



# State Capital Program Forecast 2008 Hawaii

## **Why the “State Capital Program Forecast-2008 Report?”**

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States are going through turbulent times as they weather the many factors impacting their capital improvement programs. Those who serve state departments of transportation (DOT) as contractors, engineers, or suppliers are, of necessity, in a position where they need to assess what the future holds in key markets of their business. This report, the State Capital Program Forecast-2008, published by The Tom Warne Report, offers our best insights into how each state will fare in the coming years. Using over 30 data inputs and detailed analysis, this report offers a glimpse into the future—so that business plans can be developed and executed in a way that maximizes profitability. This report offers users the value of nearly 30 years of deep involvement in the transportation industry at the state and national levels with unique insights into the factors that influence state capital programs. While no single factor can reliably be used to predict the future, the combination of key indicators and their interrelationships offers this “one of a kind” insight into what the future might hold for this industry.

The State Capital Program Forecast-2008 is divided into three sections. First, the prospects of federal funding and how the state might fare in the next few years and over the long-term. The second section will examine the state of the state’s budget and other factors at the local level that might influence future revenues and, ultimately, the size of their capital program. State performance is compared to national trends and relationships offered where appropriate. Finally, a bottom-line prediction on the future of the state’s capital program will be offered based on the combination of all factors considered.

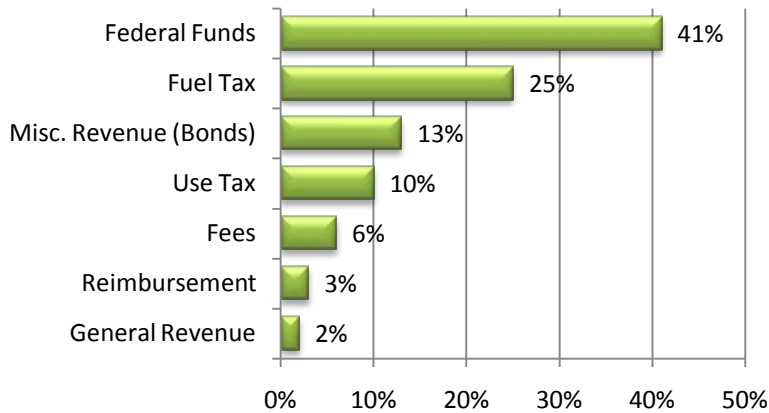
## **Federal Revenue Outlook**

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For over 50 years the states have relied on a stream of funding that was allocated by Congress through the transportation acts passed by that body. ISTEA, TEA-21, and SAFETEA-LU are the most recent versions of this legislation and have defined the extent to which states have been able to rely on federal funds for their capital program.



## Revenue Sources

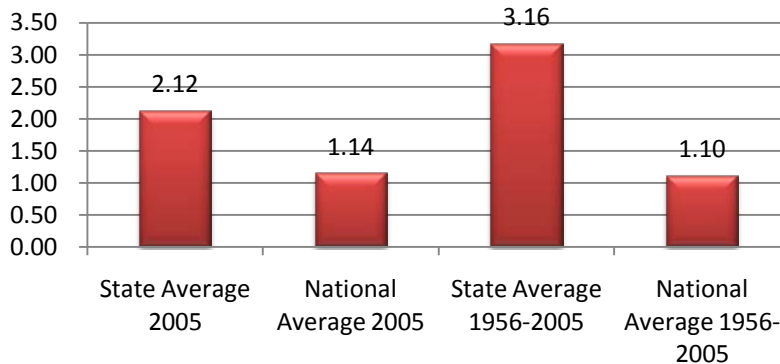


**Figure 1 – State Revenue Sources**

The federal-aid program has changed over the last 50 years. For a long time states relied almost exclusively on this revenue to fund their programs with matching ratios of federal to state funds in the 80/20 to over a 90/10 ratio. Hawaii's reliance on a variety of revenue streams to fund their capital program, including federal-aid, is reflected in Figure 1. Note that federal funds make up 41% of their capital program. When comparing all states and their reliance on federal funding for their programs the average is 39%. This relationship is important as it reflects how dependent the state will be on the outcomes of the current reauthorization process of SAFETEA-LU that will likely last for at least two years.

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## Federal-Aid Return Ratio



**Figure 2 – Federal-Aid Return Ratio**

Over the years the State of Hawaii has benefited from the generosity of the federal-aid system with the ratio of their overall funding (apportionments and allocations to payments) of 3.16% from the inception of the program in 1956 through the year 2005. That compares to a national average for the same period of 1.10%. However, in 2005, this ratio for Hawaii had been reduced to 2.12% against the national average of 1.14%. Figure 2 reflects these relationships as noted.

