MINUTES OF THE STATE TRANSPORTATION BOARD STUDY SESSION 10:00 a.m., Friday, January 8, 2010 Human Resource Development Center (HRDC) 1130 N. 22nd Ave. Phoenix, AZ 85009

BOARD ATTENDANCE

Delbert Householder, Bob Montoya, Victor Flores, Bill Feldmeier, Bobbie Lundstrom, and Steve Christy (telephonic). Felipe Zubia was absent.

PLEDGE

[The Pledge of Allegiance is recited.]

ITEM 1: bqAZ follow-up to December 7th Transportation Board Study Session

JENNIFER TOTH: This item was to address any comments received from the Board or changes proposed to the recommended scenario on the draft documents previously seen. There is only one change proposed centering on the discussion held about the area north of Chino Valley to I-40 and that network of roadways. CYMPO, through their Executive Board, requested to remove that roadway network and we will be doing that. We agreed with that situation. The network had been put in for modeling purposes because otherwise the network itself would show too much congestion along 89A to I-40. Those are the only recommended changes being proposed at this time.

CHAIR HOUSEHOLDER: So, they're all happy now?

JENNIFER TOTH: We believe that the actions taken by CYMPO represent the community's agreement on that area. We also agree with that recommendation in terms of the preservation of wildlife corridors in the area.

CHAIR HOUSEHOLDER: Environmental issues are all taken care of, too?

JENNIFER TOTH: I can't speak for them, but I would say we've tried to accommodate that as much as possible. The staff has worked extremely hard with CYMPO and all the regional partners, as well as the Nature Conservancy to find a solution that meets traveling needs as well as environmental preservation needs. We would propose coming to the Board at the meeting next week and asking for adopt of the plan.

CHAIR HOUSEHOLDER: I don't think anybody will have any problem going forward.

[Items numbered 2 and 3 have been deferred until the arrival of Mr. Feldmeier who would be arriving late.]

[Item number 4 was then taken out of order on the agenda.]

ITEM 4: State Airport System Plan (SASP) Update

MIKE KLEIN: We have a State Airport Systems Plan developed over the past year. The last complete systems plan was done in 1988 and notwithstanding the economic "hurricane" we find ourselves in today, the last 20 or so years have seen dramatic shifts in aviation in the State, so this SASP partially funded by

the FAA was conducted. The primary mission target is airport development which becomes the economic engine for a lot of communities. Out of that study, this DVD has been prepared and it reviews the systems plan, its results, and implications we have to consider as we go through our planning process. After the DVD is played, I will have closing remarks that will draw our attention to the suggestions coming out of this and what the State is telling us we need to do to build new strategies for development.

[The DVD was then viewed.]

MIKE KLEIN: What we're dealing with in an economy that's working against us is a dramatic change in how we conduct business within the agency. A major step is trying to make sense out of this system and how it fits in with the other systems plan we have within the agency. An example is passenger traffic. In a rural airport, commercial services passengers are affected by how well ADOT builds highways. There are conundrums in multimodal planning issues. Integrating this study into highways, transit, and rail, there are connections and things that have to be thought about. Those development strategies will be coming to you and some of that will be coming in the form of policy direction we will be asking you for. Right now, the policy from the Board is a detailed document which goes into minute decision-making processes.

We've been meeting for a year with members of the industry and we have 50 different measures we're looking at including automated weather services which is a system tool rather than an individual airport tool. There are 57 measures we're tracking. An intern is starting next week whose sole responsibility is to update the database from 2007 through 2008 and 2009. A software package will house that information and report the health of the system so we can modify our development strategies to meet the changes. It isn't just what we do, but what the airports do that we keep track of to see the system's progress. This is an idea of what you'll expect to see from us in the not-too-distant future.

JOHN McGEE: I just want to give introductory remarks about Agenda Items 2 and 3 and what we're doing today and why we're doing it. One of the most important duties the Board has is the adoption of the 5-Year Facilities Construction Program for highways and aviation and other modes that we deal with. A couple of months ago, I sent to the Board members an email asking them to give us ideas on study session topics that you would like to be given and one of the responses was that he would like for us to "look into our crystal" ball" and give the Board a briefing on what we see as the future funding prospects for the capital program. I saw that as an opportunity to combine that with the rollout of the tentative program for fiscal year 2011-2015 because that's where it starts with how much money we think we'll have in the program. In years past, the way the program works is literally within a month or so after the Board adopts a 5-year program in June, we look at the next 5-year cycle and through the fall Mr. Fink is giving us estimates of available. we're looking at and meeting with District Engineers and other stakeholders to start talking about and formulating ideas for the new 5-year program, generally the 5th year of the program. We ve been going through that process beginning in February, we review the plan with Board Members and ask the Board to approve, to go out for public discussion and public hearings, and then in June, we ask the Board to approval a final recommendation. One thing that seemed to be missing out of the process was a good session with the Board to talk about policy-type issues as it relates to the 5-year program. I think we tend to handle the 5-year program a little too much on a technical basis and maybe not quite enough getting up above "the weeds" and talking policy.

