Mn/DOT FINANCIAL MANAGEMENT AND LEGISLATIVE BRIEFING PACKAGE 2007

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Office of Finance

January 2007

Published by

Minnesota Department of Transportation
Office of Finance
Mail Stop 230
395 John Ireland Boulevard
St. Paul, MN 55155

Department: Transportation

STATE OF MINNESOTA

Office Memorandum

To: Managers
Office and Business Managers
Public Affairs Coordinators

Date: February 16, 2007

From: Scott Peterson, Director
Office of Finance

Phone: 651/296-1363

Subject: 2007 Financial Management and Legislative Briefing Package

Attached is the Financial Management and Legislative Briefing Package for 2007.

Over the years, this document has been a valuable resource for staff who prepare and deliver Mn/DOT's legislative programs. The document also provides general legislative information to Mn/DOT's employees.

This year's package includes:

- A summary of the 2007 budget request approved by Governor Pawlenty
- Mn/DOT's 2007 legislative initiatives.
- A discussion of transportation-related issues of current department and legislative interest.
- Summary of selected department financial and non-financial data.

I hope you will find this document to be a helpful overview for this year's legislative session, as well as a useful reference document. I encourage you to share it with your staff.

If you would like additional copies of the package, contact Bruce Briese at 651-366-4874.

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OVERVIEW

The Office of Finance prepared this briefing package to provide basic information on the Minnesota Department of Transportation's (Mn/DOT) finances and transportation-related legislative issues. The package provides a summary for this legislative session about proposed policy initiatives, gives an orientation to certain issues facing Mn/DOT, and provides background on Mn/DOT's financial picture.

The first page of the report is a one-page summary of transportation-related facts. The report is then broken down into three main sections as follows:

I. Section I describes Mn/DOT's proposed biennial budget for consideration by the 2007 Legislature.

II. Section II contains a summary of Mn/DOT's proposed 2007 legislative initiatives and key issues that may generate legislative interest in the upcoming session.

III. Section III depicts Mn/DOT's financial picture. It includes information about FY 2006 revenues, expenditures, and funding sources; it also contains a history of significant revenue changes over the past 25 years and some useful financial data.

FACTS RELATED TO TRANSPORTATION USERS AND THE TRANSPORTATION SYSTEM

Motor Vehicle Registrations:

- Minnesota's motor vehicle registrations totaled about 4.69 million in 2005.
  (Minnesota Department of Public Safety)

Licensed Drivers:

- Minnesota had 3.87 million licensed drivers in 2005.
  (Minnesota Department of Public Safety)

Seat Belt Usage

- Minnesota's seat belt usage was 84% as of August 2006.
  (2005 MN Transportation Trivia, compiled by the Office of Traffic Engineering)

Vehicle Miles Traveled:

- Use of Minnesota's roads totaled 56.5 billion vehicle miles traveled in 2005.
  (Mn/DOT Office of Transportation Data and Analysis)

Aeronautics:

- Minnesota has over 8,018 registered aircraft and 136 public airports.
  (Mn/DOT Office of Aeronautics)

Waterways:

- Minnesota has 222 miles of navigable rivers which carry 78 million tons of freight.
  (2005 Transportation Trivia, compiled by the Office of Traffic Engineering)

Transit:

- Use of Minnesota transit systems totaled 79.3 million transit trips.
  (2005 Transportation Trivia, compiled by the Office of Traffic Engineering)

Bicycle Trails:

- Minnesota leads the nation in miles of bicycle trails, with over 500 miles of state paved miles out of a total of about 2,300 miles statewide. Minnesota and Wisconsin have about one-fourth of the nation's bike trails.
  (Minnesota Department of Natural Resources)

Rail system:

- Minnesota's rail system consists of about 4,514 miles of railroad, with 4,409 rail crossings.
  (2005 Transportation Trivia, compiled by Office of Traffic Engineering)

SECTION I

Mn/DOT BIENNIAL BUDGET

BIENNIAL BUDGET INTRODUCTION

This section provides an overview of Mn/DOT's 2008-09 biennial budget request for consideration by the 2007 Legislature.

Mn/DOT's proposed budget is funded by the Trunk Highway Fund, County State Aid Highway Fund, Municipal State Aid Street Fund, State Airports Fund, a new Transit Assistance Fund (greater Minnesota transit account), and General Fund. With the exception of the activities funded by the General Fund (primarily transit and rail), requested amounts are constrained by the amount of money estimated to be available in the respective funds.

As described in the Legislative Issues section, revenue anticipated to be received from motor fuel, motor vehicle registration, and motor vehicle sales taxes has declined compared with the amounts forecasted in February 2006. This has significantly affected the amount of spending that could be proposed for the County State Aid Highway, the Municipal State Aid Street, and the Trunk Highway Funds. If no decline in revenues had occurred, funding for both the Municipal State Aid Street Fund and the County State Aid Highway Fund would have been expected to increase by about 2.4% per year. These declines were partially offset by the Governor's proposal to shift the way in which revenues from the sales tax on motor vehicle leases are deposited (see below).

The request for the Trunk Highway Fund was also significantly affected by the revenue situation. The listing below highlights many initiatives included in this proposal:

- Trunk highway bonds, in the amount of $1.7 billion, are proposed for highway construction over a ten-year period.
- The debt service on these bonds would in part come from the increased funding the Trunk Highway Fund will receive because of passage of the motor vehicle sales tax constitutional amendment, plus a portion of the revenue from the sales tax on motor vehicle leases (see below).
- Deposits of revenue from the sales tax on motor vehicle leases would be shifted from the General Fund and deposited in the same way as revenues from the motor vehicle sales tax (to the Highway User Tax Distribution Fund and to the Transit Assistance Fund).
- A General Fund surplus of $100 million would be deposited in the Trunk Highway Fund, of which $5 million will be committed to researching alternative strategies for funding highway needs (e.g., use of a mileage-based tax system).
- An exemption from the state sales tax for purchases from the Trunk Highway Fund, expected to save slightly more than $4 million per year.
- A transfer of $4.6 million from the Transportation Revolving Loan Fund to the Trunk Highway Fund.
- A payment of $1.221 million from the General Fund to the Trunk Highway Fund, to fulfill obligations related to the transfer of some Mn/DOT property to the city of Mounds View to assist with an expansion by Medtronic.
- Mn/DOT's expenditures related to the ARMER system (800 MHz radios) would be funded by 911 telephone fees, resulting in a $1.16 million per year savings to the Trunk Highway Fund.
- The request contains no funding for Mn/DOT buildings such as the Mankato headquarters building.

- Base budgets for personnel costs in operating budgets would be increased by 2% per year to help address the cost of compensation increases; costs are estimated to be $6.1 million in FY 2008 and $12.4 million in FY 2009.
- The state road construction budget would be reduced by $13 million per year, making funding available for increases to operational budgets.
- Mn/DOT's greater Minnesota transit program will receive increased funding, in an effort to maintain current service levels. This funding comes from the shift of sales tax on motor vehicle leases from the General Fund, and increased percentages of MVST revenues from the constitutional amendment. The proposed percentages of the MVST allocated to the greater Minnesota transit account in the new transit fund are: 1.55% in FY 2008, 1.65% in FY 2009, 1.75% in FY 2010, 1.9% in FY 2011, and 2.0% in FY 2012.

A one-time increase of $12 million is proposed for the Aeronautics Program to provide appropriation authority for a $15 million transfer to the State Airports Fund from the General Fund, which is a repayment of funds transferred to the General Fund in 2003. The remaining $3 million is needed to build up a fund balance to protect the greater Minnesota Airport Capital Program from the impacts of financial instability in the airline industry. Tax payments due from Northwest Airlines fall under the jurisdiction of bankruptcy court, creating considerable uncertainty about the timing and amount of tax liabilities of Northwest Airlines.

The chart below depicts the effects of these items, plus two other changes, on the Trunk Highway Fund balance:

Increases and Decreases To Trunk Highway Fund Balance Incorporated Into the Biennial Budget Recommendations
(Dollars in Thousands)

	FY 2008	FY 2009	FY 2010	FY 2011
Increases To The Fund Balance				
Sales Tax Exemption (reduced expenditures)	4,125	4,660	4,820	4,990
Medtronic Repayment	1,221			
Transfer From the Transportation Revolving Loan Fund	4,600			
Sales Tax on Leasing (new revenue)	10,814	12,864	14,701	17,034
Metro Radios to 911 Fund (reduced expenditures)	1,160	1,160	1,160	1,160
Total Additions	21,920	18,684	20,681	23,184
Reductions to Fund Balance				
DPS Traffic Safety Federal Match	111	111	111	111
State Patrol Salary Supplement	4,072	6,729	6,729	6,729
State Patrol Increase of 40 Troopers	2,060	3,653	3,653	3,653
State Patrol - Non-Compensation	1,335	1,335	1,335	1,335
Mn/DOT Salary Supplement	6,138	12,399	12,399	12,399
Debt Service on New Trunk Highway Bond Authorization	985	11,445	23,587	46,987
Subtotal	14,701	35,672	47,814	71,214
Total Change By Year	7,219	(16,988)	(27,133)	(48,030)

SECTION II

LEGISLATIVE INITIATIVES AND ISSUES

Mn/DOT 2007 LEGISLATIVE INITIATIVES

A variety of initiatives are included in the 2007 Mn/DOT legislative proposals. This section will address these proposals.

Motor Carrier Federal Conformity
This proposal includes several changes to conform state law to federal regulations. The definition of explosives, the definition of flammable liquid, the age of drivers transporting hazardous materials of trade, hazardous materials safety permits, and the requirement to display an address on the carrier's vehicles are all possible changes.

- Definition of Explosives—Repeal the current definition of explosives in M.S. 169.01, Subdivision 19, and replace it with the following language: "Explosives means any materials as defined in Code of Federal Regulations, title 49, section 173.50."
- Definition of Flammable Liquid—Repeal the current definition of flammable liquid in M.S. 169.01, Subdivision 20, and change it to read: "Flammable liquid has the meaning given in Code of Federal Regulations, title 49, section 173.120."
- Hazardous Materials Safety Permits—Create a new Subdivision 12 in M.S. 221.0314. "Subd. 12. Hazardous Materials Safety Permits. A person who transports the hazardous materials designated in the Code of Federal Regulations, title 49, section 385.403, must comply with this section and with the provisions of the Code of Federal Regulations, title 49, part 385, subpart E. The Code of Federal Regulations, title 49, part 385, subpart E, is incorporated by reference."
- Age of drivers transporting hazardous materials of trade—Add the phrase "when engaged in intrastate commerce" to the existing law in M.S. 221.033, Subdivision 2d. The corrected version should read: "A driver of a self-propelled or towed motor vehicle transporting no hazardous material other than materials of trade, as defined in Code of Federal Regulations, title 49, section 171.8, *when engaged in intrastate transportation*, must be at least 18 years of age. This subdivision does not apply unless the transportation conforms to the requirements of Code of Federal Regulations, title 49, section 173.6."
- Display of Address on Carrier Vehicles—Remove the requirement to display the address (city and state) on interstate and intrastate carrier vehicles. This requirement is inconsistent with USDOT requirements for interstate commercial vehicles. The Federal Motor Carrier Safety Regulations were changed in 2000 to eliminate the requirement to display the city and state on the sides of commercial vehicles. M.S. 221.031, Subdivisions 6(a) and 6(b) are inconsistent with this federal requirement, and must be reported in the Incompatibility Report filed annually with the Federal Motor Carrier Safety Administration as part of the Commercial Vehicle Safety Plan.

