitation costs: as operations are under-funded, capital needs increase. For NJ DOT, using capital funding for operations often leads to the use of more expensive contractors and fewer agency employees. The total net need for operations at NJ DOT and NJ TRANSIT, including ceasing the practice of capital-to-operating transfers, will be $8.3 billion over ten years.

Other needs: NJ DOT also has substantial ten year capital needs to continue and enhance program areas including pedestrian and bicycle, safety, maritime and aviation, and rail freight. NJ TRANSIT has safety and customer service/technology needs as well. Both agencies have mandatory expenses, such as equipment and rolling stock leases, that will increase over time.

Total Needs: Early estimates show that, net of Federal, State and other anticipated revenue sources, the emptying of the Transportation Trust Fund has led to a need for $2.7 billion in new revenue in FY 07. This is composed of $2 billion to finance NJ DOT's and NJ TRANSIT's capital programs and $700 million in operating funds for those agencies.





A stable and sufficient capital program can be achieved over the next 10 years with an average of $2 billion in new revenue annually. Initially, the capital program would be financed with short-term bonds, with a switch several years out to a mix of pay-as-you-go and longer term bonds.[2] This would support the cumulative 10-year capital needs for both NJ DOT and NJ TRANSIT of $24 billion, divided between NJ DOT ($17.8 billion) and NJ TRANSIT ($6.2 billion). It is assumed that capital-to-operating transfers would be eliminated and substantial non-state funding would be available for the Trans-Hudson Express Tunnel project.

The operating budget needs, which cannot be paid for with borrowed funds, are estimated to be considerably higher than current appropriations. This is due to the addition of $200 million to NJ DOT's long-starved operating budget and the elimination of over $300 million in capital-to–operating transfers. It is assumed that this report's recommended NJ TRANSIT fare increases are implemented, thereby decreasing the gap by approximately $135 million per year.

In FY 07 the new revenue need for transportation operations is projected to be $740 million. The estimated operations budget needs over the next ten years total $8.3 billion. These are divided between NJ DOT's need of $2.4 billion and NJ TRANSIT's of $5.9 billion. As shown in the graph on this page, the cumulative operating needs are projected to grow over time, so that the revenue demand will be lower in the earlier years of the 10-year period and higher in the out years. For example, NJ TRANSIT's unfunded operating deficit grows from $450 million in FY 07 to $750 million in FY 16.

In summary, the new transportation revenue need begins at $2.7 billion annually in FY 07, increasing to $3.0 billion in FY 16. To meet this startlingly high new revenue demand, New Jersey's leaders and its citizens will be faced with hard choices. Before considering how the revenue will be raised, the public needs assurance that this crisis will not recur in the future. Major reforms are necessary to restore trust to the Trust Fund.

2 It is assumed that the Trust Fund uses 10 year bonds for the first five years with a 0.14 debt service ratio and then switches to 20 year bonds with a 0.083 debt service ratio, and that 20% of the capital program will be funded with pay-as-you-go sources starting in 2016.

Recommendations for Reform

The public is entitled to a guarantee that its money will be spent on necessary transportation infrastructure, that money intended for transportation purposes is being used for those purposes, and that stability has been restored. The following set of reforms can substantiate such a guarantee.

1 Fully fund NJ DOT and NJ TRANSIT operating budgets and eliminate capital-to-operating transfers. At present, NJ DOT and NJ TRANSIT spend over $300 million in capital funds on day-to-day operations, some of which come from the Transportation Trust Fund. NJ TRANSIT uses these funds to maintain safe, reliable, affordable operations; it defers standard capital projects, because so much of its capital resources are devoted to operations. NJ DOT forgoes some basic maintenance and other operating activities due to a lack of operating funds. The state's failure to provide sufficient, predictable operating resources, coupled with state policy that froze NJ TRANSIT's fares for 11 years, have created a structural deficit in operating funds. Even if NJ TRANSIT instituted a series of regular fare increases of modest proportions, much of the operating gap would remain. New revenue sources should be allocated to the agencies to address unmet and rising operations needs as well as to eliminate the capital-to-operating transfer. Without these two reforms, structural operations deficits will persist and continue to drain the capital budget, worsening an already detrimental situation.

2 Regularly increase NJ TRANSIT fares to keep pace with expenses. No transit system in the United States comes close to supporting 100% of its Costs out of the farebox, with most agencies covering less than half of their operating cost from fares. Recent fare increases have raised the NJ TRANSIT cost recovery ratio to 47%, so that for every $1.00 it spends operating the system, it receives 47 cents from fares and other system-generated revenue. This report recommends periodic fare increases, every two years, to maintain a cost recovery ratio of about 48% – not the highest in the country, but an aggressive ratio. This will increase NJ TRANSIT's resources for operations by approximately $135 million per year, a small step toward closing NJ TRANSIT's estimated average yearly operating deficit of $730 million.