Jennifer, John, myself, and the Director talked about this over the course of several weeks and decided that we would like to add, in a Study Session environment, a policy discussion with the Board. John will give his normal description of what the future funding looks like for the department, and we invite you to make this interactive. Once you have a feel for what we're looking at on the funding side over the next 5 years, Jennifer will give a presentation that will be the "meat" of this study session. She will talk about a number of issues related to the 5-year program at a policy-level basis. We want to get your broad thoughts and ideas. We are in the process of putting together our thoughts on the tentative program, but before we finalize that document and bring it to the Board in a February Study Session review and then in the regular February session to adopt and send out for public input, we wanted to have this policy discussion. As Jennifer goes through the various topics, she'll be soliciting your input. We hope you will give us your full

and honest appraisal of some of the policy items. That's what we're trying to accomplish here today. I hope it will be worthwhile for the Department and the Board.

CHAIR HOUSEHOLDER: I'd like to recognize that Bill [Feldmeier] is here with us at this time.

ITEM 2: FY 2011 – 2015 Five Year Program Revenue and Funding Review

JOHN FINK: I am going to give you a preliminary look at the revenue and funding pictures as we embark on development of the new program for 2011-2015. We all know we're operating in a volatile financial environment. Virtually all of the traditional funding sources we use for the program have a great deal of certainty associated with them. A lot of the changes we're seeing are going to have long-term or permanent impacts. I'm certain that this great uncertainty we have is going to require flexibility from everyone involved in the process from planning to project delivery, including the Board. We are going to need to change the way we do business. We will have to look at how we fund projects and sub-programs. It's likely sub-programs that have been traditionally funded with State funds will now be federally-funded. We are going to have to increase the usage of non-traditional funding sources, meaning, we will have to explore the full potential of public/private partnerships and look at other things being done around the world. You as a Board will have to make significant policy decisions in the coming years.

To put things in perspective, this is the 5-year program as adopted in June 2009. That program totals \$6.5B. The funding is comprised of \$2.8B in federal funds (44%), bonding and help comprise \$2.7B (42%) and net worth State funding and other funding totals \$1B (14%).

Federal Funds

SAFETEA-LU expired on September 30th; there has been no long-term authorization put in place by Congress. We are operating under a 3rd continuing Resolution which runs through February 28th. That Resolution simply continues the program as it existed in 2009. It does not add additional funding. A lot of reauthorization proposals have been floated in the House and Senate; however, we have no clear direction or indication of what the next authorization will look like. There are uncertain funding levels with the federal program given the current stress on the Highway Trust Fund, federal budget deficit, and other Congressional priorities. This may not be resolved for a considerable period of time. Hopefully, it will be resolved in the next federal fiscal year. With SAFETEA-LU there were 14 continuing resolutions before it was actually passed. We could be in this period of uncertainty for a long time. There is discussion about a second Stimulus Program. We have no idea how that might impact reauthorization. The House has passed a proposal which would establish a 2nd Stimulus Package of about the same size as previous, but it has other perimeters associated with it; some of which would make it more difficult to deliver. We don't know if there will be a Stimulus Package, what it will look like, and how it will impact reauthorizations.

A graph of the balance of the highway account in the Federal Highway Trust was shown. The top two lines show 2006 and 2007 and they look almost identical, but it's relatively stable. When we started 2008 because of high fuel prices, reduced demand, slowing economy, we started to see changes in the balance in the highway account. The balance in August 2008 had almost dropped to zero. Congress had to put \$8B into the Highway Trust Fund to keep it solvent. Starting in the following year, the same thing happened and Congress put another \$7B into the Fund. If that money hadn't been put in, we would have run negative balances, which it can't do and would have effectively shut down funding for all state DOTs.

A chart was shown looking at the program funding levels under SAFETEA-LU. In 2005 and 2006 we were at \$36B and 2007, 2008, and 2009, it was a little over \$40B. In 2009, even though the program was authorized at a level of \$40.7B, there were rescissions of authority put in place by Congress reducing those program levels down to about \$29B. There was over \$11B of rescissions of federal aid authority in 2009. When Congress passed continuing Resolutions for 2010, they continued the program as it existed in 2009, meaning that those rescissions have continued in place in 2010. This could be a significant problem for us as we near the end of the federal fiscal year. We are now receiving more in obligation authority than we

have in apportionments. If that condition persists through the entire year without being addressed by Congress, we would not be able to fully utilize our obligation authority this year.

State Funding Sources

A chart was shown of the history for the User Revenue Fund over the last 10 years. Everything was fine until 2008 when HURF was down 2.7% and down 7.1% in 2009. Through the first six months of 2010, HURF was down about 7.4%. This is clearly not a good situation and is the first time this has ever happened.