Towing Authority
This legislation would give towing authority to the Mn/DOT freeway service patrol for removal of abandoned vehicles from state highways in the Twin Cities metropolitan area. As a towing authority, Mn/DOT could order custody tows provided by private towing companies for the removal of abandoned vehicles. Towing authority would be delegated to Mn/DOT Freeway Incident Response Safety Team (FIRST) employees.

Unified Carrier Registration Agreement (UCRA)
This proposal would allow the commissioner of transportation to implement a new federal program for registering interstate motor carriers operating in Minnesota, referred to as the Unified Carrier Registration Agreement (UCRA). The UCRA would replace the existing program for registering interstate carrier authority and filing proof of insurance (currently administered by Mn/DOT), as well as the USDOT numbering system (administered by the Federal Motor Carrier Safety Administration). The existing system for registering interstate motor carriers would be repealed as of January 1, 2007.

It is important for Minnesota to implement the UCRA when the federal regulations become effective. If UCRA is not implemented, all Minnesota interstate carriers would be forced to choose another state as their state of registration. This inconvenience would be inefficient for carriers, and would mean that Minnesota would lose anticipated revenue of $1.4 million.

Trunk Highway Turnbacks
Mn/DOT District 7 is proposing to turn back Trunk Highway 262 to Martin County. This transfer is called for in the district's jurisdictional plan. The county board has passed a resolution in support of this transfer. The city of Willmar has requested that a small portion of Trunk Highway 40 be turned back. Mn/DOT's District 8 is supportive of the transfer. The city is interested in pursuing economic development along this section of the roadway.

Culvert Inspections
Mn/DOT is proposing to change the maximum length of time between inspections for culverts that are in good condition to four years, rather than the two years required under current law and rules. This change would be consistent with a new federal rule that allows the inspection interval for culverts to be every four years. An exception would be those having a National Bridge Inspection Standard condition rating of four or less, which would continue to be inspected on a yearly basis. This change would apply to local governments, who support this proposal.

Rail Banks
Mn/DOT is proposing two changes related to rail banks:

- Minimum Corridor Widths—This proposal is to increase the minimum corridor width for new rail bank acquisitions from 50 feet to 100 feet, and to require that when Mn/DOT sells excess rail bank property it retains 100 feet. The proposed change will assist Mn/DOT in maintaining consistent 100-foot corridors for rail bank property. The typical corridor width for rail bank properties is 100 feet. However, the current statutory minimum corridor width for rail bank property is only 50 feet. Mn/DOT recently reviewed minimum corridor widths required for many of the transportation uses identified under Minnesota rail bank laws. Corridor widths for these uses range from a minimum of 26 feet for light rail transit to 300 feet for utility transmission lines. Most of these widths are significantly greater than the existing minimum width of 50 feet. The legislation will be structured to be prospective only (i.e., existing 50-foot corridors do not need to be expanded).
- Misdemeanor Acts on Rail Bank Right-of-Way—The proposed legislation defines a variety of specific misdemeanor acts on rail bank property. Currently, there is nothing in rail bank statutes defining unlawful misdemeanor acts on rail bank property. There is such statutory language for trunk highway rights-of-way in M.S. 160.2715. This change will allow Mn/DOT and law enforcement officials to take

action against violators. Currently, Mn/DOT can only take civil action against violators under the general statute concerning damage to state property in MS 16A.722.

Right of Entry for Geotechnical Investigations

Frequently, it is necessary to conduct soil borings for geotechnical investigations early in the highway project development process, often before the right-of-way has been acquired. Soil borings are necessary to prepare the soils recommendation for each new construction project. Without it, design plans cannot be completed, which causes project delays. Additionally, it is necessary in order to prepare an accurate cost estimate for the project. The Attorney General has determined that MS 117.041, which allows crews to enter land not held by Mn/DOT for environmental borings, does not authorize crews to conduct soil borings for geotechnical reasons. Legislation is being proposed to specifically grant Mn/DOT authority to enter property to take soil borings. Mn/DOT would pay for any damages to property resulting from geotechnical investigations, including damage caused by the process of reaching the boring sites as well as from the actual boring itself. This change would also allow local units of government to access property for geotechnical investigations.

Minnesota Rail Service Improvement (MRSI) Program Changes

The Minnesota Rail Service Improvement (MRSI) Program, a revolving loan program, was created in 1976. State and federal funds have been granted or loaned to rail users and carriers to purchase and rehabilitate deteriorating rail lines, improve rail-shipping opportunities, improve and extend rail sidings, construct storage facilities, as well as preserve abandoned rail corridors for future transportation use. During the past few months, Mn/DOT undertook a comprehensive review of the MRSI program and identified potential changes that will better meet the needs of customers. As a result of this review, Mn/DOT is proposing that M.S. 222.50, Subdivision, 7 (a) (2) be amended to:

- Allow rail carriers to participate in capital improvement projects.
- Eliminate language providing examples of capital improvement projects.
- Include language that the commissioner may expend money for rehabilitation projects (Even though rehabilitation has been a cornerstone of the MRSI program since its inception, this section of the statute did not list rehabilitation as an eligible activity).

Data Practices

Mn/DOT is proposing three changes to Minnesota's data practices statutes:

- Market Research Data—Mn/DOT recently experienced a 30% increase in the cost of one market research contract. Survey respondents were reluctant to participate in market research because of the lack of privacy. The reluctance became evident when participants were informed that their data may become public, thus reducing the effectiveness of the research as well as increasing the cost (more hours spent surveying to obtain responses). Summary data would continue to be available under the Data Practices Act, but this legislation would protect the identities of participants.
- Overhead Rate Data—This proposal will bring Mn/DOT in line with current accepted accounting practices. If this proposal is not enacted, consultants might not work for Mn/DOT because they don't want this information to become public. Professional accounting practices suggest segregating this type of sensitive financial data. Mn/DOT's Office of Audit houses this data separately to offer some measure of protection; however, it is currently public data.

- Bid Escrow Documents—If this proposal is not enacted, contractors may decline to provide accurate bid escrow documents, resulting in inequitable dispute resolution. It is imperative that Mn/DOT continues using the bid escrow process, in order to obtain accurate bid escrow documentation which allows for equitable dispute resolutions.

Electronic Bidding

Mn/DOT is proposing three initiatives related to electronic bidding:

- Bid Lettings and the Public Reading of Bids—Eliminate the public reading of bids received in the cafeteria of the Transportation Building on the day of a project letting. Rather, the public notification of bids received would be accomplished by posting them on the Internet. The results would appear on a free Mn/DOT website and on the BIDX website (membership fee required to view bid results).
- Advertisement of Bids–Eliminate the need to advertise for bids "in a newspaper, or other periodical of general circulation." Mn/DOT is proposing that placing advertisements on the Internet (free Mn/DOT website) would meet the requirement for publication.
- Electronic Bidding—Require the electronic submission of all bids for highway construction and maintenance projects. Mn/DOT intends to phase in this change according to the following schedule:
    - July 1, 2007: Contracts over $1 million
    - July 1, 2008: Contracts over $500,000
    - July 1, 2009: All contracts

Transportation Revolving Loan Fund

Current law (M.S. 161.04, Subdivision 3) allows the commissioner of transportation to transfer money from the Trunk Highway Fund to the Trunk Highway Revolving Loan Account in the Transportation Revolving Loan Fund. Mn/DOT is proposing to also allow transfers from the Trunk Highway Revolving Loan Account to the Trunk Highway Fund.

Truck Weights

Mn/DOT undertook a major effort during the summer and fall of 2005 to develop proposals for changing Minnesota's Truck Size and Weight (TS&W) laws. Numerous recommendations came out of the study, many of which were incorporated into a major bill for consideration by the 2006 Legislature. However, the legislation was not officially introduced during the 2006 session. Legislation is being proposed in 2007 to address the same issues.

A variety of proposals would allow specific kinds of trucks to have weight limits greater than 80,000 pounds. These trucks would not be able to travel on interstate highways because of federal law; exceptions would be trucks transporting intermodal containers.

Some of the major aspects of this proposal are the following:

- Allow 90,000 pound trucks with 6 axles—These trucks would be the same dimensions as today's five axle combinations. They would be allowed to reach 99,000 pounds during winter and seasonal harvest periods. They would not be allowed on the Interstate Highways unless they were carrying sealed intermodal cargo containers. The annual permit fee for this truck would be $300. This is consistent with the permit fee for the forest products trucks authorized during the 2004 legislative session.

- Allow 97,000 pound trucks with 7 axles—These trucks would be the same dimensions as today's five axle combinations. They would be allowed to reach 99,000 pounds during winter and seasonal harvest periods, but would not be allowed any other weight tolerances or exceptions. Drivers of these vehicles would have to meet Federal Motor Carrier Safety Administration driver disqualification regulations. The annual permit fee for this truck would be $600.
- Allow 108,000 pound twin-trailer trucks with 8 axles—These trucks would be the same dimensions as the twin-trailers used today by companies like UPS and FedEx. They would only be allowed on the Minnesota Twin Trailer Network and National Truck Network. They would need affirmative approval from local governments before operating on local roads. These trucks would not be allowed any harvest or winter weight increases. The trailers would have to be coupled with a B-train, which greatly increases safety. Drivers would have to meet all pertinent qualifications, and would have to follow hours-of-services regulations. The annual permit fee for this truck would be $850, which is consistent with the permit fee enacted for Blandin paper trucks in the 2005 legislative session.
- Change spring load restrictions—Current law sets a maximum weight limit of 5 tons per axle on county roads during the time when seasonal load restrictions are in effect. Under this proposal, all county roads would default to 7 tons per axle unless posted otherwise. State trunk highways would remain at 10 tons per axle unless posted otherwise, while city streets, gravel county roads, and township roads would continue to default to 5 tons per axle unless posted otherwise. Spring weight restrictions on gravel roads would be extended two weeks longer than on paved roads.
- Change the 9-ton network—The 73,280 pound limit for 5 axle semi-trailers would be removed on 9-ton roads, and axle weights and the bridge formula would be allowed to control up to 80,000 pounds gross vehicle weight.