3 Constitutionally dedicate all originally intended resources to the Transportation Trust Fund. There are three sources of revenue collected each year by the State that previously were statutorily dedicated to the Trust Fund: the New Jersey Turnpike Authority contribution ($24.5 million), heavy truck fees ($60 million) and the good driver surcharge ($30 million). Since 2001, these statutorily dedicated sources, which total $114.5 million, have been diverted to the General Fund.[3] These "leakage items" should be constitutionally dedicated to the Trust Fund. In addition, two other sources should be recouped for the Trust Fund. First, in the near future, 1.5 cents of the current 10.5 cent gas tax will no longer be obligated to pay debt service on old transportation bonds. This revenue should be dedicated to the Trust Fund. Second, the full collections from this, and the full collection from the gas tax should be guaranteed to support transportation. Full gas tax revenues are purported to exceed $45 million for each cent of the gas tax.

4 Restore long-term bondability to New Jersey's transportation financing system by limiting the term of bonds issued between 2006 and 2011 to ten years. Though shortened maturities will reduce the amount of bond borrowing the Trust Fund Authority can do until 2011, it will mean that beginning in 2011 bond borrowing can significantly increase and by 2016 will be sustainable, without requiring any further revenue increases.

5 Create an independent Five Person Financial Policy Review Committee. The Committee would function similarly to the successful New York State Financial Control Board established in 1975 to solve New York City's financial crisis. The Committee would review, oversee and hold accountable all relevant parties to ensure the Transportation Trust Fund remains solvent and the State's transportation infrastructure is stably funded. The Committee would also certify that the Trust Fund Authority itself is only providing resources at a fiscally responsible and sustainable level; without annual certification, NJ DOT and NJ TRANSIT would not receive funding from the Trust Fund. The Committee would be politically independent and provide a balance to the Governor's Office, the Transit Board and the DOT Commissioner.

This report recommends adopting the same Committee composition as Assemblyman John Wisniewski and Assemblyman Peter Biondi's proposed Trust Fund reauthorization legislation (A3414, October 2004), but with longer (five year), overlapping terms of office to ensure the Committee's independence from the political process. Appointees to the Committee should have expertise in transportation finance as well as experience dealing with transportation infrastructure, capital projects, operations, budgeting, and long-term financing. Appointees should be professionals who are able to make a five year commitment and lend their full attention to the work of the Committee.

6 Issue 6 Month Reports from the Director of the Division of Taxation. The Director of the Division of Taxation should make reports to the Committee and the public every six months showing the full amount collected from transportation-related taxes, tolls and fees. With this information in hand, the politically independent Committee would be empowered to certify that the budgets are sustainable and requests are consistent with resources available from the Transportation Trust Fund.

Conclusion

While the overall transportation funding needs for the next decade are daunting, the impact on individuals and families need not be overwhelming. The first step is reform to ensure that prudent financing practices are restored and the Trust Fund can remain stable. A second step is to ensure the transportation system receives those funds due it, both for capital and operations. Particular attention should be paid to NJ DOT's and NJ TRANSIT's operating budgets where serious problems have festered. An independent body must be created that is accountable for these outcomes.

In addition to reform, the state will need to dedicate significant new revenue to the Trust Fund, to prevent a disastrous cycle of disinvestment. A full accounting of the State's transportation funding needs leads to the conclusion that New Jersey cannot solve this crisis simply by raising gas taxes. Transit riders, truckers, businesses, tourists, and others who benefit from the State's transportation system must be part of an equitable solution. Transportation agencies and their stakeholders will need to refine their capital programs to focus only on the most needed, affordable projects that promote smart growth.

The transportation system can in fact be saved with an appropriate contribution from its users and responsible borrowing by the State. But the people of New Jersey must demand from their elected leaders improved accountability, stronger oversight, better planning, transparent budgeting, and a willingness to enact the new revenue measures regardless of short term political excuses. Reforms are necessary to guarantee that the Trust Fund Authority will not find itself in this crisis again. To do any less will damn New Jerseyans to a vicious cycle of financial crisis, a deteriorating transportation system, a stagnant economy and a lower quality of life. The cost of inaction or a "quick fix" will far exceed the price of the reforms identified in this report and new revenue sources. The right choice is a long-term solution that implements pay-as-you-go funding of operations and recognizes responsible borrowing for capital projects that will bring years of benefit to residents and businesses. In return, New Jersey will get a functioning road and transit system, reduced congestion, safer bridges, less sprawl, and a new rail tunnel under the Hudson. By sharing the full cost with all users of roads and rails, the burden can be more equitably distributed.

This report identifies reforms to restore accountability to the current transportation financing system and guidelines for ensuring the results are sustainable over the short- and long-term. Only through a strategy that focuses on reform can the state rebuild the public's trust in the Transportation Trust Fund.

3 At about the same time, part of the motor fuels tax, auto sales tax and petroleum gross receipts tax were constitutionally dedicated to the Transportation Trust Fund.

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