

**Testimony Before
The House Finance and Appropriations Committee
Hon. Charles Calvert, Chairman**

By Gordon Proctor
ODOT Director
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Chairman Calvert, members of the Committee, I am Gordon Proctor, Director of the Ohio Department of Transportation. Thank you for this opportunity to present to the committee.

First, let me thank you for all the support this Committee has given to me and to ODOT for the past eight years. This committee has been very engaged and supportive in our efforts to improve Ohio's transportation system. Together, we have made major improvements to the safety, convenience and economic competitiveness of Ohio.

For nearly a year now, we at ODOT have been informing the public, the media, local governments and state and Congressional officials about the significant effects that construction inflation is having upon ODOT's construction program. We have faced a nearly 40 percent loss in our construction purchasing power in the past 48 months with a disproportionate amount of that inflation occurring in the past 18 months.

This has been caused by record oil prices. Higher oil prices have resonated through all aspects of construction materials and construction activities. Asphalt is an obviously affected commodity but we also have seen record increases in concrete, steel, excavation, aggregates and even plastic pipe. Activities such as quarrying stone, crushing stone and delivering and placing stone are very diesel intensive. Cement is produced in giant kilns that must be heated to 3,400 degrees for days. Plastic pipe is made from oil. Excavation is performed by diesel-consuming heavy equipment.

As a result, in the past 24 months earthwork prices rose 19 percent, drainage prices increased 26 percent, concrete pavement has risen 34 percent and asphalt base prices rose 46 percent. Overall, ODOT has seen a 40 percent increase in its basic market basket of construction prices in the past four years. The past 12 months saw a compounded growth of 12.2 percent alone. Prices are forecast to rise in the next 12 months by another 8 percent.

Ohio is not alone in this trend. World wide oil prices and the strong international demand for steel, cement and other construction materials are driving up these prices. The phenomenal growth in India and China are affecting international steel, cement, oil, gasoline and diesel prices.

Clearly this is having a major effect upon ODOT's construction program and its long-term capital plan. Personally, I have been surprised by the lack of public discourse about this issue outside of transportation circles. Because we have yet to cancel many projects

the issue has not received much media attention. We have taken several steps to inform policy makers but they have not generated much discussion. Therefore, I appreciate this opportunity to address the committee personally.

The ODOT budget process will elaborate upon this issue but as you know the budget process is hurried with the March 30 passage deadline that Ohio faces. With ODOT undergoing a transition in January I wanted this opportunity to brief you all so that you can anticipate the long-term effects.

The short-term effects should not be apparent to the public. We have cancelled very few projects, with the exception of the Ironton-Russell Bridge. Its high price caused us to cancel that bid award last January and to re-design the bridge into a more affordable structure.

However, the longer-term effects will be significant. I will attempt to summarize a great deal of analysis into a few brief concepts.

ODOT had planned to spend about \$700 million annually from 2006 through 2012 for basic repairs to ODOT's bridge and pavements. Instead, we will have to increase that spending by \$455 million over four years to compensate for inflation.

The Major New Construction projects that had been approved by the TRAC in 2004 rose in cost by at least \$700 million because of inflation.

Federal funds from the 2004 highway bill have come in at about \$100 million less than projected. Revenue into the Highway Trust Fund has not been as great as predicted when the 2004 bill was passed and Ohio is receiving about 91 percent of what the legislation authorized in 2004.

As you may recall, ODOT and Gov. Taft proposed two far-reaching transportation initiatives in 2003.

In 2003 Gov. Taft and ODOT proposed a 6 cent fuel tax and fee proposal for ODOT and for local governments. That plan called for raising \$578 million for state and local governments when fully implemented between 2002 and 2008. That plan proposed to raise \$289 million for cities, counties and townships and to raise a like amount for ODOT. After some minor modifications by the Ohio General Assembly that plan was enacted and those funds are flowing to ODOT, to cities, counties and townships. ODOT pledged to devote \$250 million of its new revenue totally to new construction for 10 years. That is happening and the 2003 fuel tax commitments are being kept.

Later in 2003, Gov. Taft and ODOT proposed a federal strategy for the then-pending federal transportation bill. The plan called for another \$250 million annually for ODOT's

new construction program if Congress addressed several issues. Those were the “Ethanol Penalty”, Ohio’s rate of return and a slight increase in overall transportation spending.