For Regional Area Road Funds, everything was fine until 2007. By 2008, RARF was down 3.2%, down 13.7% in 2009, and through the first 5 months of 2010, it's down 13.6%. Gasoline taxes are the largest component of the Highway User Revenue Fund. A slide was shown of the 12-month moving average collections for gasoline tax. The peak in 2007 was at about \$500M; currently it is about \$455M, now returning to the March 2004 levels. So far, we're down 9% from the peak. The good news on the gas tax is things have maybe turned up a little bit. It appears that gas tax revenues have stabilized some.

The HURF portion of the vehicle license tax peaked at \$395M calculated on a 12-month moving average. Currently, it's at \$340M, returning to September 2005 levels, and down about 14% from the peak. Unlike the gas tax where there's stabilization over the last couple of months, vehicle license tax is continuing to decline. The rate of the decline may have slowed, so there may be a grain of positive in that, however, it does not appear to be stabilizing. We may have a period of time before the VLT stabilizes and it may continue to go down more. Since this is one of the components of the HURF that is problematic, I wanted to focus in on that. The way the vehicle license tax is structured there is automatic depreciation essentially built into the tax every year as long as the vehicle is owned and it's above the minimum VLT, the VLT goes down by 16.25%. For that tax to be stable or to grow, there has to be enough growth in the VLT to offset that natural depreciation built into the tax and that can occur through trade-in for newer vehicles and replacement of older vehicles, population growth, and the new to Arizona registrations as people move into the State and register their vehicles. This is offset to some extent by people that move out of the State, but historically Arizona has been a growth State and that component of the VLT has grown. In the year 2000, it grew 7.5%. At the peak of the "bubble" in 2006, it grew about 13.9%. However, in 2008, it was down 2.1%. In 2009, it was down 7.2%, and in 2010 YTD it was down 9.6%.

Included is a chart showing national new vehicles sales with data from Global Insights. The chart shows actuals and projections through 2019. The 1st quarter of 2007, the annualized rate was 16.5M new vehicles sold. By the 1st quarter of 2009, it had dropped 40%. You can see the impact from "Cash for Clunkers" in the chart. The 3rd quarter of 2009 shows a steep increase when "Cash for Clunkers" was in effect and then immediately after it ended, things started to go back down again. We are not expected, at least nationally, to return to the 2007 levels until 2013-2014. That may be even more significant here in Arizona. In Arizona, the difference from the peak to the drop was about 50%, a little more magnified [than national numbers]. Population growth in the State is slowing. From 1970 to 2000, growth averaged 3.6% per year. In 2009, it is estimated the growth rate was about .7%. Several cities and counties in the State have lost population in 2009. A list was provided, which included the City of Tucson.

Forecasts for the Highway User Revenue Funds estimated HURF revenues in the 2011-2015 time frame at \$6.77B representing a 3.2% compound annual growth rate over the 2010 forecast. Even though less than 6 months from the official forecast, I don't believe the forecast is appropriate to use for planning purposes for the upcoming program. After discussions with staff and in consideration of the data, we have adopted a planning forecast somewhat lower than the official forecast. The forecast is for total revenue over that time period of \$6.59B, compound annual growth rate is 2.8%, showing a lower and more conservative growth rate and forecast, although this forecast may not be achievable. Over the 5 years of the program, this represents a reduction in Highway Revenue Funds of \$180M.

Also going on is the State budget deficit problem compounding issues. The State's projected deficit for 2011 is \$3.4B; the State projection estimates structural deficits that will exist through the entire period of the program. This means that there will be continued pressure from the State to transfer money out of HURF for DPS and to sweep the VLT to the State General Fund. It also means it is unlikely the State will have cash balances such that you, as a Board, would be able to issue forthcoming obligations to support the program.

The chart is produced by the Governor's Office of Strategic Planning and Budgeting and shows the estimated State journal of fund structural deficit through 2014. It shows a \$3.4B estimate for 2011; on the graph it widens going forward through 2011 and by 2014 it is \$4B. Through the period of 2002 through 2007, revenues and expenditures were fairly balanced, but even with the amounts of DPS funding that have been transferred from HURF and the State Highway Fund, it was at a level significantly higher. Over that time period, the transfers were \$300M. In 2002-2010, assuming no further transfers in 2010, those transfers have been about \$542M; a not increase of \$407M in DPS transfers. This was during a period of time when the State budget was in a relative balance.

VLT transfers from the State Highway Fund to DPS and the State General Fund in 2005-2006 were a small amount of VLT to the DPS Parity Compensation Fund of \$2-3M, but has totaled \$14 over the last five years. In the same time frame, there's been an additional \$234M swept to the State General Fund adding up to \$248M on top of the \$407M discussed earlier.

In terms of debt issuance during the 2011-2015 timeframe, we're projecting we would issue \$345M HURF bond in 2014-2015, \$2.1B RARF bonds through the entire five years of the program, and \$120M of grant anticipation notes planned for this year, but to be issued next year. One thing to note as we get further along in the program development process, these numbers might change as more information is received on the budget situation and revenues.