Additionally, this legislation will be used to "clean up" a few selected truck size and weight regulations in statute and, in a few cases, bring state law into conformance with federal requirements.

Exempt Northstar Commuter Rail and All Future Projects From State Sales Tax

In addition to the proposed exemption of Mn/DOT purchases using trunk highway funds that is part of the Governor's budget recommendations, Mn/DOT is requesting that purchases for commuter rail construction and equipment be exempted from the state sales tax. This initiative is included in the Governor's tax bill.

Reconvenance of Surplus Trunk Highway Property

Mn/DOT is proposing that some of the money received from the sale of lands be deposited into Mn/DOT operating budgets as dedicated receipts, instead of being considered non-dedicated receipts deposited into the Trunk Highway Fund which are then available for appropriation in future years.

2007 POTENTIAL LEGISLATIVE ISSUES

A variety of issues are likely to surface that directly affect Mn/DOT and the transportation community of Minnesota. Ten of these issues are discussed in the sections below.

Transportation Revenue Forecasts Experience Major Declines

The November 2006 Economic Forecast, prepared by the Department of Finance, projected a surplus of nearly $2.2 billion in the state General Fund that will be available for FY 2008-09 budget decisions. This was a major focus of news media stories about the state government's current financial condition. Not nearly as well publicized was the forecast for transportation funds. Revenues for highways and transit are forecasted to substantially decline when compared with the last forecast prepared in February 2006. Declines are expected in all three of the principal state sources of funding for highways – motor fuel tax (MFT), motor vehicle registration tax (MVRT), and motor vehicle sales tax (MVST).

Highway Revenues

The forecast for MFT and MVRT revenues is lower for FYs 2007, 2008, and 2009, compared with the amounts in the February 2006 forecast.

MFT and MVRT Forecasted Revenue Changes
($ Thousands)

	FY 2007	FY 2008	FY 2009
February 2006 Forecast	1,144,952	1,159,802	1,176,094
November 2006 Forecast	1,127,649	1,136,596	1,145,344
Difference	(17,303)	(23,206)	(30,750)
% Change	-1.5%	-2.0%	-2.6%

The November 2006 forecast for FY 2007 for MFT and MVRT is $10.7 million (0.9%) lower than was actually received in FY 2006.

The November 2006 forecast for MVST revenue is substantially lower than was included in the February 2006 forecast. The table below shows the changes for this revenue source, irrespective of which funds would receive revenues:

MVST Forecasted Revenue Changes
Total Receipts, Irrespective of Funds To Which Revenue is Deposited
($ in Thousands)

	FY 2007	FY 2008	FY 2009
February 2006 Forecast	549,000	557,700	581,100
November 2006 Forecast	512,500	505,600	523,400
Difference	(36,500)	(52,100)	(57,700)
% Change	-6.6%	-9.3%	-9.9%

Had the voters not approved the constitutional amendment dedicating up to 60% of this revenue to highways and at least 40% to transit, significant reductions in funding for highways and transit would have resulted.

Because the constitutional amendment was adopted, the November 2006 forecasted amounts for MVST were projected to differ from the February forecasted amounts (the February forecasted amounts did not include additional revenue from the constitutional amendment).

MVST Forecasted Revenue Changes*
Highway User Tax Distribution Fund
($ in Thousands)

	FY 2007**	FY 2008	FY 2009	Total All 3 Years
February 2006 Forecast	164,700	178,464	185,952	529,116
November 2006 Forecast	153,750	193,392	231,605	578,747
Difference	(10,950)	14,928	45,653	49,631
% Change	-6.6%	8.4%	24.6%	9.4%

* This chart assume 60^ of MVST revenues will be allocated to highways.
** The constituional amendment does not take effect until FY 2008.

The sum of all three of these revenue sources and the forecasted changes in revenue are shown below:

Changes in Forecasted Revenues From MFT, MVRT, and MVST
Highway User Tax Distribution Fund
($ in Thousands)

	FY 2007	FY 2008	FY 2009	Total All 3 Years
February 2006 Forecast	1,309,652	1,338,266	1,362,046	4,009,964
November 2006 Forecast	1,281,399	1,329,988	1,376,949	3,988,336
Difference	(28,253)	(8,278)	14,903	(21,628)
% Change	-2.2%	-0.6%	1.1%	-0.5%

As the table demonstrates, revenues are more than $28 million lower in FY 2007, $8.3 million lower in FY 2008, and $14.9 million higher in FY 2009. For all three years combined, revenues from these three sources are $21.6 million less than was forecasted in February 2006, despite passage of the constitutional amendment.

The effect of these changes is to reduce available funding for highways through the Trunk Highway Fund, the County State Aid Highway Fund, and the Municipal State Aid Street Fund. The latter two funds provide funding through apportionments to all 87 counties and to 138 municipalities with population greater than 5,000. These reduced revenues will also have a significant effect on the size of the fund balance available from the Trunk Highway Fund, from which new initiatives can be funded by the 2007 Legislature.

Transit Revenues

Transit receives a substantial amount of its funding from MVST revenues. Prior to passage of the constitutional amendment, which by 2012 will dedicate at least 40% of this revenue to transit, 22.93% of MVST revenues were allocated to transit (both metropolitan and greater Minnesota transit) in FY 2007. This percentage was scheduled to be reduced to 21.75% in

FY 2008 and beyond. Greater Minnesota transit, for which Mn/DOT is responsible, received 1.43% in FY 2007, which would have been reduced to 1.25% in FY 2008 and beyond. The phase-in embodied in the constitutional amendment provides an additional 3.75% of MVST revenues over current law in FY 2008, and an additional 4% of MVST revenues in FY 2009 (The distribution of the increased percentages of MVST revenues among metropolitan area transit and greater Minnesota transit is currently not defined, and the 2007 Legislature is charged with deciding this distribution).

Reduced MVST revenues will thus have a significant effect on transit funding. The November 2006 forecast, as compared to the February 2006 forecast, estimated the following changes in revenues for transit (metropolitan and greater Minnesota combined):

Change in Transit Funding Forecasted in February 2006
Compared With November 2006
($ in Thousands)

Changes in Forecasted Revenues For Transit From MVST
($ in Thousands)

	FY 2007*	FY 2008	FY 2009	Total All 3 Years
February 2006 Forecast	125,886	121,300	126,389	373,575
November 2006 Forecast	117,517	128,928	154,403	400,848
Difference	(8,369)	7,628	28,014	27,273
% Change	-6.6%	6.3%	22.2%	7.3%

* The constitutional amendment does not take effect until FY 2008.

<u>Summary</u>

Despite passage of a constitutional amendment, which by 2012 will dedicate all of MVST revenue to transportation (with at least 40% dedicated to transit and up to 60% dedicated to the Highway User Tax Distribution Fund), revenues forecasted in November 2006 for highways from the three principal revenues sources for FYs 2007-09 are less than the amounts forecasted in February 2006. Only in FY 2009, when an additional 12.25% of MVST will be provided to the Highway User Tax Distribution Fund, are revenues from MFT, MVRT, and MVST forecasted to be greater in November 2006 than the amounts forecasted in February 2006. The forecasts for transit revenues from MVST have also barely increased because of the overall reduction in estimated revenue from the MVST. These changes in forecasted revenues will have a significant effect on the amount of spending the Legislature is able to provide for highways and transit, and may also result in some policy proposals to address the reduced revenues.

Transportation Funding Increase Initiatives

Proposals to substantially increase funding for transportation are expected to be a major focus in the 2007 legislative session. Proposals are likely to include increases in the gasoline tax, increases in the motor vehicle registration taxes for passenger vehicles (tab fees – generally these proposals advocate moving away from the maximum tax amounts enacted during the

Ventura Administration), a one-half cent metropolitan area sales tax, and additional trunk highway bonding.

Governor Pawlenty has proposed a major transportation funding initiative that would commit significant portions of the revenue provided by passage of the MVST constitutional amendment. Under the Governor's proposal, the increased Trunk Highway Fund-related revenues from the MVST would be dedicated to debt service on $1.7 billion of trunk highway bonds. The new bonding would begin in FY 2008.

Motor Vehicle Sales Tax Constitutional Amendment

A constitutional amendment dedicating MVST revenues to highways and transit, with a five year phase-in period, was passed by the voters in the November 2006 general election. The amendment states, in part:

> The revenue "...must be allocated for the following transportation purposes: not more than 60 percent must be deposited in the Highway User Tax Distribution Fund, and not less than 40 percent must be deposited in a fund dedicated solely to public transit as defined by law."

Since the amendment was approved by the voters, the 2007 Legislature will need to pass new statutory language that would conform to the constitutional amendment. Currently, this portion of statute allocates 32% of MVST revenues to the Highway User Tax Distribution Fund, 1.25% to the Greater Minnesota Transit Fund, 20.5% to the Metropolitan Area Transit Fund, and 46.25% to the General Fund for the period FY 2008 and beyond. The constitutional amendment does not specify the percentage that would be allocated to the Highway User Tax Distribution Fund, nor does it provide a specific percentage for transit. Additionally, neither of the transit funds currently in statute was addressed. Instead, the amendment says that revenues for transit would be allocated to a "...fund dedicated solely to public transit assistance as defined by law." The only completely clear part in the constitutional amendment is that the percentage of MVST revenues allocated to the General Fund will be 36.25% in FY 2008, 26.25% in FY 2009, 16.25% in FY 2010, 6.25% in FY 2011, and 0% in FY 2012 and beyond.

The Governor's proposal for statutorily dedicating these revenues is shown in the table below. This proposal allocates 60% of these revenues to the Highway User Tax Distribution Fund (HUTD) and 40% to transit, with 95% of the transit portion being allocated to Metro Transit and the remaining 5% to greater Minnesota transit.

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
HUTD Fund	38.25%	44.25%	50.25%	56.25%	60%
Transit	25.5%	29.5%	33.5%	37.5%	40%
Greater MN	1.55%	1.65%	1.75%	1.9%	2%
Metro	23.95%	27.85%	31.75%	35.6%	38%
General Fund	36.25%	26.25%	16.25%	6.25%	0%

Major Revision of Truck Size and Weight (TS&W) Laws

Minnesota's laws regarding allowable weight limits, lengths, and widths of commercial motor vehicles are designed to ensure safe vehicle operation on Minnesota's roadways, and to preserve the state's investment in highway and bridge infrastructure. Federal laws govern limits on the interstate highways and other selected state highways.

