Financial Services Update

Vol.1-No.8 August 2006

Greetings from Financial Services:

This is the eighth 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 ***June 2006 Transportation and Economic Revenue Forecast.***

This update summarizes the probable course for economic growth in Oregon and the subsequent effects on the State Highway Fund. It also offers a contrast of the June 2006 forecast to the December 2005 forecast.

As always, we welcome your comments and suggestions on these and other financial issues of importance to the Department. Feel free to share the Update with your staff or others you think might be interested. Please email your comments or suggestions for future issues to:

dennis.strachota@odot.state.or.us

Dennis Strachota,
Chief Financial Officer

Oregon Department of Transportation

Transportation Revenue Outlook Improves Slightly

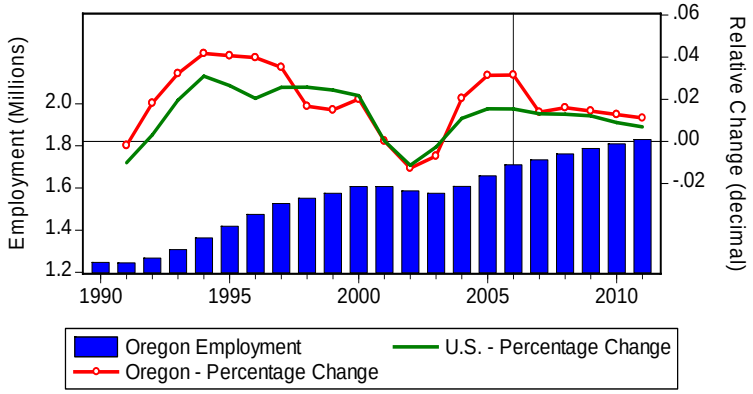
Financial Services' June 2006 *Summary of Transportation Economic and Revenue Forecasts* has been recently released. In sum, the outlook is for very modestly higher revenues out through 2011 than in our prior forecast. Some key results of this updated outlook, in terms of the state's economy and for overall gross revenues, are highlighted here. For more complete coverage of the forecast, 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, as well as changing demographics in Oregon, 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 through 2005 and into early 2006, it is expected to grow more slowly during the next several years as economic conditions nationwide reflect the post-rebound phase of the business cycle. The Oregon economy has smartly outpaced the nation and most states on the basis of employment growth for the past two years, and it is expected to continue to out-pace slightly the nation as a whole. The chart below summarizes the foregoing for Oregon's economic performance in terms of total non-farm employment and that of the nation as a whole historically back to 1990 and projected out through 2011.

The outlook is, however, not without some uncertainty or risks, and these span a somewhat daunting range of possibilities that could pose some perils down the road ahead. These principally include tighter monetary policy by the Federal Reserve as an outgrowth of accelerating and widespread price/wage inflation, in large part due to the persistent run up in crude oil prices worldwide. Geopolitical tensions may not recede, causing consumer sentiment to deteriorate and making consumers turn more cautious in their spending. Elevated rates on mortgages from the Fed tightening will affect the housing

Oregon and U.S. Employment Trends



Economic & Revenue Forecast

Financial Services' Financial and Economics Analysis Unit produces an update of the Transportation Economic and Revenue Forecast on a semi-annual basis. 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 state economic forecast and the associated baseline macroeconomic forecast from *Global Insight Inc.* (*GII*).

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

market and related sectors by slowing both new residential construction and existing home sales. Should anything worse than this loom in the housing sector, it would be of very considerable consequence inasmuch as housing was a major component of economic growth in the boom years of 2004-2005.

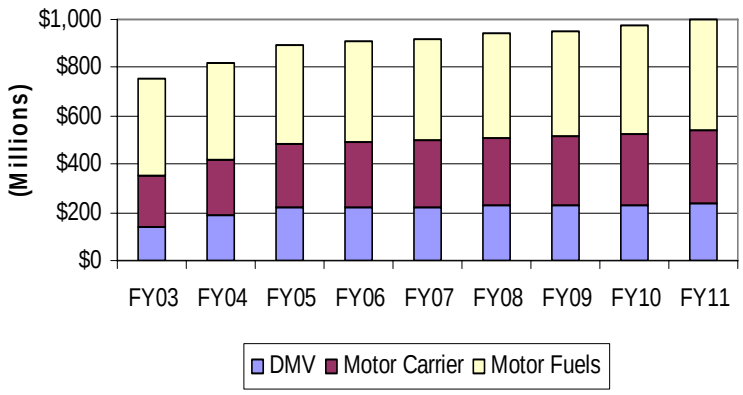
Outlook for Highway Fund Revenues

With the foreseeable pattern in many of the economic variables that affect transportation-related activities appearing milder for the next several years, revenues to the State Highway Fund are equally restrained. The chart below depicts our current forecast of revenue from all major sources, before collection and administrative costs. During FY05, gross revenues grew approximately 8.5 percent, reaching over $890 million. This rapid growth reflects both robust economic conditions statewide in 2004-2005 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 1.9 percent annually.

Along with the trend of gross revenues over the 2003-2011 period, the chart also reflects roughly the share of revenues generated from our three major sources of taxes and fee receipts: motor fuels, motor carrier, and DMV. The shares from the latter two have risen somewhat with the implementation of OTIA III. Nevertheless, fuel tax revenues still account for the largest share, representing about one-half of gross revenues.

Revenues net of collection and program costs are expected to rise only slightly over the next several years, as well. Over the 2006 – 2011 period, net revenues increase at an annual average rate of only 1.3 percent. On the other hand, headline inflation as measured by the urban CPI is forecast to average 2.2 percent yearly. Our construction cost trends outlook paints an even more discouraging picture on the cost escalation front. It currently sees annual average construction inflation at 3.7 percent. Thus, under current fees and tax rates, the purchasing power of the State Highway Fund will continue to erode at a steady clip of nearly 2.5 percent per year.

Comparison to Previous Forecast

The current forecast indicates that Highway Fund revenues will be slightly higher than predicted in the prior forecast. Out through 2011, projected net revenues to the State Highway Fund are about 1.6 percent higher than in the previous forecast, a comparatively minor change overall. Motor fuels tax receipts and motor carrier revenues are the sources for the modest gains over the last outlook.

Gross Highway Fund Revenues by Source