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History of Transportation Earmarking		
Bill	Number	Value
1982	10	\$362 million
1987	152	\$1.4 billion
ISTEA	538	\$6.2 billion
TEA 21	1851	\$10.3 billion
SAFETEA-LU	5716	\$21.3 billion

**Table 1 - History of Transportation Earmarking**

Whether called Demonstration Projects, High Priority Projects or Earmarks, they all represent efforts by members of Congress to exercise influence on the legislative process on behalf of their constituents.

Those familiar with the earmarking process and the manner in which it reflects a state's program know that most of these projects do not come with additional funding. That said, the propensity of a Congressional delegation to ensure earmarks for their state are included in a highway bill is one reflection of how well a state will do in the overall reauthorization process now underway. Clear evidence exists that senior members of Congress, those in leadership, those who are the ranking members of committees and those who are members of key committees are in a position to not only influence the earmarking

*Average # of Earmarks per Congressional member:*

*Hawaii - 4.8*

*National- 9.4*

*Average \$\$ of Earmarks per Congressional member:*

*Hawaii - \$31,400,000*

*National - \$27,492,026*

process but are also able to advance their state's cause in other ways in the legislation. So, whether the connection to earmarks and future funding is oblique or not, it is a factor that has to be recognized in the overall

discussion of a state's future federal funding and their resulting capital program.



In the case of the State of Hawaii, SAFETEA-LU included 19 earmarks inserted by its delegation with an average value of \$31,400,000. With a total Congressional delegation of 4, its members netted the state 4.8 projects apiece. This compares to a national average of 9.4 earmarks per member of Congress with an average value of \$27,492,026. This would reflect that most of the state's delegation will probably not exercise significant influence in the reauthorization process.<sup>1</sup>

The reauthorization of SAFETEA-LU is complicated by many factors including:

- The need to “bail out” the Highway Trust Fund from its deficit position going into reauthorization
- The current recession and its collateral impacts on nearly every sector of the nation's economy
- Reduced federal fuel tax receipts due to declines in vehicle-miles-traveled (VMT) and reduced fuel sales
- Further need by Congress to shore up the US economy thus reducing its flexibility to divert funds to transportation
- Continued funding of the wars in Iraq and Afghanistan
- The needs of other domestic programs such as health care, Social Security, etc. that are in no less dire straits than the transportation program

The states enjoyed significant increases in their federal transportation dollars during the last two-reauthorization cycles (TEA-21 and SAFETEA-LU) with averages of about 50% for the former and in excess of 30% for the latter. However, there is nothing to indicate or portend a double-digit increase when the new bill is passed.

In past reauthorizations the issue of donor/donee has polarized the states and made a final resolution more difficult as lawmakers sought to divide scarce resources among the diverse circumstances reflected in the 50 states. Donor states seek to retain more of the money they send to Washington and donee states work to protect their favored status of having a higher return on the dollars they send to the nation's capital. History has shown that if money is plentiful then “the rising tide raises all boats” and the proportionality of the increase is less important. However, when funds are scarce dividing the available money becomes more difficult as each state exerts significant effort to protect what they have. The efforts required to reach a highway bill in 2009 and 2010 will prove this final point to be true. Little prospect exists for a significant increase above current levels in the allocation of federal funds coming out of the next highway bill regardless of a state's donor or donee status.

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<sup>1</sup> SAFTEA-LU, Section 5702.02



A wild card that Congress may play that would change the whole nature of federal funding would be some kind of massive debt financing strategy wherein federal funds would be leveraged prior to sending money to the states. This could result in a large federal investment in the near-term but would then commit federal funding to debt service for many years to come. This abandonment of the long-term “pay as you go” philosophy of the federal program could benefit the states for now but would then constrain federal lawmakers into the future. It also brings into question issues such as if the money is already leveraged at the federal level then what issues are raised in the states as they then turn and bond against this same revenue.



Each of the factors discussed in this section contributes to whether or not a significant increase in federal funding for Hawaii will manifest itself. However, a pure empirical analysis would ignore the other subtle and not so subtle pressures that will often change the outcome in the highly charged political world of transportation funding. The country is in an

election period of unprecedented complexity. What happens in November may change some aspects of how the states fare individually and collectively. That said, at the time of this printing, the prospects of Hawaii increasing their current levels of federal funding by a significant amount is given a rating of “1”.

## State Revenue Outlook

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### State Revenue Assessment

Many states have recognized that federal funds will never be adequate to meet the growing demands of their capital program. In fact, there has been a marked increase in funds raised by states from local sources to fill this gap and address critical projects. Figure 1 reflects the diversity of revenue streams that fund transportation in Hawaii.