In recent years, the Legislature has approved many exceptions and special provisions to state laws governing TS&W on state and local roads. In light of changing patterns of economic growth and logistics, continued increases in truck traffic, and numerous requests for changes to laws, a comprehensive review of Minnesota's state TS&W laws was needed.

Accordingly, Mn/DOT undertook a substantial study of TS&W laws during the last seven months of 2005. Mn/DOT developed a list of recommended changes to Minnesota's TS&W laws for consideration by the 2006 legislature. However, the 2006 legislature chose not to consider proposed legislation developed to implement these recommendations.

It is likely that legislation to address at least some of the recommendations developed in the 2005 study will be considered by the 2007 legislature. Even if Mn/DOT's proposal is not enacted, parts of it will be pursued by various interest groups.

TS&W laws affect the cost of transportation for Minnesota's freight shippers and carriers. Allowing heavier payloads means fewer truck trips and lower transportation costs. Changes to these laws should improve productivity and local access, allow for more direct routing of freight, all the while promoting uniformity. Research has shown that heavier trucks equipped with additional axles, as was recommended in the 2005 study, do less damage to road pavements than lighter trucks with fewer axles. Having weight spread over additional axles, combined with fewer truck trips, means less wear and tear on pavements. Allowing heavier vehicles also means that some additional bridges would need to be posted, and would require higher bridge design standards in the future. All but seven of these bridges were identified as a result of the timber haulers bill that was passed in the 2004 legislative session.

Passage of a New Federal Transportation Authorization Bill (SAFETEA-LU)

Under federal law, an authorization law must exist for Congress to be able to appropriate money, consistent with the purposes of the authorization law. For highways and transit this authorization is provided by a law known as SAFETEA-LU, which became law on August 10, 2005. This law was the successor to TEA-21, which was scheduled to be in effect from 1998 until September 30, 2003, and was extended several times because a successor bill had not yet been passed. Nationally, SAFETEA-LU provided inflation-adjusted increases of 5% for highways and 16% for transit.

Minnesota received the second highest proportional increase in highway funding of any state in the nation. This included a 17% increase in highway formula funds and a 162% increase in "earmarked" funding committed to 142 projects. Over the six-year life of the act, Minnesota's apportionments are approximately $3 billion; of which $2.5 billion are formula funds and the remainder are earmarked funds. The majority of the increase in formula funds is projected to come to Minnesota in federal FYs 2008 and 2009. A major reason for Minnesota's large proportional increase is its mandated use of 10% ethanol blends in gasoline, the only state with this requirement. The tax treatment of ethanol-blended gasoline in federal law was changed in the past year. Credits for the blending of gasoline with ethanol are now paid directly to marketers from the Federal General Fund. The credits are based on the gallons of ethanol blended, rather than through use of a reduced fuel tax on gasoline blended with ethanol, which had been reducing Federal Highway Trust Fund revenue. This resulted in an increase in revenue to the Federal Highway Trust Fund, and also a substantial increase to the proportional share of gasoline (whether or not it is blended with ethanol) attributed to Minnesota. Since part of the formula for allocated federal highway revenues is based on gallons of fuel attributed to each state, this increases Minnesota's proportional share of fuel tax revenues collected by the federal government.

Mn/DOT forecasted and planned for the increased federal highway formula funding contained in this bill, and programmed projects for almost all of the additional funding through 2008.

There are three important financial issues to watch under SAFETEA- LU: (1) Will the Federal Highway Trust Fund be able to sustain the funding levels authorized in the latter years of the bill; (2) Will annual appropriated obligation authority (spending authority) levels be lower than under TEA-21 (obligation authority received in 2005 and 2006 was about 5% lower than anticipated); and (3) With talk of passing a year-long continuing resolution to keep transportation funding at 2006 levels, it is possible that Minnesota will see a decrease of $20 - $40 million compared to the amounts guaranteed in SAFETEA-LU.

Among the new features to the highway portion of SAFETEA-LU are a new Equity Bonus Program (replaces the Minimum Guarantee Program from TEA-21), the Highway Safety Improvement Program (replaces the Hazards Elimination Program that was part of STP funding from previous law), which greatly increases the safety funding, and the Safe Routes To School Program.

The purpose of the Equity Bonus Program is to assure that all states receive at least specified percentages of the revenues they contribute to the Federal Highway Trust Fund as follows:

- Fiscal Years 2005 and 2006 — 90.5% (the same as TEA-21)
- Fiscal Year 2007 — 91.5%
- Fiscal Years 2008 and 2009 — 92%

Historically, Minnesota has received more funds in apportionments than its contributions to the Federal Highway Trust Fund (and has been thus termed a "donee" state), but in recent years this has been due primarily to Minnesota's mandated use of ethanol in gasoline and the federal tax treatment that was just changed in the past year. Minnesota is now a "donor" state (it contributes more than it receives), and the Equity Bonus Program will provide Minnesota with a substantial amount of federal funds.

The Highway Safety Improvement Program approximately doubles the amount of funding provided for safety projects. Included in this program are set-asides for rail-highway crossings and high risk rural roads projects.

The Safe Routes To School Program will provide Minnesota with about $9.5 million of apportionments for projects that improve the ability of students to walk and bike to school.

SAFETEA-LU provided an estimated 66% increase in federal transit funding, or $168 million. This included a substantial increase in rural transit funding for which Mn/DOT has a major responsibility.

Some of the project earmarks in SAFETEA-LU:

• Union Depot	$50 million
• Trunk Highway 53, Falls to Falls Corridor	$50 million
• Red Rock/Rush Line/Central Corridor Studies	$ 4 million
• Bus and Bus-Related Capital	$14 million
• Minneapolis/St. Paul Non-Motorized Pilot Program	$25 million
• University of Minnesota as a National University Transportation Center	$16 million
• Humphrey Institute's Center For Excellence in Rural Road Safety	$ 3.5 million

Local Government Transportation Funding

In recent legislative sessions local governments have actively pursued transportation initiatives, and this trend is expected to continue in the 2007 legislative session. Local governments are expected to again request substantial funding for local bridges, even though 2007 is not a capital budget year. A request for $50 million of General Fund bonds has already been included in a bill introduced in both the House and the Senate. Additionally, changes to current law regarding county wheelage taxes (a specific amount for each vehicle in a county) are expected to be considered. During the past year, three metropolitan counties have levied wheelage taxes, based on current law. Municipalities may request the authority to charge street "utility fees" (a fee based on traffic generation formulas), a proposal that occurred over the past several years. Another initiative, proposed for the first time in 2006, would be to change the language for distribution of money in the "Flexible Highway Account" (about 2.7% of total Highway User Tax Distribution Fund revenues) to create new accounts specifically for local government use (currently this money is allocated among county turnbacks, municipal turnbacks, and the Trunk Highway Fund).

Primary Seatbelt Legislation

Minnesota has had a seat belt law since 1986. Currently, this law requires every person in the front seat of every vehicle to use a seat belt, and it requires every person under the age of 11 who is riding in the back seat to also be buckled up. However, people who are not buckled up cannot be stopped and ticketed for their violation unless a police officer observes the driver committing some other traffic violation. Changing this law to allow police officers to stop people for seat belt violations only is often referred to as "primary seatbelt legislation."

There is likely to be renewed interest in this legislation in 2007, because the new federal authorization bill provided funding for incentive grants to states that either have primary seatbelt legislation or have 85% or higher seatbelt use in the state for three years in a row. Unfortunately, Minnesota's seatbelt compliance is currently less than 85% (~84%), and compliance decreased in the past year. Under this program, Minnesota would be eligible to receive a one-time grant of $15 million. Current plans, if this funding were available, would be to use $10 million for rural road safety, $2 million for cable median barriers, and $3 million to continue the existing speed management program. Minnesota would also be eligible for a grant to assist with education of the new primary law. This would amount to $1.6 million in federal FY 2008.

Not only would Minnesota receive additional federal revenue, but safety experts predict that this change in law would save 40 lives and 700 serious injuries per year. The overall societal benefit of enacting primary seatbelt legislation is estimated by the National Highway Safety Administration to be $114 million per year in Minnesota.

All Terrain Vehicle Funding

The 2005 Legislature included a requirement to conduct a study to determine the relative amount of gasoline that is used in all terrain vehicles. Existing law sets this usage at 0.15% of all gasoline consumption. Provisions in statute provide that the gasoline tax paid on these gallons is considered to be "unrefunded," and is therefore transferred to an account under the control of the Department of Natural Resources, to be used for programs related to all terrain vehicles. Under current law, approximately $800,000 is transferred annually under this provision.

Prior to the beginning of the 2006 legislative session, the study was completed (with participation by Mn/DOT) and concluded that 0.27%, rather than 0.15%, of gasoline is used in all terrain vehicles. Legislation was introduced to implement the findings of the study. It did not pass, however, partly because the issue became quite controversial in the Senate. One of the issues raised was to what extent the all terrain vehicles' gasoline usage estimated in the study resulted from all terrain vehicles being driven in highway right-of-ways. Some felt that if this was the case, the gallons from those vehicles should not be counted because these vehicles were actually resulting in increased expenditures to repair the damage they caused. Ultimately, statutory language related to this issue was incorporated in a transportation appropriations bill for which conferees were not able to reach agreement, and in the end no transportation appropriations bill was passed in 2006. Legislation related to this issue is likely to be considered by the 2007 Legislature. Additionally, the Governor's 2007 budget proposal recommends implementation of the 0.27% provision, and the proposed budget for the Department of Natural Resources takes this into account. If this proposal is enacted, approximately $640,000 more than under current law will be transferred annually to the Department of Natural Resources, beginning in FY 2008.

A related issue that will come up is legislation regarding driving all terrain vehicles on public roadways. Late last session, a bill was enacted creating two classes of all terrain vehicles. However, the language that the Department of Natural Resources preferred was not included. As a result, Class 2 all terrain vehicles can now be operated on public roadways, but are not subject to certain safety regulations. The Department of Natural Resources will be pursuing a change to current law, with support from Mn/DOT, the Department of Public Safety, and local governments.