There is no HURF bond issuance planned until 2014. The primary reason is because of current revenue trends and the amount of money transferred from HURF, we don't have HURF bonding capacity right now and I don't expect we'll have any until 2014. At the rate we're currently spending HURF bond proceeds. because we still have some HURF bond proceeds from the bonds issued in 2008, those will last until fiscal year 2012, a 2-year gap where we might not have HURF bond proceeds available to us. Right now, we're using a significant part of HURF bond proceeds to match federal aid because we don't have State funds to use. If we get to the point where we don't have bond proceeds and we don't have additional revenues, we could be in a situation where we wouldn't have funds to match the federal aid, so we will have to ensure that we are always able to match federal aid and will have to take whatever actions necessary to ensure the State doesn't lose the federal aid. We may have to have a discussion with the Board about restructuring our existing portfolio of HURF debt and lowering our annual debt service requirements making more money available for other uses and create additional capacity. We're running up against coverage levels that we've told the rating agencies we would maintain and by lowering debt service, we would create cushion to generate additional capacity. The problem with that strategy is there is a significant cost associated with doing a restructuring. The numbers range on a present value basis in the magnitude of \$80-100M spread over the terms of the bonds.

BOB MONTOYA: When you talk about restructuring the debt have you done a spreadsheet of the cost and benefits or is it a work in progress?

JOHN FINK: To do this analysis, you have to look at all your existing debt, what is refundable, what is not refundable, everything that goes into this analysis. Several years ago, the Legislature did extend the maximum term of HURF bonds to 30 years. We haven't issued any bonds in that last years of that, so there's significant capacity. We would be lowering debt service in the early years and moving that out to the later years. We've looked at it in detail. The time's not right for that, but it may be at some point in the future.

STEVE CHRISTY: The bottom line I'm reading is that our 5-year plan is going to be going through an annual base budget deficit worse than it is today. Am I correct?

JOHN FINK: Yes, that is true, unless the State Legislature takes action to correct the structural deficit.

BOBBIE LUNDSTROM: When you said there was a 30-year extension, when did it begin? How far do we have?

JOHN FINK: It was 2007 when the legislature passed the extension. They took the statutory limit off the amount of HURF bonds we could issue. There had been a limit of \$1.3B. They also extended the maximum allowable term of HURF bonds from 20 to 30 years. At the time they did that based on the financial picture existing at that time, we calculated that was going to create significant HURF bond capacity because we would be able to utilize that last ten years. Because of revenue declines and the amount swept and transferred, that capacity has evaporated.

The funding sources we have traditionally utilized for the program, HURF, RARF, and bond proceeds have a high degree of uncertainty. We don't know when there will be a recovery in Arizona and revenue sources will start to improve. We don't know if these are long term structural changes in our venue funding sources or if this is permanent, but we believe some of these changes will have long-term impact. We will need to be more flexible in how we deal with this from planning through program project delivery. The only way we can guarantee projects and subprograms in the future is if they're federally-funded. We are going to need to increase non-traditional funding sources.

VICTOR FLORES: It's apparent that policy changes with regard to making changes to our bonding capacity is not something we would entertain. What are you alluding to as an example of a policy?

JOHN FINK: Jennifer will follow up more on the policy side. We may get to the point where we have to have a serious discussion about that. The bond ratings we carry on our HURF bonds are AAA from S&P for a long time. One of the reasons we had that rating is because the Board has made a commitment to keep coverage above a certain level. The Board may decide, and similarly with respect to subordinate debt, whether it's worth risking a downgrade to go below coverage levels and then deal with the overall issue of restructuring.

BILL FELDMEIER: If we pay additional interest and you utilize additional funding, how do we protect the proceeds from the bonds?

JOHN FINK: There are three funding sources insulated from the Legislature: federal funds, RARF funds, and bond proceeds.

BILL FELDMEIER: We could lower ourselves to the statutory requirement.

JOHN FINK: One thing that could be done, at the same time the restructuring is done, would be to issue new debt to utilize that funding tying it up from being used for other purposes.

BILL FELDMEIER: How long would it take to realize the gain if the Board lowered it to three times?

JOHN FINK: The change wouldn't be effective until we actually implement it.

BILL FELDMEIER: I'm thinking we need to protect ourselves to keep these projects going. How long will it take us to do that?

JOHN FINK: It's just a matter of a couple of months. There would be a significant amount of analysis we would do before we come in with any recommendation.

JOHN McGEE: We have enough HURF and bond proceeds to continue to match federal funds for another year or two which buys time to see how these things play out and what happens with the State deficit and additional actions that might be taken there, and to start planning in this direction if it's determined that's where we need to do. At the point we change the coverage, we would probably incur a ratings downgrade at that point. As opposed to having to send \$700M in federal funds back to Washington, it may be a small price to pay.

