

Financial Services Update

Vol. 1-No. 3

March 2006

Greetings from Financial Services:

This is the third in the series of updates on financial and economic topics of interest to ODOT managers and stakeholders.

The focus of this update is on the December 2005 transportation and economic revenue forecast.

This update summarizes the expected slowing of growth in the Oregon economy and subsequent affect on the State Highway Fund. It also compares the December 2005 forecast to the June 2005 forecast, which shows slightly lower revenues are expected to the State Highway Fund than in the June forecast.

As always, we welcome your comments and suggestions on these and other financial issues of importance to the Department. Please email me at:

dennis.strachota@odot.state.or.us

Dennis Strachota,
Chief Financial Officer



Transportation Revenue Outlook Largely Unchanged

Financial Services' December 2005 *Summary of Transportation Economic and Revenue Forecasts* has been recently released. Some results of this updated outlook, which projects State Highway Fund revenues through FY11, are highlighted here. For additional details, please see the forecast report available at <http://www.oregon.gov/ODOT/CS/EA/reports.shtml>.

Outlook for the Oregon Economy

Changes in both state and national economic conditions affect each of the primary revenue sources for the State Highway Fund. These revenue sources include gas taxes, driver and vehicle fees, and heavy truck taxes and fees. Although Oregon's economy continued to show marked improvement in 2005, it is expected to grow more slowly during the next several years as economic conditions nationwide start to experience the post-rebound phase of the business cycle. However, the Oregon economy has smartly outpaced the nation and most states on the basis of employment growth for the past

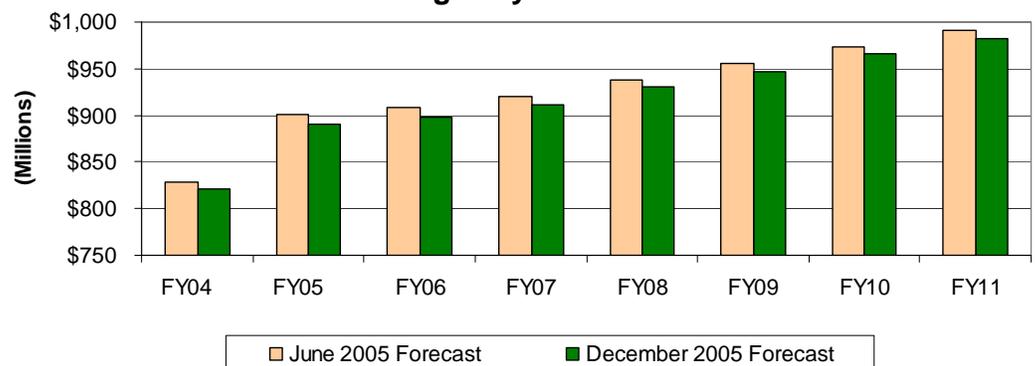
two years.

There are, in addition, some risk factors beyond the baseline economic outlook. For example, concerns about inflation, driven in part by high fuel costs, may lead to more stringent monetary policy and to weakened demand for Oregon's traded sectors. Growing and continuing geopolitical uncertainty may further undermine consumer confidence, causing already stretched consumers to retrench their spending even further. In addition, rising mortgage interest rates are expected to negatively affect the housing market by slowing growth in new residential construction. Therefore, although positive growth is expected for Oregon's economy throughout the forecast period, there are few signs that continued, rapid economic expansion should be anticipated.

Outlook for Highway Fund Revenues

Because growth in many of the economic variables affecting transportation-related activities appears mild for the next several years, the forecast reflects only

Gross Highway Fund Revenues



Economic & Revenue Forecast

Financial Services' Economics and Policy Analysis Unit produces an update of the Transportation Economic and Revenue Forecast on a semi-annual cycle. The forecast report provides detailed information on the key components of the State Highway Fund: DMV revenues, Motor Carrier revenues, and Motor Fuels revenues.

All forecasts are consistent with the most recent Department of Administrative Services forecast and the associated baseline macroeconomic forecast from *Global Insight Inc. (GII)*. When possible, the same methodology and model structure are used for each forecast to allow for ease of comparison.

Financial Services is a branch of ODOT's Central Services Division. Financial Services provides centralized accounting, financial reporting, payroll and benefits, budget development, economic and financial analysis, business planning, debt administration, cash management, the Oregon Transportation Infrastructure Bank, tax collection and auditing, revenue forecasting, tax policy analysis and cost allocation services.

ODOT Financial Services
 355 Capitol Street NE
 Room 434
 Salem, OR 97301-3872
 Phone: 503-986-3900
 Fax: 503-986-3906

moderate expansion as well. The first chart depicts our current and prior forecasts of revenue from all major sources, before collection and administrative costs. During FY05, gross revenues grew approximately 8.4 percent, reaching \$890 million. This rapid growth reflects both robust economic conditions statewide and full implementation of OTIA III fee increases. However, gross revenues are expected to grow at much slower rates thereafter. Growth over the 2006 – 2011 timeframe averages only 1.7 percent annually.

Another dimension of the revenue forecast is the implication for the State Highway Fund, net of collection costs and apportionment distributions to county and city governments statewide. This gives a picture of the resources available – before federal assistance – for investing in the State Highway System for maintenance, preservation, modernization and bridges. Not surprisingly, this chart largely mirrors the pattern of gross revenues. Net revenue is nearly \$450 million in FY05 or about 9 percent more than FY04, before OTIA debt service and set-aside. Net revenues are expected to stay flat over the next several years. Over the 2006 – 2011 period, net revenues increase at an annual average rate of only 1.0 percent. On the other hand, headline inflation as measured by the urban CPI is forecast to average 2.5 percent yearly. Thus, under current fees and tax rates, the purchasing power of the State Highway Fund will continue to erode at a steady clip of roughly 1.5 percent per year.

Comparison to Previous Forecast

Differences between the current and prior forecast can originate from several sources. First, the current forecast incorporates updated data on transportation transactions used for model estimation purposes. Second, it reflects the most recent revisions to the state economic outlook. And third, the forecast takes into account changes in the national macroeconomic outlook that affect transportation revenues but are not directly captured in the state forecast.

The current forecast indicates that Highway Fund revenues will be slightly lower than predicted in the previous forecast. Both charts on gross revenues and on net revenues to the State Highway Fund contain the comparison of the current with the prior forecast from June 2005.

For FY06 and FY07, net revenues to the State Highway Fund (the second chart) are forecast to be \$5.8 million and \$5.7 million lower than in the prior forecast. On an average annual basis, these differences translate into a diminution of 1.3 percent. The remaining years of the forecast have been revised downward as well. Over the period out to 2011, projected net revenues to the State Highway Fund are about 1.2 percent lower than in the prior forecast, a comparatively minor change overall.

Net Revenues to State Highway Fund