Return of $15 Million from the General Fund To the State Airports Fund

The 2003 Legislature and Governor Pawlenty were faced with developing a 2004-05 biennial budget for the General Fund, starting from a projected deficit of over $4 billion. A variety of strategies were adopted, one of which was to use money available in the State Airports Fund. Revenue to this fund largely comes from statutorily dedicated sources (the aviation fuel tax, airline flight property tax, and aircraft registration fees), and is used primarily to assist with acquisition, construction, improvement, maintenance, and operation of airports outside the seven-county metropolitan area. The specific language adopted by the Legislature was the following:

> "By June 30, 2003, the commissioner of finance shall transfer $15,000,000 of the cash balance in the State Airports Fund established in Minnesota Statutes, section 360.017, to the General Fund. On July 1, 2007, the commissioner must transfer $15,000,000 from the General Fund to the State Airports Fund."

July 1, 2007 marks the beginning of FY 2008, and the 2007 Legislature is charged with developing budgets for the 2008-09 biennium. The transfer of $15 million back to the State Airports Fund from the General Fund provides a significant one-time infusion of funds for appropriation. Mn/DOT's budget proposal is to appropriate $6 million of this money in FY 2008 and another $6 million in FY 2009 to Mn/DOT's Aeronautics Program. However, the Legislature will have the final word on how this money is appropriated. It is possible that other uses for this money may be considered in the budget process.

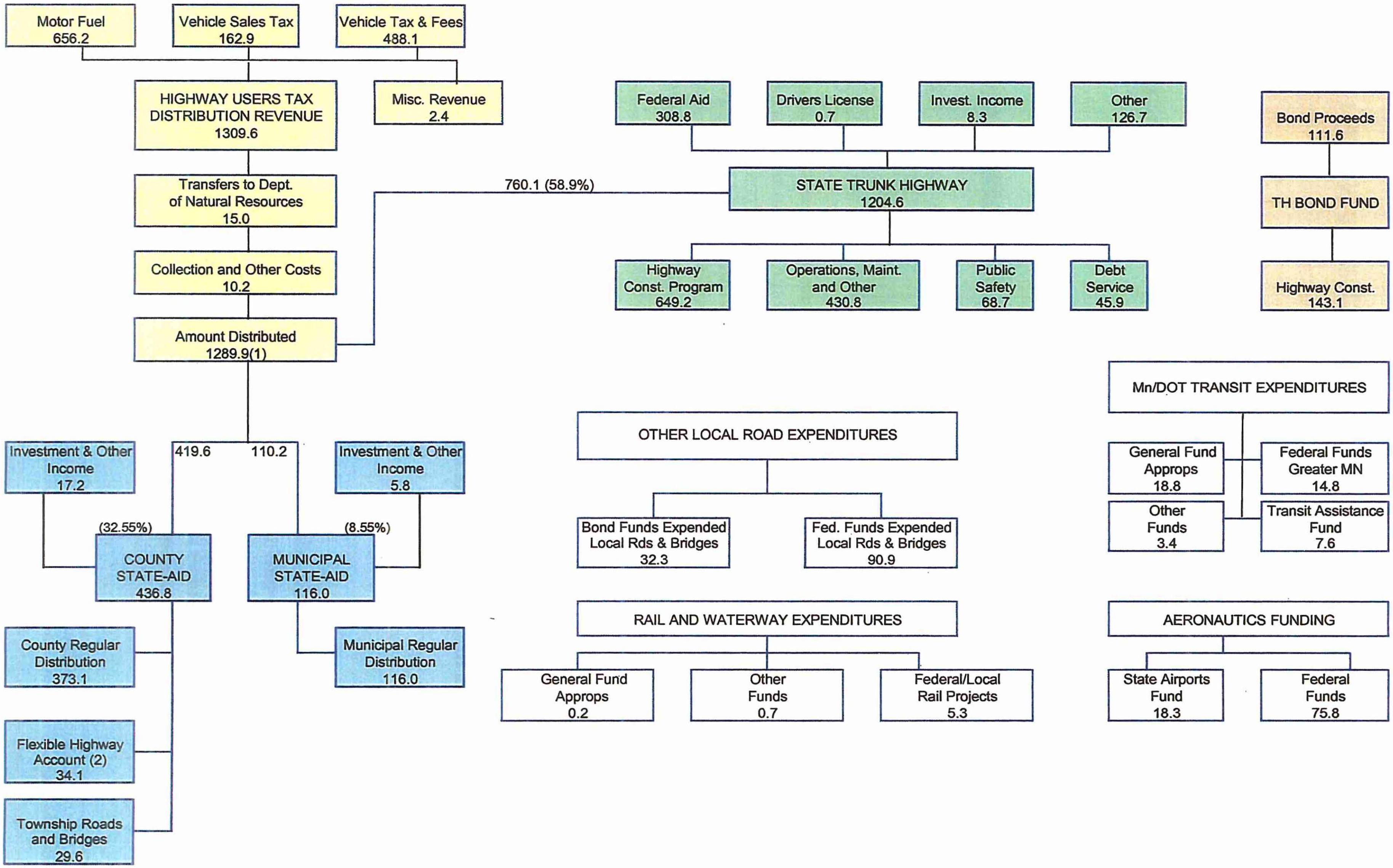
Metropolitan Area versus Greater Minnesota Revenues and Spending

It is expected that the Legislature will give serious consideration to major transportation funding proposals during the 2007 session. When this occurred in the past, it sparked debate about the degree to which revenues are generated in the metropolitan area compared with the rest of the state and how spending is allocated among different parts of the state. For example, in the Bond Accelerated Program enacted by the 2003 Legislature, 50% of the spending of construction funds was required to be allocated to the metropolitan area with the remainder allocated to greater Minnesota. Mn/DOT has historically analyzed the distribution of motor fuel tax revenue (using vehicle miles traveled as a proxy) and motor vehicle registration tax revenues. The department has also analyzed spending for highway purposes for the Trunk Highway Fund, as well as the apportionment amounts for the County State Aid Highway Fund and the Municipal State Aid Street Fund. It is expected that this issue will be prominent in the 2007 session, and that additional analysis on a county-by-county basis may also be required.

SECTION III

FINANCIAL AND HIGHWAY USE INFORMATION

MINNESOTA STATE GOVERNMENT
REVENUE AND EXPENDITURES FOR TRANSPORTATION PURPOSES
ALL SOURCES OF FUNDS (Dollars in Millions)
FY 2006 Final



Prepared by Financial Reporting - December 20, 2006

(1) - Net Revenues $1284.4 plus $5.5 from Fund Balance
(2) - Trunk Highway = $10.4, County Turnback = $18.0 , Municipal Turnback = $5.7.

HISTORY OF Mn/DOT REVENUE CHANGES

Motor Fuel Taxes (Gasoline and Special Fuels)

1975 Increased from 7 to 9 cents per gallon.
1980 Increased from 9 to 11 cents per gallon.
1981 Increased from 11 to 13 cents per gallon.
1983 Increased from 13 to 16 cents per gallon (for eight months) and then to 17 cents per gallon beginning January 1, 1984.
1988 Increased from 17 to 20 cents per gallon.
1994 Phased out 2-cent gasohol credit over 4 years.

Motor Fuel Tax Rates per Gallon: Federal, Minnesota, and Neighboring States

	Federal	MN	WI	SD	IA	ND
Gasoline	18.4	20.0	30.9	22.0	21.0	23.0
Diesel	24.4	20.0	30.9	22.0	22.5	23.0
Gasohol (10% blend)	18.4*	20.0	30.9	20.0	19.0	23.0

*The American Jobs Creation Act (AJCA) of 2004 changed federal tax treatment related to ethanol-blended gasoline (gasohol). The Highway Account of the Federal Highway Trust Fund now receives the same amount of revenue from gasohol as it does from unblended gasoline. Credits are paid from the Federal General Fund for ethanol blended with gasoline, based on the gallons of ethanol, thus maintaining the federal tax incentive for the use of ethanol. The effect of this change is to increase the federal gasohol (10% blend) tax (as relates to the Federal Highway Trust Fund) to 18.4 cents per gallon.

Motor Vehicle Registration Taxes

1981 Increased passenger vehicle registration taxes by phasing in an increased minimum tax. The minimum was increased in 1981 on a phase-in schedule from $23 to $35 in 1985, which is the current minimum tax.

1986 Increased truck registration taxes for heavier trucks:

Truck Size	Old Tax	New Tax
9 ton	$1,520	$1,595
10 ton	$1,620	$1,760

1989 Adjusted schedule for reduction of taxes paid for passenger vehicles as they become older, such that citizens pay more over the life of the vehicle.

2000 Retained the same policy for calculating the tax for passenger vehicles, but provided a maximum tax of $189 for the first renewal and a maximum tax of $99 for the second and subsequent renewals.

Motor Vehicle Sales Tax as a Transportation Revenue Source

The Motor Vehicle Sales Tax (MVST) was previously defined as the Motor Vehicle Excise Tax (MVET)

1981	Established phase-in of MVST as a transportation revenue source (75% Highways, 25% Transit) over three bienniums (100% by FY 1990).
1983	Delayed scheduled phase-in by two years.
1984	Added one additional year (FY 1985) at the 25% share.
1986	Removed FYs 1986 and 1987 (@ 25% share); left intact the schedule for FY 1988 and beyond.
1987	Eliminated the phase-in concept. Allowed 5% transfer for FY 1988 and beyond.
1988	Allowed 30% MVST transfer for 1989 and beyond; provided that beginning July 1, 1991, none of the highway share would be distributed to CSAH and MSAS Funds.
1989	Allowed 35% MVST transfer for FY 1990 and beyond. The entire highway share (75%) of the additional 5% is transferred to the Trunk Highway Fund.
1990	Allowed 30% MVST transfer for FY 1991 and beyond. The 5% reduction was taken from the HUTDF share, resulting in 25% for HUTDF/transit distribution, and 5% credited entirely to the Trunk Highway Fund/transit.
1991	Eliminated as a transportation revenue source.
2001	<u>HIGHWAYS:</u> In FY 2002, 30.86% of MVST revenues were deposited in the Highway User Tax Distribution Fund. In FY 2003, 32% of MVST revenues were deposited in the Highway User Tax Distribution Fund. <u>TRANSIT:</u> For FY 2003, 20.5% of MVST was dedicated to the Metropolitan Area Transit Fund and 1.25% of MVST was dedicated to the Greater Minnesota Transit Fund, both for property tax relief. An additional 2% of MVST was scheduled to be dedicated to the "Metropolitan Area Transit Appropriation Account" beginning on July 1, 2003.
2003	For 2004 – 2007 the distribution was changed to the following: <u>HIGHWAYS:</u> 30% of MVST revenues to be deposited to the Highway User Tax Distribution Fund, 0.65% to the County State Aid Highway Fund, and 0.17% to the Municipal State Aid Street Fund.

TRANSIT: 21.5% of MVST revenues to be dedicated to the Metropolitan Area Transit Fund and 1.43% to the Greater Minnesota Transit Fund. No money will be deposited to the "Metropolitan Area Transit Appropriation Account."