A brief look at how Hawaii is doing in the current economic environment helps to put the revenue streams into perspective. First it must be noted that no matter what the source of state funding, the taxation system is largely closed in nature—meaning that the ebb and flow of one source of tax revenues is not totally independent of any others that make up the system. The State of Washington learned this fact in a very evident way when a number of years ago a voter initiative reduced the taxes owners paid on their motor vehicles. The resulting relatively minor windfall to the citizens nearly bankrupted the state’s ferry system which relied on these revenues to operate their fleet.



The State of Hawaii's tax collections is therefore important when assessing how the DOT will fare in the coming years as new funding is sought for critical projects. These patterns of collections, whether directly related to transportation, or solely indicative of financial health, all figure into the prospects for increased capital investment on the part of the state DOT.

*Hawaii State Revenue Assessment:*

*Nat'l Tax Collection Average (2007): 2.3%*

*Nat'l Average w/ Adjustments : -4.3%*

*HI Tax Collection Average (2007): 2.5%*

*HI Average w/ Adjustments: -2.7%*

Overall, tax collections across the nation have declined to their lowest level in five years with a 2.3% year over year gain during the last quarter of 2007. In contrast Hawaii had a 2.5% increase. This number must be further adjusted for any legislative changes resulting in tax reductions and for inflation. Applying these factors nets Hawaii to a 2.7% decrease

in real value of their revenues for state programs. Nationally, this decrease in net collections measures at 4.3%.<sup>2</sup>

Even if a state is not allocating general revenues to transportation purposes a weak overall revenue picture results in less likelihood that a state will raise other funds for capital projects for the following reasons:

- Inflation effects on other state programs puts pressure on existing limited revenues
- Cautionary spending on other programs “bleeds” into efforts to fund transportation projects even if the DOT’s funding is secured or constitutionally protected
- Entitlement programs (social programs, employee benefits, etc.) are a large portion of the state’s budget and tend to grow regardless of the state of revenues in a given year

Increasingly, states are turning to the sales tax as a means for raising transportation revenues. While the motor fuel tax is very inelastic and doesn't fare well in current economic conditions, the sales tax tends to withstand these turbulent times and provides more reliable funding. That said, if a state has already oversubscribed or committed its available sales tax capacity with little “headroom” to use this means for additional funding then no opportunity exists here for transportation. The degree to which a state relies on the sales tax to fund its overall tax burden therefore is a measure of the “opportunity”

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<sup>2</sup> State Revenue Assessment Report, March 2008, Nelson A. Rockefeller Institute of Government



for this to be a source of revenue for future projects. Nationally, states rely on sales tax for 30.4% of their revenues while Hawaii counts on sales tax for 48.2% of its overall revenues.<sup>3</sup> This strong reliance can have a double-edged effect on future assessments. First, it says that the citizens of Hawaii are very familiar with the sales tax as a means for funding their governmental services. Second, the existing commitments to this revenue stream may make it difficult to further tap it for transportation purposes.

### State Budget Assessment

The national economy is in turmoil and many states have not escaped those effects at the local level. In Fiscal 2008, thirteen states enacted budget cuts totaling over \$5.2 billion. In contrast, only 2 states resorted to these measures in 2006 and three in 2007. This critical indicator of a state's fiscal health is important to the transportation industry because it portends the possibility of new money being available for boosting capital spending on highway and transit projects. In the case of Hawaii, the state cut its Fiscal 2008 budget after it was enacted by \$6.7 million. Budget components used to achieve these reductions were:

- Other cuts
- Across the board percentage cuts<sup>4</sup>

While much of a state's transportation budget comes from constitutionally or ballot protected sources state DOTs are not immune from the impacts of weak fiscal condition. For example, in some states where across the board cuts are made to all agencies the expectation is that the DOT also "feel the pain" and must equally endure these mandates.

The US economy is predicted to languish through 2009 and possibly into 2010. Even if it strengthens in 2010, it will be several years before fiscal vigor will return to the states; offering a fiscal situation that would allow lawmakers to divert monies to transportation projects over other pressing programs. For example, in Fiscal 2007 the components of overall state spending were broken down as follows:

- Medicaid-21.1%
- Elementary and secondary education-20.9%
- Higher education-10.3%

<sup>3</sup> Recessions and State and Local Taxes, presentation by Donald J Boyd, Nelson A Rockefeller Institute of Government, May 16, 2008.

<sup>4</sup> *Fiscal Survey of States*, National Governors Association and National Association of State Budget Officers, June 2008.



- Transportation-8.4%
- Corrections-3.4%
- Public assistance-1.7%
- All other expenditures-34.1%<sup>5</sup>

While it may seem logical to divert the “All other expenditures” category of funding to transportation the reality of state government is that a myriad of programs are demanding funding from this source. The level of truly discretionary spending in a given state varies but in the overall budget picture is typically a very small amount after all of the obligatory programs are funded. Therefore, in the short-term, improvements in revenue collections will first go to the mandatory programs listed above with transportation falling outside that group of recipients.