BOBBIE LUNDSTROM: How are the bonding companies reacting to this?

JOHN McGEE: The investment banking firms and irrespective of whether we were at a 4x or 3x level, our bonds would still be highly rated relative to other municipal debt. We would pay a slightly higher interest rate, but it would not make our bonds unmarketable. Our bonds would still be in demand.

JOHN FINK: I'd like to look at locating alternative funding sources proactively, not reactively. We can look at what the debt restructuring will look like, costs and gains.

Airport Development Program

JOHN FINK: A historical chart shows 2009 revenue for the Aviation Fund totaling \$26.4M; flight property tax represents 45% of the total or \$11.7M, aircraft registrations represent 27% or \$7M, federal grants represent 15% or \$3.9M. Assuming no more sweeps or transfers in 2010, the Aviation Fund started at \$.5M, revenue estimates totaled \$27.6M, expenditures \$22.7M, leaving an ending fund balance of \$5.4M. The 5-year program for aviation shows federal matching grants range from \$3.5-4.5M by 2015. State/Local grants will start in 2011 at \$2M. It will be significantly higher in 2012-2015. Airport pavement preservation in 2011 starts at \$3.8M growing to \$5.6M in 2015. Airport development loans, none anticipated in 2011; in 2012 \$.5M, and \$1.5 2013-2015. State planning is \$.5 in 2011 and \$300K in each succeeding year.

All federal dollars go directly to the sponsor meaning the State does not receive funds for assisting with a grant. We will need to continue assisting the FAA by providing State matching dollars for sponsors. The Aviation Fund is being swept extensively due to the State deficit. We need to make sure we maintain sufficient revenue to support airport development and operations. Sweeps are reducing the funds available for subprograms; currently grant reimbursement payments are being deferred and future programs are reduced substantially or zeroed out. We need to be flexible to hold the dollars on the highest prior priority programs including airport preservations, State matching funds for federally-funded projects, and paying current obligations. The distribution policy was identified as being inadequate to meet today's needs. There are new federal criteria to be accommodated. State eligibility criteria are not reflective of new safety and security standards. Flexibility is the challenge.

ITEM 3: FY 2011 - 2015 Five Year Program Policy Discussion

JENNIFER TOTH: It's important for us to understand the regulations in terms of our Statewide Transportation Improvement Program and the 5-year Program, including Federal and Arizona Revised Statutes. The program is not a plan, but we do a lot of planning that is translated into programming and project development. Requirements from the federal regulations include that the program must cover no less than four years and must be updated at least every four years. We update our program every year. For each project or phase in the program, we have to have the estimated total project cost. That is something we have not been doing, so if you see something in the program you need to denote what the total project cost is going to be for that entire project. The first two years of the program need to be limited to projects for which funds are committed. The last three years we use can be there for illustrative purposes. Let's say we have a \$5M placeholder in the third year, we do need to still denote that the total project cost is \$25M. We need to be transparent and provide that to the public so they understand the project's not costing \$5M, it's actually costing \$25M, but based on the programming, we can only program \$5M for that third year. It has to be fiscally constrained and has to go through a public involvement process.

In terms of the 5-year program, there is a slew of project criteria provided in the Arizona Revised Statutes, some of which are safety, level of services, etc. Those criteria are gone through with a Technical Advisory Committee as we put the program together to select new projects. The first year shall consist of projects that can be reasonably certain to be advertised. The Statutes also outline the priority programming process. A Resource Allocation Advisory Committee discusses funding levels along lines of subprograms and funding available for the major projects, a Technical Advisory Committee internal to ADOT consisting of different areas within ADOT that provides input to the projects coming from the Districts as the COGS and MPOS and prioritizes those based on certain project criteria, and the Priority Planning Advisory Committee which is a public meeting and provides recommendations from the PPAC coming to the State Transportation Board.

Fiscal constraint based on credible revenue and bid cost estimates will continue to be an area of emphasis from the USDOT, specifically FHWA and FTA, in relation to the STIP. Big picture thinking is important in defining transportation priorities and our transportation investments go well beyond serving just a transportation need. Transportation planning, programming, and decision-making strike a balance among numerous and sometimes conflicting and competing interests, but our partners, customers, and stakeholders expect us to meet that challenge. Accountability to the public is important; program priorities should flow from good planning. We started the vision process in terms of "Building a Quality Arizona" and we're now moving into the long range transportation plan with "What Moves You Arizona."

The funding situation is rapidly approaching the point where virtually no funding will be available for major project capacity enhancements outside of Maricopa and Pima Counties and there is a need to ensure that proper prescription of our infrastructure investments happen. Failure to do so will increase costs in the future. We need to decide on which programs will get us the biggest return on our investment in terms of mobility and safety, i.e., system efficiency-type projects versus capacity. All projects cannot be funded and strategic investments should focus on projects which add value across jurisdictions and modes to make a difference in everyday lives of the citizens. The citizens care about the outcome as heard through the bqAZ process. Our competitive advantage is increasingly dependent on our ability to attract skilled workers, businesses that employ them, places that provide affordable housing options, a high quality of life, and transportation hubs that act as gateways to the global economy. If we are unable to move those goods and services efficiently, we could lose that advantage.