After 2007, the distribution would revert to that which was in effect for FY 2003, except there will no longer be a distribution to the "Metropolitan Area Transit Appropriation Account."

2005 Constitutional amendment was passed, providing that by FY 2012 all revenues would be dedicated to transportation as follows: (1) not more than 60% to be deposited in the Highway User Tax Distribution Fund; and (2) not less than 40% to be dedicated to transit. Currently 46.25% is deposited in the General Fund, and in 2012 none of MVST revenue would be deposited to the General Fund. A five-year phase-in schedule is provided in the amendment.

2006 Voters approved the proposed constitutional amendment in the November 2006 general election. Under terms of this change to the constitution, the distribution of MVST revenues will be as shown below (assuming that 60% is allocated to the Highway User Tax Distribution Fund and 40% is allocated to transit):

Fiscal Year	2008	2009	2010	2011	2012
Allocation to the Highway User Tax Distribution Fund	38.25%	44.25%	50.25%	56.25%	60%
Allocation to transit	25.5%	29.5%	33.5%	37.5%	40%
Total To Transportation	**63.75%**	**73.75%**	**83.75%**	**93.75%**	**100%**

As stated in the amendment, not more that 60% may be deposited in the Highway User Tax Distribution Fund, and not less than 40% must be allocated to transit. Therefore, the table above shows the maximum percentages that will be allocated to the Highway User Tax Distribution Fund and the minimum percentages that will be allocated to transit.

MINNESOTA'S HIGHWAY FINANCES

Motor Fuel Tax

At current consumption levels, each one-cent increase in the gas tax would yield about $32 million per year to the Highway User Tax Distribution Fund and generate $19 million in revenues to the Trunk Highway Fund. The current tax of 20 cents per gallon yielded $629 million in FY 2006 after refunds, collection costs, and transfers to Department of Natural Resources. The tax was last increased in 1988. In 1994, the Legislature enacted a phase-out of the ethanol tax credit over four years.

Eighty-two percent of motor fuel tax revenues are generated from gasoline sales. The remainder comes mostly from diesel and special fuel sales.

State law requires transfers of non-highway use (e.g., boats and snowmobiles) gas tax revenues to accounts managed by the Department of Natural Resources. About 3% of gasoline tax revenues, or approximately $16 million, are termed "unrefunded" and transferred from the Highway User Tax Distribution Fund to the Department of Natural Resources accounts each year. The Governor has recommended increasing the percentage attributable to all terrain vehicles beginning in FY 2008, which would slightly increase the amount transferred annually to the Department of Natural Resources.

Based on information supplied by the American Petroleum Institute, twenty-three states have gasoline tax rates higher than Minnesota and three states have gas tax rates the same as Minnesota. Some states have local option gas taxes and/or levy a sales tax on gasoline sales. Taking statewide sales taxes into account would raise the number of states with higher gas tax rates than Minnesota to twenty-nine.

Motor Vehicle Registration Taxes

In FY 2006, motor vehicle registration taxes, after refunds, collections, and other costs, yielded $484 million. Passenger class and pickup truck vehicles generated approximately 80% of total motor vehicle registration tax revenues.

Motor Vehicle Sales Tax

When passenger vehicle registration taxes, e.g., tab fees, were reduced in the 2000 legislative session, the Legislature provided replacement revenue for the Highway User Tax Distribution Fund (HUTDF). This consisted of a General Fund transfer ($162 million) for FY 2001, and specified percentages of revenue from the motor vehicle sales tax (MVST) in subsequent years.

In FY 2002, the HUTDF received 30.86%, or $189 million of MVST revenues. In FY 2003, the HUTDF received 32%, or approximately $194 million of MVST revenues. The 2003 legislature changed the percentages of revenue from the MVST to the HUTDF to 30% for FYs 2004-07. The HUTDF received $178 million in FY 2004, $166 million in FY 2005, and $161 million in FY 2006 from these transfers. New distributions were provided for the County State Aid Highway (0.65%) and Municipal State Aid Street (0.17%) Funds.

The 2005 legislature approved a constitutional amendment that would dedicate all MVST revenues to transportation, with a phase-in over 5 years. This amendment was passed by the voters in the November 2006 election. Therefore, the HUTDF will receive up to 38.25% in FY 2008, up to an additional 6% in each of FYs 2009-11, and up to 60% beginning in FY 2012.

Federal Highway Funds

The level of federal funding is a critical issue for Mn/DOT and for various local governments across the state, because federal funds make up a substantial portion of transportation spending.

As described earlier a new federal authorization bill, SAFETEA-LU, was approved in August 2005, which will stay in effect until September 30, 2009. Uncertainty remains concerning the level of "obligation (spending) authority" that will actually be appropriated. Prior to the passage of SAFETEA-LU, the percentage of obligation authority appropriated to the State of Minnesota had ranged from 90-95% of the amount authorized. In 2005-06, the amount of obligation authority appropriated to Minnesota fell to approximately 85% of authorized levels.

Recently, new concerns have arisen about federal highway funds. The 2006 Congress did not pass a budget for 2007, instead passing a "continuing resolution" through February 15, 2007, which keeps spending at 2006 levels. There is a strong possibility that the 2007 Congress will pass an additional continuing resolution that would keep spending at 2006 levels for the remainder of federal fiscal year 2007. This, combined with recent forecasts for the federal highway trust fund suggest that the fund will run out of money at the beginning of 2009. Because of these factors, the current forecast for federal funds may have to be reduced in the next official forecast of state revenues that will be released at the end of February 2007.

Highway User Tax Distributions

The Minnesota Constitution provides that 95% of Highway User Tax Distribution Fund revenues are distributed as follows: Trunk Highways - 62%; County State Aid Highways - 29%; and Municipal State Aid Streets - 9%. The remaining 5%, known as the five percent set-aside, is distributed in accordance with a formula established by the Legislature, but the formula may only be changed once every six years. The 1998 Legislature most recently changed this formula. Since July 1, 1999, all of the five percent set-aside revenues - approximately $65 million per year - have been transferred to the County State Aid Highway Fund, where they have been further allocated to the Township Roads Account (30.5 %), Township Bridges Account (16 %), and Flexible Highway Account (53.5%). The most recent allocation of the set-aside revenues prior to July 1, 1999 distributed them to the Trunk Highway Fund (28%), the County State Aid Highway Fund (64%), and the Municipal State Aid Street Fund (8%). This formula could be changed by the 2007 legislature, as nine years have passed since it was last changed.

Flexible Highway Account

The Flexible Highway Account was created by the 1998 Legislature, essentially by combining money from the five percent set-aside that was previously allocated to the Trunk Highway Fund, the County Turnback Account in the County State Aid Highway Fund, and the Municipal Turnback Account in the Municipal State Aid Street Fund. The commissioner of transportation must recommend allocation of money in the Flexible Highway Account among these funds and accounts for each upcoming two-year period, as part of the biennial budget proposal.

The following table describes the HUTDF five percent set-aside for FY 2006-09:

(In Millions of Dollars) HUTDF 5% Set-aside Distributions		2006	2007	2008	2009
Town Road Account	(30.5%):	19.4	19.2	19.9	20.6
Town Bridge Account	(16.0%):	10.2	10.1	10.4	10.8
Flexible Highway Account					
County Turn Back Account		18.0	24.8	16.0	18.0
Municipal Turn Back Account		5.7	1.5	6.0	2.8
Trunk Highway Fund		10.4	7.4	12.9	15.3
Subtotal Flexible Highway (53.5%):		34.1	33.7	34.9	36.1
GRAND TOTAL 5% HUTDF Set-aside:		63.7	63.0	65.2	67.5

Since the distribution of money in the Flexible Highway Account is subject to decisions made in the biennial budget process, the relative amounts in the preceding table could be different in future bienniums. Also, the 2007 legislature could choose to change the distribution of the HUTDF five percent set-aside money, or the allocation of money in the Flexible Highway Account (a change to this provision was included in legislation considered in the 2006 legislative session).

County State Aid Highway Fund and Municipal State Aid Street Fund Spending

Money in these funds is allocated to counties and municipalities with populations greater than 5,000 based on statutorily defined apportionment formulas. For the County State Aid Highway (CSAH) Fund, the counties' respective shares are based on monetary needs (50%), relative shares of lane miles of roads (30%), relative shares of motor vehicle registrations (10%), and equal shares to each of the 87 counties (10%). For the Municipal State Aid Street (MSAS) Fund, the municipalities' respective shares are based on monetary needs (50%) and population (50%).

As a result of each decennial census, or as a result of the annual state demographer's estimate, additional municipalities may qualify for funding because their population grew beyond 5,000. At each census, some municipalities may stop qualifying for funding because their population fell below 5,000. As the decade progresses, additional municipalities may qualify for funding due to incorporation, consolidation, or by state demographer's estimate. Municipalities may also appeal their census counts.

The total number of municipalities qualifying for MSAS funds from 2002-06 is shown below:

	2002	2003	2004	2005	2006
Total Number of Municipalities Qualifying for MSAS Funds	130	133	136	138	138

Bonding

As of November 1, 2006 trunk highway bonds outstanding totaled approximately $464.8 million. This outstanding balance was comprised of bond authorizations dating back to 2000, totaling $620 million less bond principal repaid to date. The most recent bond authorization occurred when the 2003 Legislature approved $400 million of trunk highway bonds to eliminate traffic bottlenecks and improve interregional corridors that were deemed "at risk". The 2003 Legislature also approved a bond authorization of $110 million that effectively transferred funding of projects originally appropriated out of the general fund. The 2002 Legislature approved $10 million of trunk highway bonds used to transfer funding of projects from the general fund back to the trunk highway fund. This action freed up general fund dollars which were used for various flood relief projects in northwest Minnesota. The 2000 Legislature approved $100 million of trunk highway bonds for projects in accordance with a $459 million transportation funding initiative.