Those provisions were included in the 2004 act. However, lower-than-anticipated receipts into the Highway Trust Fund have resulted in the equivalent of an overall 9 percent reduction in expenditures from what was anticipated when the act passed. That has cost ODOT about \$100 million annually, in very general terms.

This lower federal funding combined with extraordinary inflation have combined to seriously affect ODOT’s capital program.

What have we at ODOT done in response? We have:

- Lowered operating costs between 2008 and 2011 by \$105 million through further efficiencies;
- We increased basic preservation spending by \$455 million to meet system goals in the face of higher costs;
- We have deferred, cancelled or postponed nearly \$450 million in new construction projects between 2007 and 2012;
- Have scaled back several other major new construction projects to retain their most essential elements but had deferred other aspects of the projects for later years;
- We have increased our borrowing by \$600 million between 2007 and 2009 to provide additional income.

The initial 2003 long-term capital plan basically called for the following:

1. Preservation funding of about \$700 million in 2004 rising to \$763 million by 2013 to preserve ODOT’s bridge and pavement conditions. Now, that spending will rise as much as another \$163 million annually by 2010 to compensate for inflation.
2. ODOT had planned for a Major New construction program averaging \$500 million from 2004 through 2013. Now, the 10-year average is predicted to be \$479 million, or \$21 million less annually for 10 years.

A reduction from \$500 million to \$479 million for a 10-year average does not sound significant. I would point out, however, that the average is not uniform for the 10 years. For the first six years of the plan, spending averages \$668 million but falls to \$275 million for the last four years of the plan.

That means that ODOT will have very little ability to commit to new construction projects beyond what is currently on ODOT’s funded Tier I list for many years. ODOT is front-ending or accelerating projects ready for construction in this year and the next two to avoid as much construction inflation as possible. ODOT is doing that by borrowing an additional \$600 million which must be repaid. The higher bond debt will

be paid off in the later years of the plan, which in part reduces available funds in 2010 and beyond.

We have pursued this bonding only after careful analysis. In effect, it is cheaper to borrow today at interest rates less than 4 percent than it is to delay projects and incur inflation of 8 percent or more per year. ODOT has a AAA bond rating and borrows money for relatively short 10-year terms. Therefore, we get interest rates of less than 4 percent, which causes interest costs to be less than the cost of inflation if projects are delayed.

Mr Chairman, these forecasts I am making today are based on three conservative assumptions:

1. The first is that inflation will continue at a moderate rate of about 6 percent for several more years;
2. It assumes Ohio will receive no increase in federal funds in the next transportation bill, which has not happened before;
3. It assumes that there will be no growth in state motor fuel receipts because high prices depress consumption, and therefore receipts.

If there is any improvement in those three assumptions, ODOT's financial situation would improve. However, we believe it prudent to make conservative forecasts when dealing with the uncertainty of long-term needs.

Mr. Chairman, members of the Committee, we have produced a lengthy list of business documents for the public and for the next administration to be fully aware of this issue and of the details of ODOT's finances. After all the help this committee has provided me in the past eight years, I would have been remiss to not come here personally and to brief you on these issues.

ODOT's long-term budgeting practices leave the next Administration the capability to make well-informed and rational decision in the years ahead to deal with construction inflation. At a minimum I believe that ODOT must continue to do the following:

1. It must continue to constrain its operating costs;
2. It must continue its market analysis and forecasting that is conducted by its estimating team to stay abreast of inflation trends.
3. It must continue to participate in a Congressionally created national study commission that is examining ways in which Congress can address long-term transportation funding needs.
4. ODOT should continue its practices to time its bid lettings to receive maximum competition and, therefore, lower prices.
5. It must continue its innovation in maintenance practices to get the most performance out its current bridge and pavement assets.
6. It must work closely with Ohio's Congressional delegation to ensure Ohio's success in the 2009 highway bill.

It was my sincere hope that we would leave ODOT with a stable 10-year capital plan which would preserve system conditions and provide a stable \$500 million annual new construction program through 2013. Now, the financial uncertainty of ODOT's new construction program will occur as early as 2010. In effect inflation has consumed about 2.5 cents of the 6 cent fuel tax increase and it has consumed almost all of the growth from the 2004 federal highway act. This compels ODOT and the General Assembly to monitor income and inflation trends closely in the upcoming years and to continue its long-term efforts to hold down costs and to secure additional revenue.

Mr. Chairman, I appreciate this opportunity to speak before you and I would be happy to answer any questions.