Challenges are also to security and economy with fluctuations in oil prices, dependence on foreign oil sources, transportation-related greenhouse gas emissions. There is a call for more sustainable transportation and development solutions. The Department must continue and increase its efforts in developing those multimodal transportation systems including planning a reliable, sustainable funding mechanism to match federal aviation funds, federal transit dollars, federal rail dollars, and highway dollars.

Of our paved surfaces, we have over 28,000 lane miles. Maintenance has been cut on our ability to maintain services on those roads from \$11M to \$0. We need to look at how to preserve our system. We are not keeping up with the vehicle miles traveled with pavement preservation expenditures. The mission of the Department's pavement management system is to develop and provide a cost-effective pavement rehabilitation construction program that does preserve the State's investment in its highway system, and enhances the public transportation and safety of that system. A worldwide standard is used for measuring pavement smoothness called the "International Roughness Index" (IRI) and this measures roughness in terms of inches per mile that a laser, mounted in a van, jumps as it's driven across the roadway system. Performance goals for the condition levels of the pavement have been developed and is expressed in terms of serviceability defined as "the ability of the pavement to serve the traveling public." The IRI translates into a serviceability measurement called the "present serviceability rating" (PSR) which is based on a 5-point scale. The goal of the Department is to maintain a level of 3.23 or better for all roads in the State highway system. The measurements are done on an annual basis.

Current funding levels over the 5-year program are at \$700M; there is 16% of the system below an acceptable level of PSR. With \$700M, we will only be able to "put out fires" and 26% of the system will be below the acceptable level. If we invest \$300M more, we will be able to get to a 19% acceptability level. If we invest \$500M more, we will be able to prevent the "fires" and maintain the system with 17.5% below acceptable levels.

Other areas needing our attention are the Bridge Program; 59% of the bridges in the State were constructed prior to the 1970s, and only 21% have been constructed in the last 20 years. Bridge decks are deteriorating to the point where we can no longer maintain them. Construction funds need to be added to bring them up to speed. Maintenance dollars are not able to cover what they used to and so construction funds need to be brought in line to preserve the infrastructure we have. The same thing applies to drainage and rest areas. Although we have closed rest areas, there were many facilities that needed upgrading and will still need those upgrades prior to reopening.

BOBBIE LUNDSTROM: How much does it cost to maintain a rest area per year?

JOHN MCGEE: About \$250 - \$300K per rest area. It varies as some of the rest areas have significant operational issues that may be more costly. A lot of the cost is in utilities such as for lighting.

BOBBIE LUNDSTROM: Would we face a liability issue in closing these, for example, if there is no place to stop and rest and they fall asleep at the wheel?

JOHN MCGEE: The question becomes one of can somebody prevail in that kind of a situation. There are pretty good protections in the statute and case law that give governmental jurisdictions protection in cases where they just don't have the money to do whatever it is they quit doing. That's a pretty basic protection. But we've had other protections that as times change and court cases change the law "moves."

JENNIFER TOTH: There are subprogram increases in the 5-year program which bring those subprograms up to federal funding levels. There are some we are proposing to bring up to at least a 90% rate of apportionment, some which are strictly based on needs, and then new subprograms. In terms of those subprograms where we are trying to bring them up to the 90% apportionment that's the Statewide Planning and Research funds that fund planning activities for the Department as well as federal reporting requirements such as the Highway Performance Monitoring system, the Recreational Trail Program, Safe Routes to School Program, Rail Highway Crossing Hazard Elimination or Section 130 Program, and Bridge Replacement and Rehabilitation Program. We are trying to make sure that within the 5-year program we are programming up to our apportionment level. Items based on needs are right-of-way, bridge, pavement preservation, etc. The Right-of-way Acquisition and Appraisals program was reduced from \$2.5M to \$2M in 2003 in order to balance the cash flow shortages and is mainly used for smaller acquisitions in the Greater Arizona regions. Funds from other right-of-way subprograms have been used to supplant that subprogram, so we're asking for an increase in that funding in order to make that goal. The right-of-way plans are funds used to supplement on-call services for right-of-way surveys, plan preparation, and title reports for statewide right-of-way projects.

With the hiring restrictions and increased volume of work, the use of consultants has increased to meet program needs. Bridge Repair and Inspection subprogram is used to inspect both on and off highway bridges including concrete and pipe culverts and approximately 60 bridges a year are added to the inventory due to the capacity expansions that we've had over the years. These funds need to be caught up to that future inventory to inspect those bridges and pipe culverts in order to maintain our deficiency rating of 92.5 or better. Same thing with bridge deck replacement. This is a non-federal subprogram created to provide funding for maintaining integrity of the bridge decks which are deteriorating to a point where major rehabilitation and replacement is needed rather than using maintenance dollars. District maintenance cannot keep up with deck patching and repairs due to funding cuts.