Advance Construction

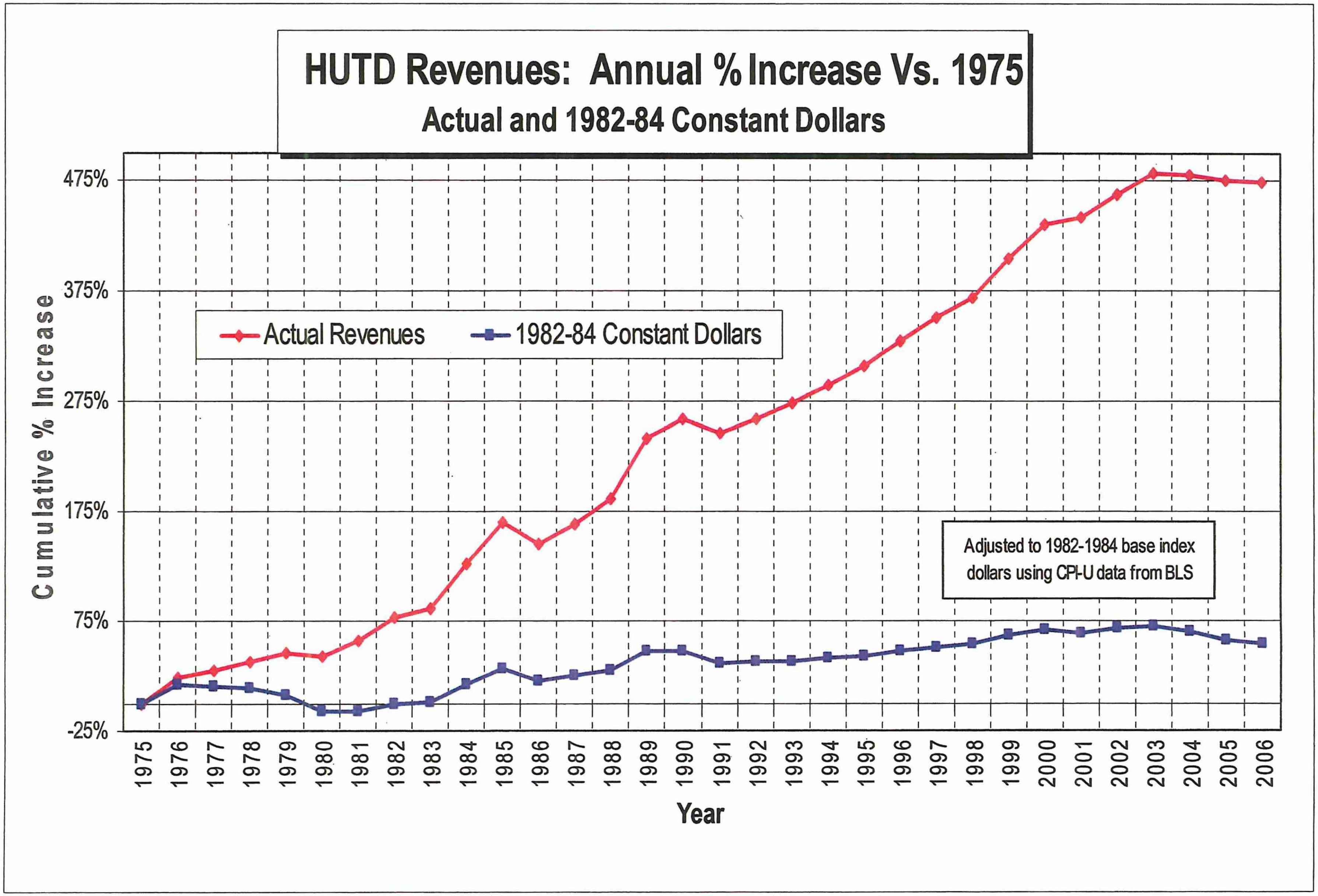
The legislation authorizing $400 million of trunk highway bonds, referenced above, also explicitly authorized Mn/DOT to spend federal funding using advance construction. In general, advance construction funding permits recognizing, in the current year, federal revenues scheduled to be received in future years. A number of benefits are realized using advance construction funding. It should be noted that this is borrowing from future federal revenues to be used in the current or at least earlier years than planned. Thus, careful management of the use of this funding is needed, and Mn/DOT has developed, and continues to refine, sound advance construction management techniques.

HIGHWAY USE AND FINANCING

The following charts include:

- Cumulative Percentage Increase in Highway User Revenue Since 1975, both actual dollars and adjusted for inflation.
- Vehicles Miles Traveled (VMT) and Motor Fuel Consumption from 1975 to the present.
- Vehicles Miles Traveled (VMT) per Gallon from 1975 to the present, which provides a measure of automobile efficiency (MPG).
- Minnesota Highway User Tax Revenue by major type from 1975 to the present.
- Minnesota Highway User Taxes per Vehicle Mile Traveled from 1975 through the present, as adjusted for inflation.

The charts demonstrate that real, or inflation-adjusted, revenues have only increased slightly even though nominal, or actual, revenues have increased much more substantially. Use of the highway system, on the other hand, has more than doubled over a thirty-year period. Finally, on an inflation-adjusted basis, Minnesota highway user taxes per vehicle mile traveled have declined dramatically over the same thirty year period.


HUTD Revenues: Annual % Increase Vs. 1975
Actual and 1982-84 Constant Dollars
Actual Revenues
1982-84 Constant Dollars
Adjusted to 1982-1984 base index dollars using CPI-U data from BLS
475%
375%
275%
175%
75%
-25%
Cumulative % Increase
1975
1976
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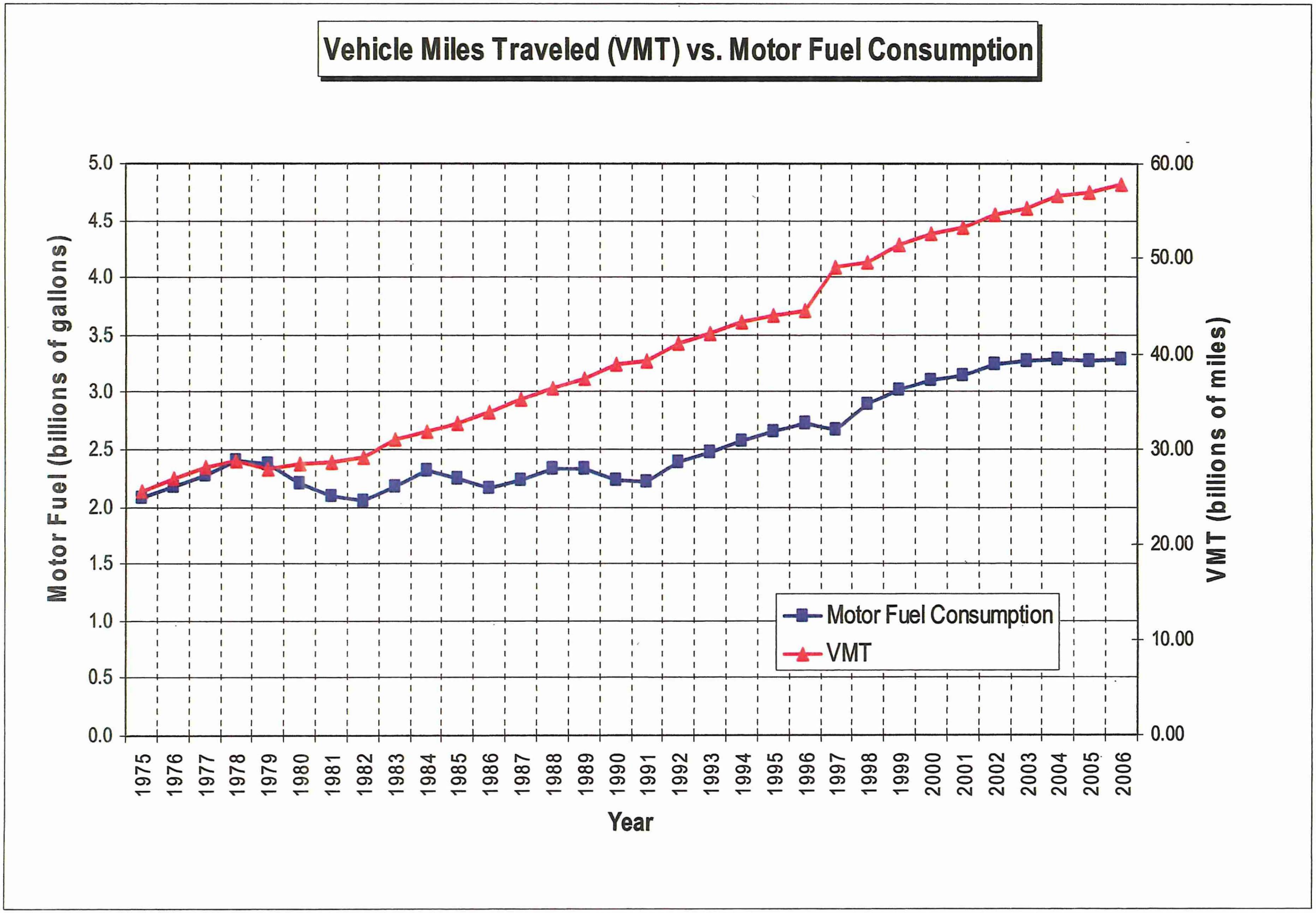
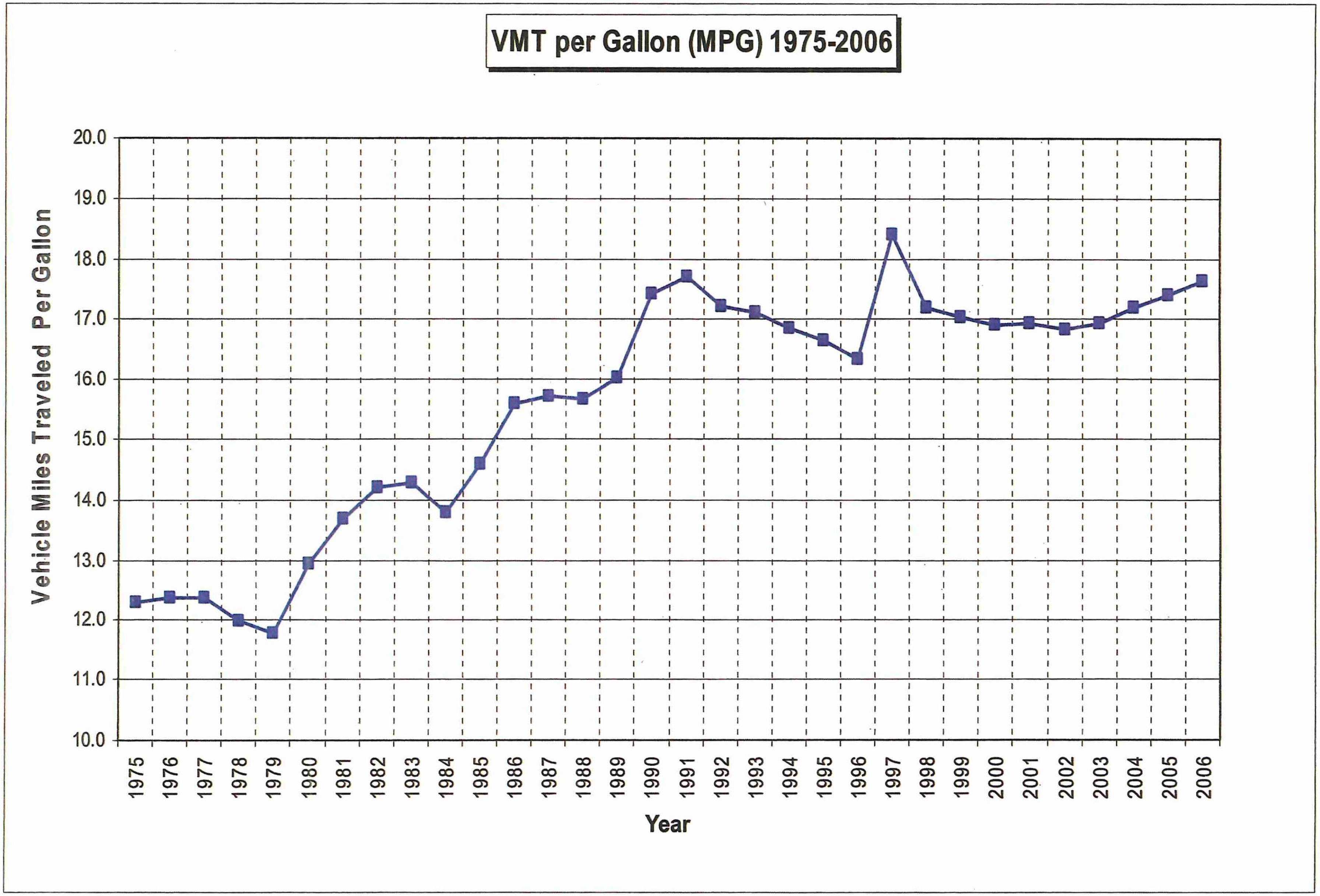