Overall, the prospect of the DOT receiving increased funding from the state legislature from the state’s general fund in the near-term is small given all of the other factors influencing the process.

### State Ballot Initiatives Assessment

State ballot initiatives have proven to be a valuable means for states and counties to raise desperately needed money for transportation projects. Year after year the voters have demonstrated their willingness to raise their own taxes if three conditions have been met:

- A specific list of projects is guaranteed
- A specific timeframe for delivering the projects is guaranteed
- There is a “sunset” provision on the tax when it will be eliminated or have to be reauthorized by another public vote

Those initiatives that have followed this format appear to have greater appeal and success at the ballot box over the prospects of a general tax increase that is left to the good will or wisdom of a commission or some other body to disperse as they see fit.

A brief review of the national picture for state ballot initiatives serves to illustrate how this trend is occurring across the country. Figure 3 depicts the states where ballot initiatives were placed before the voters in 2006.

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<sup>5</sup> Ibid

## 2006 Ballot Initiatives

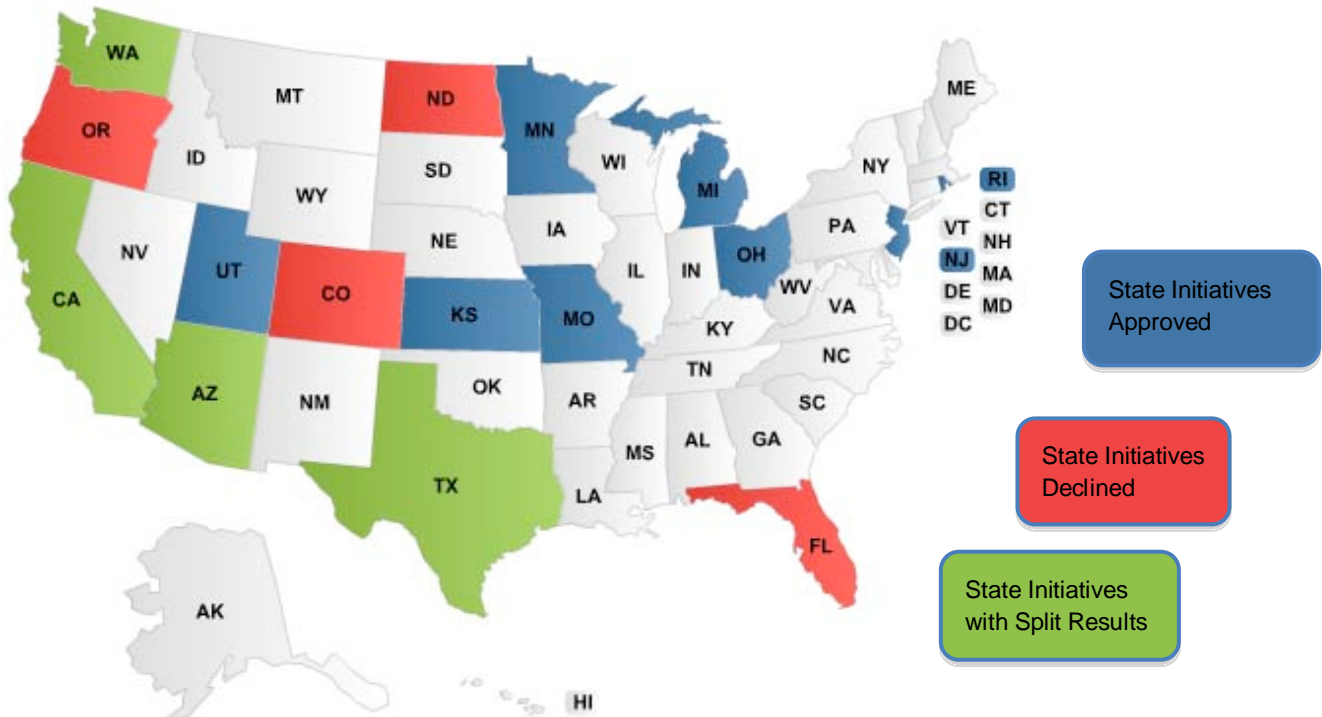


Figure 3-2006 State Ballot Initiatives

2007 was an “off-year” for elections but many states asked their citizens to consider transportation funding questions on their ballots as well. Figure 4 reflects those who did.