The Ports of Entry subprogram supports 22 fixed ports including 6 international facilities that require constant modification and improvement just to maintain basic operations. It is estimated there will be a 40% increase in truck traffic over the next 10 years through those ports. The ports generate approximately \$18M in HURF funds and port inspections help to preserve highway pavement conditions. This program also supports mobile enforcement operations across the State.

The Privatization Subprogram is needed to support the P3 program. We are gearing this up and anticipate unsolicited proposals because of new legislation that came forward this year.

JOHN McGEE: These slides are meant to show specific subprograms that at this point we will be recommending for increases.

JENNIFER TOTH: Two new subprograms were added this year, one in relation to environmental stewardship. We feel this subprogram will assist the Department in practicing and promoting environmental excellence, cooperative planning and management of those resources. Environmental stewardship can also be related back to safety in terms of wildlife connectivity. The Roadside Improvements Subprogram will construct new guards, right-of-way fencing, and drainage improvements, and addresses livestock on the State highway system.

In terms of capacity projects, there is approximately \$30M to distribute across the State - not a tremendous amount for the 5th year.

Next steps will be:

- Setting up individual meetings with Board Members and a February Study Session to present program recommendations and solicit comments from the Board as a while
- Present the tentative program at the February Board meeting to seek approval and then move it forward for public comment
- Public hearings will be hold in March, April, and May in conjunction with the Board meetings
- June Study Session to discuss changes to the tentative program based on those public hearings
- · Seek adoption of the program at the June Board meeting

JOHN McGEE: A second Stimulus Package (ARRA-2) as it now sits in the House is similar to ARRA with one exception which is the House version would have the States and locals obligating and getting to contract the money quicker than ARRA-1 did. ARRA-1 was a real challenge. I would not want to overlook ARRA-2 as a potential opportunity to, from a policy perspective, address the issues we've been talking about. Information has been shown regarding pavement preservation. Using ARRA funds for pavement preservation creates projects we can get out within mandated time frames and they address a real problem we have with funding. If ARRA-2 comes along, it has even more stringent requirements in terms of how soon the funds have to be spent. We may want to look at another infusion of funding for core preservation. The other area we need to think about is rest areas. Since we've suspended operation on the rest areas, there hasn't been another issue where we've gotten so much feedback on. It was a necessary decision we stand by and believe it was what we had to do, but there may be an opportunity through the ARRA funds to do capital improvements we need done on some of the facilities. With the P-3 program, Gail and I have spent significant time thinking about rest areas and how that system should work. I've concluded that a good rest area program in Arizona is going to have to be based on: 1) an "oasis program" although not met with much success so far, and 2) some degree of privatization although not in low demand areas. We have chosen not to put money into rest areas to a degree, but perhaps ARRA will represent an opportunity to catch up. I would ask the Board to at least be thinking about this should ARRA-2 come through.

JOHN FINK: There are already a lot of projects on "somebody's list" and rumor has it those projects will have to be awarded much sooner, so there is a running start on the projects already existing.

JOHN McGEE: Because of the way the law is written in the House version, 50% of all funds both State and local has to be under contract in 90 days. Under ARRA-1 it was only 50% of the total had to be obligated within 120 days and then the remainder within a year. I don't think there was a single local project that made that 120 day obligation; there may have been one. Almost all the local projects are coming on the tail end and that has been a struggle. To get \$75M in local projects under contract in 90 days, I don't know how it's going to happen. We're looking at State projects and believe we can be successful in getting out piece out. We're going to bring more to the Board in the next month; a new prioritization list of projects for ARRA-2 and to utilize FY-10 federal money. This Department is starving for operating funds. However, ADOT has received \$350M of additional ARRA funds and potentially an equal amount of ARRA-2, and then \$600M in regular federal aid. The Board is aware of the issues we had to go through last federal fiscal year to ensure we used all those funds. We are literally being asked to do much more than we normally do in a year with fewer resources. We have always had a rigid process for giving projects out and business as usual, but we're having weekly conversations with FHWA on we can work together to make things happen. Everyone involved is going to have to look at something other than "business as usual" if we're going to be successful over the next 8-9 months to utilize all these federal funds,

BILL FELDMEIER: Is there any latitude we have to contract with the locals to speak for their projects?

JOHN McGEE: Because these are federal funds, unless you are a self-certified entity having gone through a process the Federal Highway Administration has signed off on that proves you have the capability to administer a federally-funded project and go through all the steps required, and there's only 7-8 entities in the State qualified, ultimately we have to administer those projects, but if we don't do it, those projects don't get done and the money goes back to Washington. Our goal should be whatever we have to do, we cannot let the State send anything back to Washington.