Vehicle Miles Traveled (VMT) vs. Motor Fuel Consumption
Motor Fuel (billions of gallons)
5.0
4.5
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
VMT (billions of miles)
60.00
50.00
40.00
30.00
20.00
10.00
0.00
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
Year
Motor Fuel Consumption
VMT


VMT per Gallon (MPG) 1975-2006
Vehicle Miles Traveled Per Gallon
20.0
19.0
18.0
17.0
16.0
15.0
14.0
13.0
12.0
11.0
10.0
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987
1988
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2004
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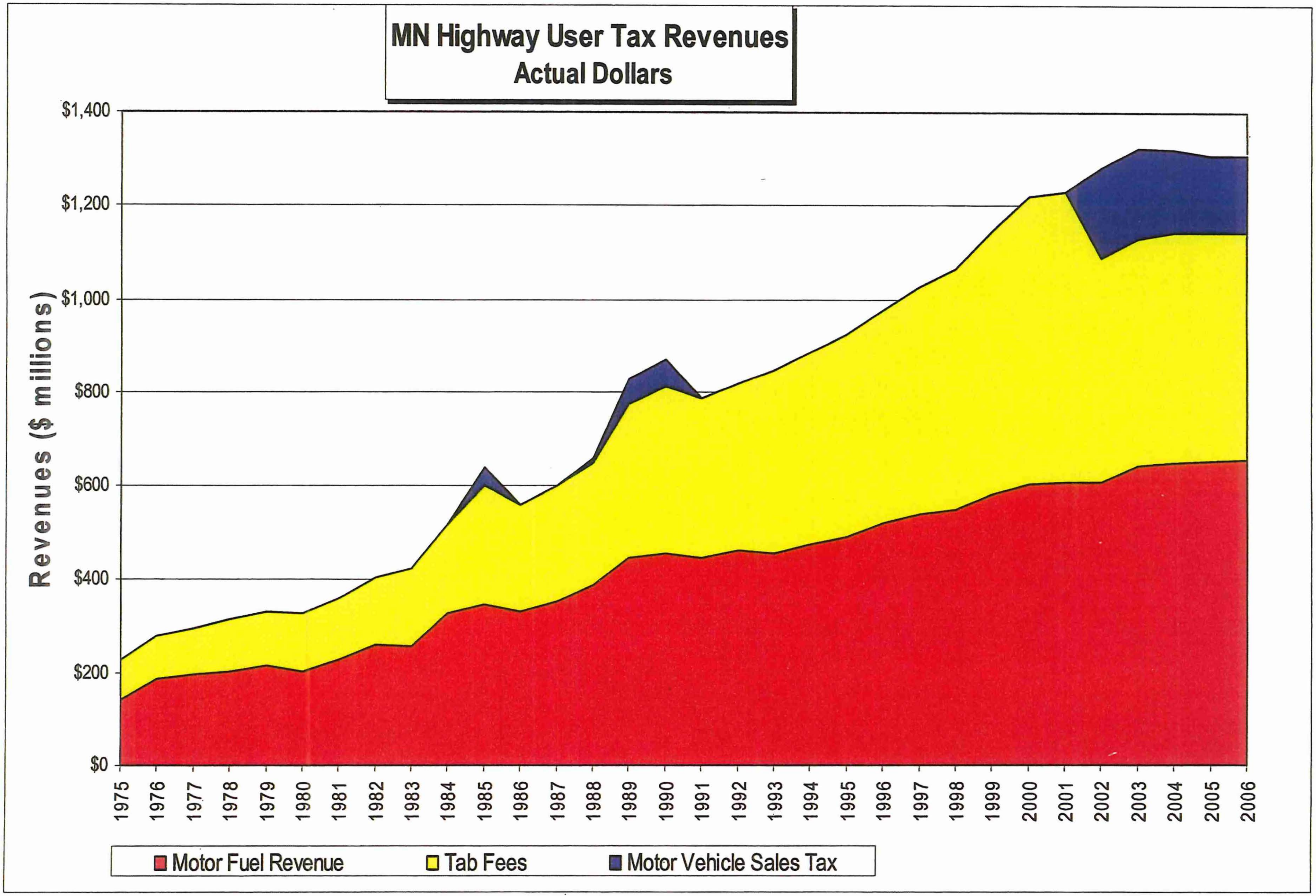
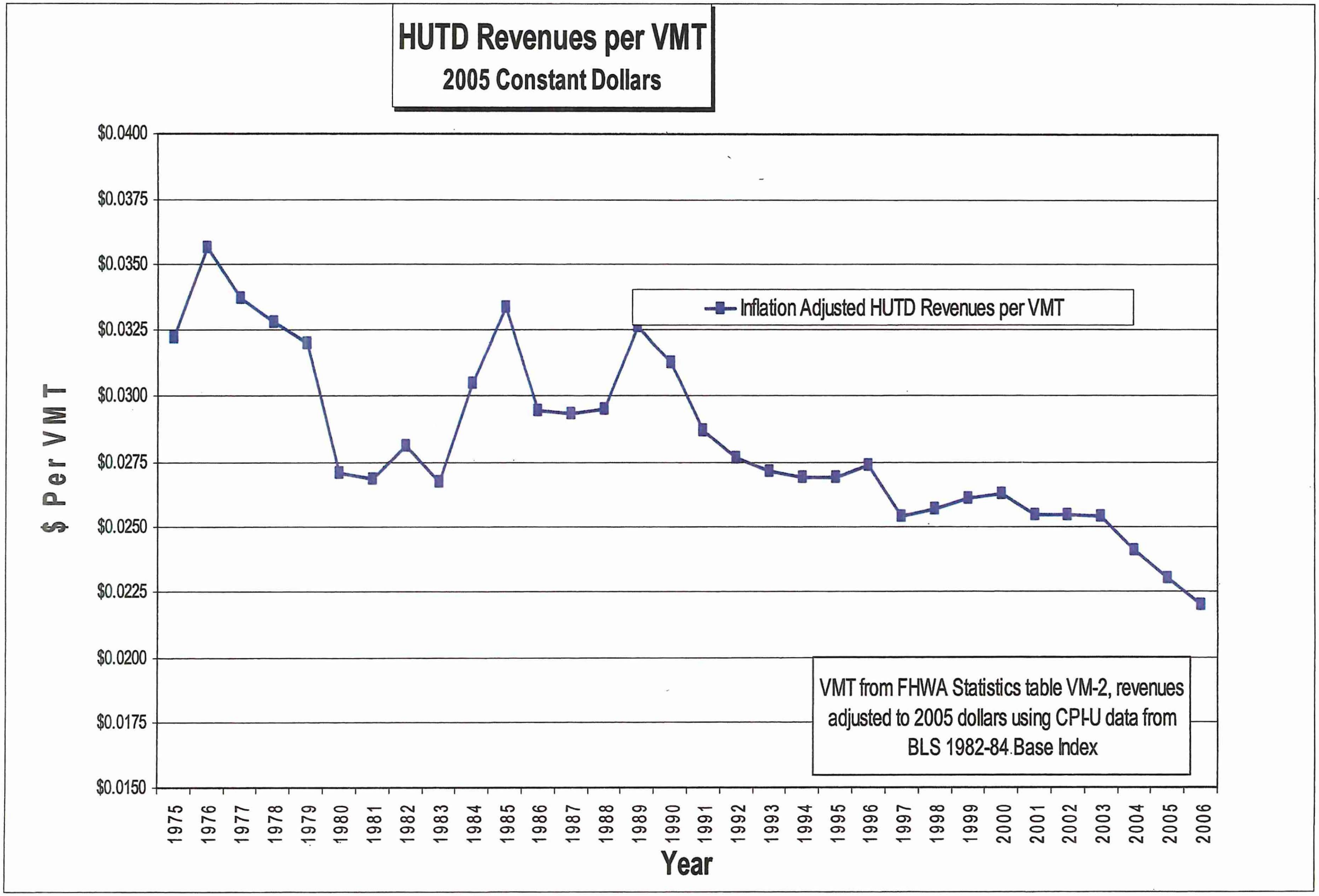
2006
Year


MN Highway User Tax Revenues
Actual Dollars
Revenues ($ millions)
$1,400
$1,200
$1,000
$800
$600
$400
$200
$0
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
Motor Fuel Revenue
Tab Fees
Motor Vehicle Sales Tax


HUTD Revenues per VMT
2005 Constant Dollars
$0.0400
$0.0375
$0.0350
$0.0325
$0.0300
$0.0275
$0.0250
$0.0225
$0.0200
$0.0175
$0.0150
$ Per VMT
Inflation Adjusted HUTD Revenues per VMT
VMT from FHWA Statistics table VM-2, revenues adjusted to 2005 dollars using CPI-U data from BLS 1982-84 Base Index
1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006
Year