

HB

275

SFIN

FILE

HB 275

was referred to the
Senate Finance
Committee

No hearing was held
on this bill

Mindy Rowland

From: Emily Ferry [emily@aktransportation.org]
Sent: Thursday, May 05, 2005 11:29 AM
To: Mindy Rowland
Subject: For Senate Finance Committee Packet
Attachments: GARVEE.doc; GARVEE%20BONDS%2003-11-2005 1 .pdf

Mindy,

Thank you for including these two attachments in the committee packet for today's hearing on HB 275.

- Emily

Emily Ferry, Coordinator
Alaska Transportation Priorities Project
419 6th St., #200 Juneau, AK 99801
P(907) 209-0082, F(907) 463-3312

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GARVEE Bonds Deserve Careful Review

GARVEE (Grant Anticipated Revenue Vehicle) bonds pledge against future federal transportation grants to construct projects today. HB 275 would expend \$193.3 million to construct a range of construction projects – some controversial and others universally supported. In previous years the legislature has viewed GARVEE bonds with a critical eye, and for good reason: the bonds depend on speculative future federal transportation receipts and reduce flexibility for future transportation planning.

Steady work for Alaskans, not boom and bust

The Associated General Contractors (AGC) of Alaska have consistently advocated for steady work for Alaska's contractors, which requires a steady cash flow, not the boom and bust cycle that can result from the use of GARVEE bonds.

In a March, 2005 position paper AGC writes that "It is extremely difficult for a trade organization representing contractors to argue against additional work for their industry. But when the work comes at the expense of future work and when future-funding levels might decline due to external factors beyond Alaska's control, then it becomes an issue for finding the best means of stabilizing the industry."

Better planning now, not debt for the future

With Congressman Don Young completing his last year as Chairman of the Transportation Committee, Alaska will likely see a spike in federal transportation dollars in the next few years followed by a future decline. It makes little sense to prepare for a famine by cooking up an even bigger feast.

The state has already issued \$102.8 million in GARVEE bonds in 2003 to be paid back in 10 years for construction and repairs on 8 roads and bridges. If the state continues on a pattern of taking from the future, there will be little left when we need the money is most.

Careful analysis, not political expediency

According to the Brookings Institution, "Project savings through accelerated planning and construction should remain the primary consideration for using GARVEEs rather than political expedience."¹ GARVEE bonds can achieve savings through reduced mobilization, staging, and inflation costs for projects which would traditionally take multiple years to complete.

It is unclear what the benefit is for rushing a mean of \$6.25 Million for 21 different projects. Indeed, this list appears to rise out of political expediency rather than careful analysis of projects in which GARVEE bonds could save money for the state.

"What our industry is concerned about is the fluctuations the peaks and the valleys... Are we going to have a big party and then a hangover later?" Association of General Contractors Executive Director Dick Cattanaach in the *Juneau Empire*, March 11, 2002.

¹ Puentes, Robert, David Warren "Today's Roads with Tomorrow's Dollars: Using GARVEE Bonds to Finance Transportation Projects." The Brookings Institution Series on Transportation Reform.

GARVEE BONDS

Benefits from Garvee Bonds

Acceleration of Projects:

The ability to accelerate major projects to deal with significant infrastructure problems is very compelling to the Department of Transportation, Municipalities, and contractors. By the nature of our current funding, large, high cost projects are phased over a period of time to minimize their impact on the overall highway program. Unless phased, one large project, such as the Glenn Highway expansion in Anchorage could well dominate the highway program in a given year. That means that funds would not be available to deal with projects in other parts of the State. Phasing also has the disadvantage of prolonging the period of construction trauma inflicted on the public from issues that are associated with highway construction.

The use of Garvee Bonds allows the State to deal with major projects in a manner that will not significantly impact the overall statewide highway program. An additional benefit is that by dealing with an entire project rather than phasing the project the construction disruptions to the public can be minimized.

Timing of projects:

In a perfect world, government programs would never overheat or cool the economy. If all the projects contemplated under the current proposal were to be issued in a single year as an addition to the normal construction program, the construction market would be strained to deal with the work. In essence we would be trying to complete almost one and one half seasons of work in one year. The design community does not have the manpower to increase their efforts to that level and the State does not have project engineers to manage the work.

The State should also consider the impact potential "mega-projects" such as a gas pipeline or ANWR, will have on the economy and program the release of the bonds to minimize the consequences of the inevitable contraction in the economy that traditionally follows the completion of a major project.

Construction Cost Savings:

By building sooner, rather than later, the impact of inflation can be reduced and projects can be delivered at a lower overall cost. Consequently Alaska could get more projects completed with the projected funding from the federal highway fund. This benefit is mitigated somewhat by the fact that the bonds require an interest payment that will increase the cost to the program. So long as the interest costs of the bond issue are less than the rate of inflation, the program benefits from the issuance of bonds.

Benefits from Interest Earnings:

In the most basic sense, bonds require an interest premium for the privilege of borrowing money under the terms and conditions outlined in the bond indenture agreement. During the early years of the program it is expected that the State will invest the unused portion of the bonds and earn

interest at a rate in excess of that required on the bonds. That difference represents a savings that can be used for various purposes such as payments required on the bonds themselves or State match for the federal highway appropriation. At some point, all the bonds will be issued and the State will incur a higher cost due to the interest portion of the bonds. Any benefit from this interest arbitrage will be received shortly after the bonds are issued. Once the bond funds are invested in projects rather than financial assets, the benefit disappears.