## 2007 Ballot Initiatives

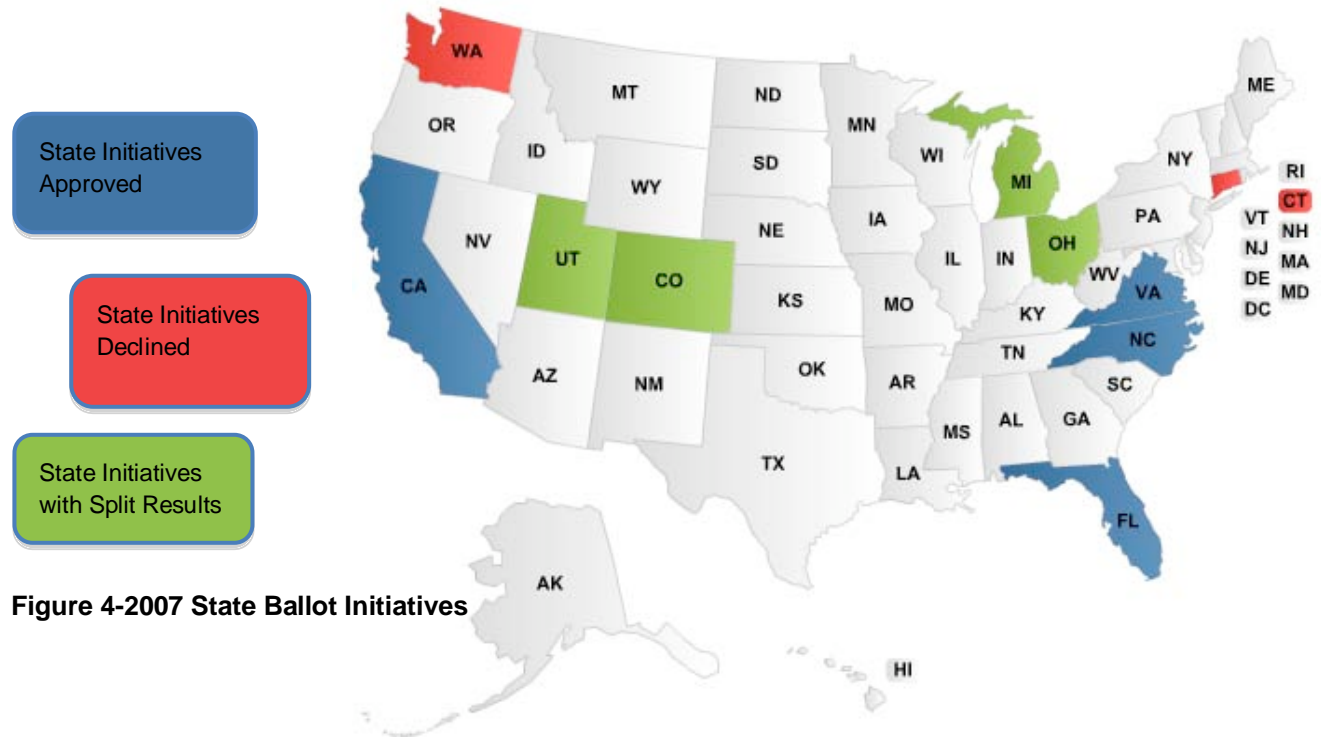


Figure 4-2007 State Ballot Initiatives

When tracking the success rate of ballot initiatives it obviously varies from state to state. The average approval rate for all of the measures tracked in the last two election cycles is 63%. Many factors influence the outcome of such measures and the success or failure of a specific effort must be analyzed against the backdrop of the circumstances that existed at the time.

Hawaii is one of the states in the country where transportation initiatives are sometimes considered by the electorate. There were no significant measures put before the voters in 2006 or in 2007 and only one has been placed on the ballot for 2008.

In August the Honolulu City Council voted to place a ballot initiative before the voters that would fund the \$3.7 billion light rail project that would extend from Kapolei to Ala Moana adjacent to Waikiki.

Our observation is that this initiative could go either way in November. Those who have watched politics in Hawaii over the years recognize the challenges to achieving consensus on virtually anything major in the way of transportation projects. You'll also recall that a rail project along the Alawai Canal back in the 1990's failed on a 4-5 vote at the Honolulu city council after hundreds of millions in federal funding were secured from Congress.