BILL FELDMEIER: Are we charging for our time to administer these projects?

JOHN McGEE: Yes, we do.

BILL FELDMEIER: Don't we have the ability to contract with MAG and PAG, and the City of Phoenix to do some of that additional work for us and just transfer the cost of the service over and reduce part of the workload?

JOHN McGEE: That is a strategy we're looking at and discussing with FHWA and will probably be discussing with other certified entities as to whether they can also step up and help some of the other locals do their projects.

BOB MONTOYA: Are all of these providers' municipalities or private entropreneurial companies that are self-certified?

JOHN McGEE: They have to be a governmental entity to be a recipient of federal aid. We do employ outside consultants to help, but it has to be administered through the government.

BOB MONTOYA: ADOT could then hire those consultants and it's not a long term obligation?

JOHN McGEE: And we do hire consultants.

CALL TO AUDIENCE

STACEY HOWARD (Aircraft Owners and Pilots Association) I represent a national organization of over 400,000 members; 12,000 of whom live here in Arizona. The State Aviation System Plan. The plan is very clear in its benefits and its shortcomings of the current system. I'd like to add some anecdotal facts to encourage investments in rural airports. First of all there is, under the federal program, a 95% share provided by the federal government; a large share of the cost of these projects. Secondly, Arizona Blood Services has confirmed that with the blood donations given from these rural communities, it's very important that the volunteer pilots be able to get that blood down here to Arizona Blood Services quickly in order to preserve the blood's condition and be able to produce the most products. Airports are vital to that. There are about three times as many donations that are coming from rural airports into the metropolitan areas as are going back out, so it's very important to get those down and to keep up those rural airports. Flight instruction in Arizona, according to the FAA, there are more flight certificates, initial pilot ratings given in Arizona by the District Office here than in the next two District Offices combined. So, flight training is very important and Arizona and the safety of the pavement conditions, obstruction clearances, and good weather reporting is vital for that portion of our industry. There is an argument going on at the federal level right now and a strong airline campaign to reduce the federal share to non-commercial airports, and you've probably seen some of those articles in USA Today and in the Wall Street Journal. The airlines would like to introduce some user fees which the general aviation community is opposing. The Office of Management and Budget has confirmed that the current tax system at the federal level is more than enough and adequate to fund the next generation of airport developments and air traffic control.

Arizona pilots are very willing to do our share. We understand there are budget shortages statewide that everyone will need to contribute to the resolution of, however, we would like to encourage the Board to support reasonable State level funding versus the devastating sweeps that have taken place in the Aviation Fund in the last couple of years and to permit the State to come up with for help the locals and the State match those federal grants and pavement maintenance programs for airports. So, we will be taking to our State Legislators and we hope that you will, too, throughout the session and especially at Aviation Day at the Capitol which will be on January 20th.

MAGILL WEBBER (Arizona Nature Conservancy) I just wanted to comment very briefly on Item #1 on the agenda today, on the bqAZ Study, and really I think I went into a lot of comment at our last Study Session, so I'm not going to go into too many details, but I do want to say thank you for your responsiveness to our comments and to the comments of some of our partners including the Yavapai County Public Works Department, the Arizona Game & Fish Department, and some other members of the community. And especially, I wanted to thank Jim and the staff at ADOT for incorporating our comments under the CYMPO recommendations into the bqAZ Transportation Framework Study that just came out and encourage the Board to consider those recommendations when adopting that plan at the next meeting next week.

BILL FELDMEIER: When we're talking about engaging ourselves in creative thinking in terms of additional revenues or new ways in which we can look for revenues. We might as well resign ourselves to doing short-term fixes like lowering the bond rating from 5 to 3 and I'm not saying that's a bad thing, but we're going to run out of those little fixes and until we create mechanisms for which we can obtain resources and revenue, whether it's increasing fees or creating new taxes, developing new partnerships, it's going to be worse than it is today. We're going to look to staff to help us with additional Study Sessions if that's what it takes.

JOHN McGEE: I would recommend talking about that in a month or so. There may be some things coming out of this Legislative session, or at least being proposed, that may start trying to get to the point Mr. Feldmeier is talking about. I know we've been asked for a fair amount of information on different revenue sources and that sort of thing. I'm not privy to what we've been asked from the Governor's office and what they're going to be doing with that information, but I am anticipating the Governor's budget which should be out in a couple of weeks to see if there's anything in there that might help address some of these issues. I think once we know that and the direction the Governor may or may not be going, along with the Legislative proposals, then would be a good time to sit down and have additional discussion.

BILL FELDMEIER: My preference is to become more proactive instead of reactive because essentially all we do is try to respond to the shots that we take.

ADJOURN

The meeting was then concluded at 12:23 p.m.

Delbert Householder, Chairman

State Transportation Board

John McGee, Executive Director for Planning and Policy

Arizona Department of Transportation