Potential Problems with Garvee Bonds

Selection of Projects:

The theoretical benefits of Garvee Bonds are undermined when the program becomes just another means of funding desired projects. A \$400,000 project in Anchorage hardly seems to demand a creative means of project acceleration. The State should establish a process that meets strict criteria for selection rather than one that seems to curry favor from local residents.

Also absent from the discussion is how projects are to advance in the STIP to replace the projects funded by the bond proposal. The STIP process was developed to minimize the political influence that can occur in project selection. That same process does not seem to have been applied to the selection of projects for inclusion on the Garvee Bond list. Until the selection process is better explained and understood the end result must be questioned.

Over-heating the economy

Can the construction community handle an additional \$145 million in work phased in over three to four years? Yes. Can the State and the design community design this additional work in that time frame? The answer to this is less clear. The State presently has a problem in getting the work to bid to comply with the current construction season. A job bidding in August and September is less valuable to the industry than one that bids in March or April. From the construction industry this bidding history impacts two construction seasons. For the State, the work is released in one fiscal year.

Over time however this problem corrects itself as the fall release of jobs becomes the base from which the future years work is programmed. But delays in projects being released is symptomatic of a problem that will only be exacerbated by a significant increase in the project load.

Impact on future construction volume:

Under the current scenario described by the State, Alaska would see construction volume increase during the first few years following the bond issue and then lag the "non-Garvee" trend for the remainder of the time bonds are outstanding. Perhaps the appropriate question is not "Will the Garvee bonds overheat the economy?" but "What will happen to the industry after the projects funded by the bond issue are completed?"

Implicit in the assumptions surrounding the issuance of Garvee bonds is that the State of Alaska will continue to be a net benefactor from the federal highway trust fund allocation formula at the same level as currently experienced through all future federal highway reauthorizations. This assumption may well be true, but reason suggests that as Alaska's senior leadership retires,

Alaska's share of the highway funds will be reduced. Should that happen, Alaska's receipts from the program will plummet and the State of Alaska and the highway construction industry in Alaska would be severely impacted.

One of the arguments for the bonds is that future inflation can be avoided by early construction. If however the construction industry must purchase new equipment to meet the peaks imposed by the increased volume accompanying Garvee bonds, it seems reasonable to expect that they will attempt to amortize the cost of the increased equipment over the expected life of the increased volume. The cost of the Garvee projects under such a scenario may actually be higher than expected and the proposed inflation savings non-existent.

Highway construction is a capital-intensive business. Self-inflicted modifications to construction volume can seriously impact the economic viability of the construction industry particularly as the volume of work contracts to normal sustainable levels. Bidding then becomes defensive as the firms attempt to generate cash flow and the entire industry suffers until the excess capacity can be relieved. In the end some firms may well go out of business, not because of economic decisions they make, but because of economic distortions to the economy by those that did not consider the ramifications of their decisions.

A Proposed Approach to GARVEE Bonds

Bond payments limited to 5% of federal highway program:

More is frequently not better. New Mexico issued approximately \$1 billion in Garvee bonds to do a number of major projects. The bonds supposedly are being paid back over a number of years at a rate of almost \$100 million per year. New Mexico's highway program is approximately \$242 million dollars before the reduction for the Garvee bonds and other senior sub-ordinate lien bonds. After the reduction, the program is reduced to approximately \$164 million. More than one third of their highway program funds are being used to payback the bonds. This reduction has seriously impacted the economic viability of their highway construction industry.

The problem is further magnified when the highway funding for 2003 is considered. In President Bush's 2003 budget proposal, New Mexico's estimated highway appropriation was \$199 million. After the reduction for the bond payments, the State had less than \$125 million for their highway program. This reduction in the highway allocation was unique, but could easily occur again.

It can be argued that the problems in New Mexico are unique, and perhaps they are. Other states are also gaining valuable experience in this area. Colorado, Kansas, West Virginia, and others have experiences that should be analyzed and understood. Where appropriate, these experiences should be avoided or replicated. More importantly, Alaska should seriously look at its own experience with Garvee bonds and the impact the annual payments had on the highway program in 2004. Fortunately the Legislature greatly reduced the amount of Garvee Bonds requested Governor Knowles but in 2004, Alaska experienced a contraction in highway funding and the bond repayments had a significant impact on the highway program that year.

Given the problems experienced in some states, AGC would propose that any allocation of the federal highway funds for repayment of bonds should not exceed five percent of the projected,

sustainable highway funds. General obligation bonds should fund major projects that will require a higher repayment level.

Project Selection:

Projects selected for funding under a Garvee Bond approach should be determined by the application of a rigorous set of criteria. No project should be selected that has not successfully undergone the process imposed in the STIP. But inclusion on the STIP should not be sufficient in and of itself. The project should be of sufficient size that the State would normally phase the construction to minimize the impact on any one year's project list. The rationale for inclusion on the list should be compelling. Removals of significant safety hazards, environmental issues, or economic benefits from project acceleration are all reasons that a project might be included on a Garvee Bond list. This approach could potentially be a valuable tool for the State, but the goals should be clearly defined and the problems carefully evaluated.

Summary

It is extremely difficult for a trade organization representing contractors to argue against additional work for their industry. But when that work comes at the expense of future work and when future-funding levels might decline due to external factors beyond Alaska's control, then it becomes an issue of finding the best means of stabilizing the industry. The problems experienced in other states suggest that the use of Garvee bonds should be approached cautiously. Wild swings in construction volume will permanently damage the highway industry in Alaska. The Associated General Contractors of Alaska cannot support any method or alternative that will cause long-term harm to the industry. As currently proposed the issue is not good for the industry and most likely not good for the State.