## 2008 Key States Ballot Initiatives

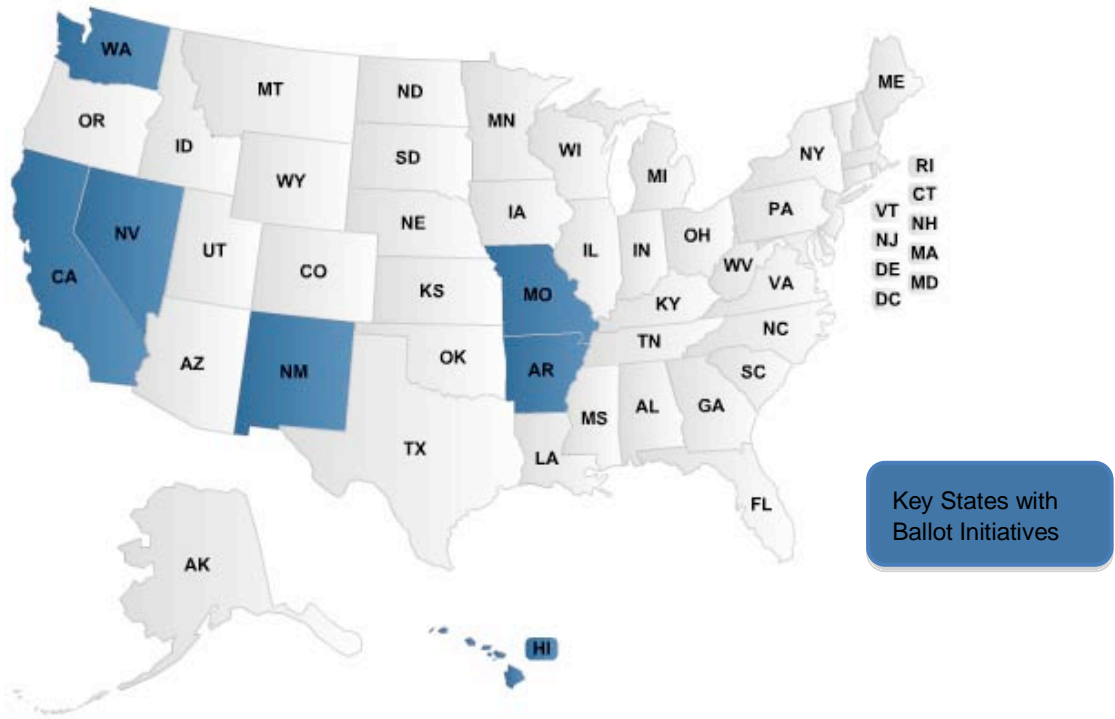


Figure 5-2008 Key States Ballot Initiatives



## PPP Assessment

Public Private Partnerships (PPP) or Public Private Ventures (PPV) represent a new financing tool that some states and other jurisdictions are using to advance transportation projects. While new to many locales in the United States, the notion of a private sector partner assisting a government agency in delivering some kind of infrastructure improvement is not new to most of the rest of the world.

In most cases the discussion of PPPs involves the collection of tolls. When a private sector finance partner is involved they must make a return on their money so some fashion of collection must occur. An exception to this might be the use of “shadow tolls” or “pass through tolls” where the private financier receives payments from a governmental entity without the vehicle operators actually paying a toll. The Spur 601 project in El Paso, Texas is a PPP but the public will never be tolled for their use of the facility since the Texas Department of Transportation will make the payments directly to the Developer, JD Abrams.

A number of factors will impact the future potential of PPPs in a given state or market. Some of the more prevalent factors are:

- Past experience with PPPs
- Past experience with toll roads
- Congestion
- Traffic volumes
- Rules, regulations and laws that encourage PPPs
- Public sentiment towards tolls
- Public sentiment towards foreign firms being involved
- Abundance or lack of money from other sources

In assessing the potential for PPPs to help fund transportation improvements in Hawaii all of these factors have been weighed and analyzed. At this time there appears to be little opportunity for PPPs to help the state fund their needs.

## State STIP Trends

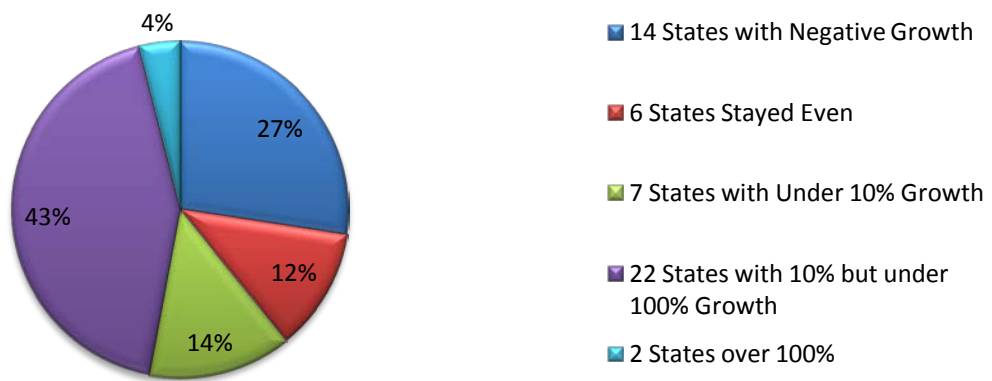
Each state is required to produce a Statewide Transportation Improvement Program (STIP) which reflects their plan for capital projects for the coming years based on the reasonably available funding they will have. Title 23 specifies the requirements for a state’s STIP. Included are the following:



- A state’s STIP must cover the whole state
- The minimum period for a state’s program must be at least four years
- It must be updated every four years unless the state’s Governor chooses a more frequent interval
- States may include a longer period than four years and the Federal Highway Administration (FHWA) and Federal Transit Administration (FTA) will consider the additional years as informational
- STIP documents must be fiscally constrained, meaning that only projects with a reasonable assurance of funding can be included in the first four years of a state’s plan

A recent national analysis of state STIP’s over the last three cycles reveals a number of trends. Figure 6 reflects the change in a state’s current STIP over the Immediate Past STIP. The two states with over 100% growth in their STIPs are Colorado who reformatted their STIP and included additional existing programs in their new totals and Mississippi whose program increased dramatically due to hurricane related projects. The average increase for all 50 states, excluding Colorado and Mississippi was 16%.

### Growth Analysis of STIPs Current STIP from Immediate Past STIP

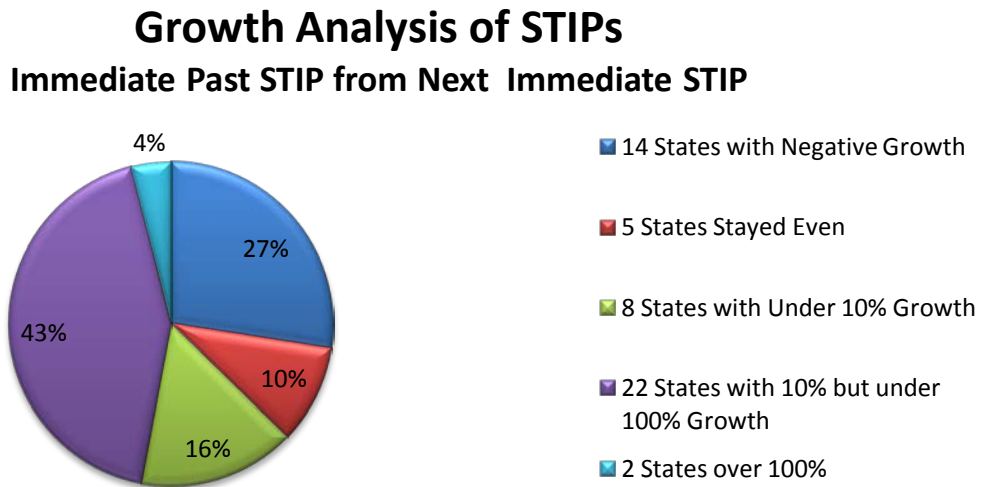


**Figure 6 - Growth Trends in State STIPs – Current STIP over Immediate Past STIP**

Figure 7 reflects the change in STIP amounts for the states between the Immediate Past and the Next Immediate STIP. Note that there is little change in the statistics between the data in both figures with only a one state difference in two of the categories

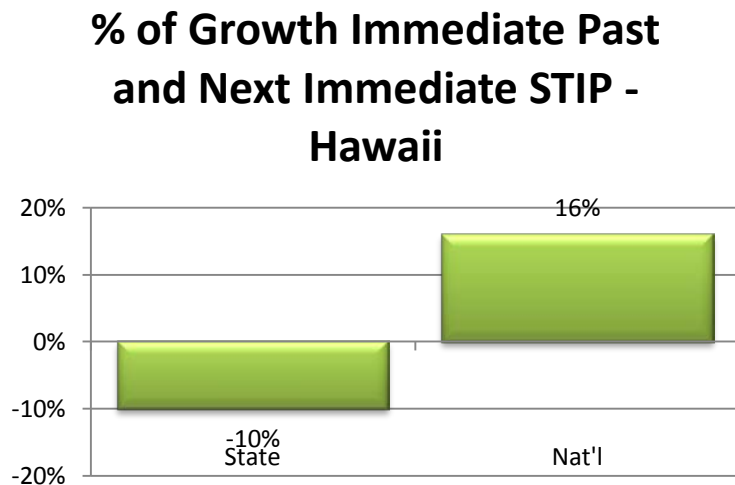
and no change in the others. That stability in trends is significant and cannot be ignored in assessing future state programs.

In this case the average increase from STIP to STIP is 15% with New Mexico and Kentucky removed from the calculation as being inordinately low and high respectively and their inclusion would skew the national averages.



**Figure 7 – Growth Trends in State STIPs – Immediate Past from Next Immediate Past**

Figures 8, 9, and 10 summarize the historical changes in STIPs for Hawaii and the relevant national averages for the periods described above.



**Figure 8 – Growth of Immediate Past and Next Immediate STIP**



### % of Growth Current over Immediate Past STIP - Hawaii

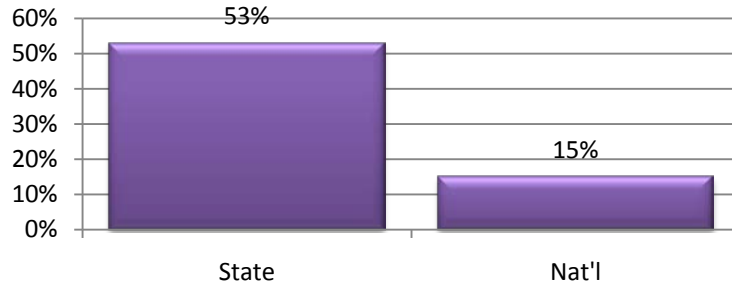


Figure 9 - Growth of Current over Immediate Past STIP

### STIP Historical Growth Trends - Hawaii

Dollars in Millions

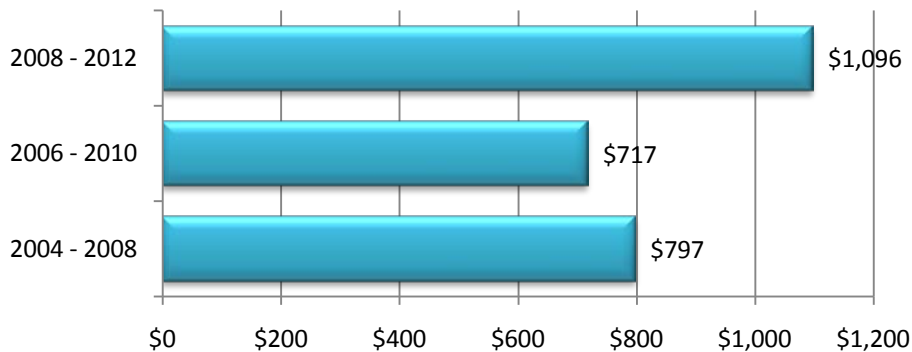


Figure 10 – STIP Historical Growth Trends

This information is relevant as an indicator of how Hawaii’s STIP may fare in the future. In addition, the ravaging effects of inflation on construction costs, most notably for steel, asphalt and cement, is taking its toll on transportation projects. Even if the STIP grows by another 10% in the coming update cycle, the number of actual projects will likely decline.



**Prospects for a Significant  
Increase in  
State Funding**

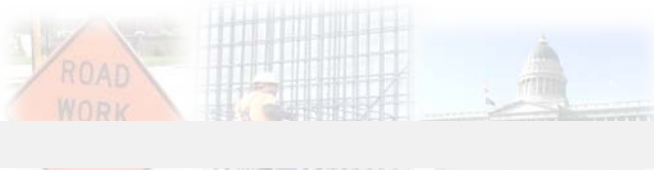
The state component of transportation funding has never been more significant to the future of a DOT's capital program. As noted in this report, many factors play into the prospect of additional state funds being raised to fund transportation projects. Most states are not projected to see a substantial increase due to the combination of legislative actions, electoral support and other economic factors involved. All things considered the probability of a substantial increase in Hawaii is unlikely.

**State Capital Program Forecast**

No single factor can be used to predict how a state's capital program will change over time. That said, the ability to take many factors and assemble them into a coherent analysis offers those who must plan for the future of their firms the ability to do so with the best available information possible. This is what the State Capital Program Forecast Report has done here. A short summary of key revenue sources and the probability of their increase is shown below. They are rated on a scale of from "1" to "5" representing very low and very high probabilities respectively.

**Possible Revenue Increases**

<b>Funding Source</b>	<b>Probability for Increase</b>
Increased Federal Funding	1
Increased State Funding-Legislative	1
Increased State Funding-Ballot Initiatives	1
PPP Opportunities	1



## Forecast

The future of Hawaii's capital transportation program is the aggregate of all that has been presented in this report and how these basic elements interact and respond to one another. In addition, other factors tend to play into the discussion and may change how a state addresses their transportation revenue shortfalls. For example, a state may have limited funding opportunities today but have growing congestion issues that will lead to a stronger market condition in the future. Or a state may experience a short-term increase in funding from an emergency or some other source but, in the long-term, will revert back to a more modest capital program. Therefore, no empirical formula can be applied here—rather once the data is collected and analyzed long-term experience in the industry must be relied upon to make a final assessment.

Based on the foregoing analysis two predictions of the state of Hawaii's capital program are offered: A near-term look of from 1-5 years and a long-term view from 6-10 years.

**Prospects for a Significant Increase in Near-Term Funding**

**Prospects for a Significant Increase in Long-Term Funding**

Predicting the future and planning for it is fraught with risks. Yet leaders throughout our industry must do so all the time. The look ahead today may be even more challenging than in the past given all of the factors that might influence the future of the transportation market. But look ahead you must—to ensure the future profitability of your company. I trust this report will serve as a useful tool as you do so.

Best wishes for your success,