



STATE OF MICHIGAN
DEPARTMENT OF TRANSPORTATION
LANSING

JENNIFER M. GRANHOLM
GOVERNOR

KIRK T. STEUDLE
DIRECTOR

March 13, 2008

Mr. James J. Steele, Division Administrator
Federal Highway Administration
315 West Allegan, Room 201
Lansing, Michigan 48933

Dear Mr. Steele:

This letter is in response to your correspondence dated February 14, 2008. The Michigan Department of Transportation (MDOT) is disappointed with the Federal Highway Administration Michigan Division's (MiFHWA) decision to conditionally approve the FY 2008 - 2011 State Transportation Improvement Program (STIP). The STIP was developed consistent with Michigan's transportation planning process and is financially constrained, as required by federal regulations. MDOT has a proven track record of financial constraint and successful program delivery.

We have worked diligently, in cooperation with your office and our Metropolitan Planning Organization (MPO) partners, to implement the new, uniform format, electronic STIP. Throughout this process, we have tried to address your comments and concerns. Although there have been challenges along the way, we feel that significant progress has been made in automating the STIP development process. Many of the questions raised by FHWA were the result of exercising new, untried software.

FHWA also had questions related to documentation of numbers. Recently, MDOT and FHWA staffs came together in a joint working session, as requested in your February 14, 2008 letter, to discuss the revenue estimating and advance construction (AC) processes used for the development of the FY 2008 - 2011 STIP. Flow charts illustrating both the federal and the state revenue estimating processes were provided, as well as a document identifying MDOT's use of AC (see enclosures).

MDOT's federal revenue specialist, Eric Mullen, provided a table of estimated FY 2008 - 2011 apportionment and explained the federal revenue estimating process, its assumptions, historic growth rates, Safe, Accountable, Flexible, and Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU) base amounts, and distribution to the MPOs. In summary, it was identified that for development of the FY 2008 - 2011 STIP, the overall apportionment estimates provided in SAFETEA-LU were used as the baseline assumptions for federal revenue for FY 2008 and FY 2009. Adjustments were made to account for changes in Michigan's bridge and equity bonus apportionments. These estimates were used in Michigan's 75/25 distribution of federal-aid to estimate the amount of federal-aid each MPO was to use as a baseline for their individual TIPs.

MDOT developed an overall growth rate of 3.2 percent annually by calculating the annual growth rate of SAFETEA-LU apportionments (3.6 percent) and conservatively estimating that 90 percent of this growth would continue in future federal reauthorization periods. MDOT then uses an estimated rate of 87 percent obligation authority when programming projects to ensure fiscal constraint. Concurrently, the MPOs and MDOT decided to continue using a reduced 2 percent growth rate for the MPO TIPs to account for their preference of programming jobs to the apportionment estimates.

Craig Newell, one of MDOT's state revenue experts, described the state revenue estimating process and how it is distributed according to Michigan's Act 51, which governs transportation in the state. It was identified that MDOT meets twice a year with the Michigan Department of Treasury to develop a

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consensus transportation revenue forecast for two years, and the MDOT transportation revenue model is then used to develop a long-range state revenue estimate. The results are an estimate of available state funding that is distributed to the state, counties, and cities according to Act 51. The state transportation funds available for the state trunkline system were further described, including deductions and additions to the funding, resulting in the estimated revenue available for the state trunkline capital program.

In addition, MDOT staff outlined the state and local project commitment process and the state STIP and MPO TIP development processes. The transportation planning revenue estimating process comes full circle when the federal revenue in the MPO generated financial constraint tables is compared to the baseline revenue estimates. Uncommitted federal revenue is added into the statewide financial constraint table to reflect a more realistic estimate of total federal revenue.

MDOT's uses of AC were described in detail using a three-page handout that defined AC and identified the three types/ways of using AC and the extensive internal controls MDOT uses to manage it. In our discussion, you indicated some concern regarding how we utilize AC for indirect GARVEE projects and multi-year federal funding allocations (earmarks) in the STIP. MDOT utilizes AC for these types of projects as a cash flow management tool in its day-to-day operations. Therefore, we believe it is appropriate to have them classified as financial AC and handled in the same manner as other financial AC. To identify them in the STIP in the same manner as planned, AC would be confusing to the public and TIP committees, would be administratively burdensome, and could reduce our flexibility to fund the program in an efficient and timely manner. These types of projects have been handled as financial AC over several years and have not affected STIP financial constraint. MDOT has always been financially constrained and remains financially constrained with the FY 2008 - 2011 STIP.

The joint session concluded with participants discussing potential next steps to improve the revenue estimating process and move toward an automated STIP development and maintenance process. Your comments on future STIP updates will continue to be a topic of discussion.

With the conduct of this meeting, we request that you remove your conditional approval of the STIP and give the State of Michigan full STIP approval. In order to proceed with program delivery in a manner consistent with the interrelated transportation and economic needs in Michigan, this approval should be granted upon receipt of this letter.

If you have any questions, please contact me or Denise B. Jackson, Division Administrator, Statewide Transportation Planning Division, at 517-335-2962.

Sincerely,



Susan P. Mortel, Director
Bureau of Transportation Planning

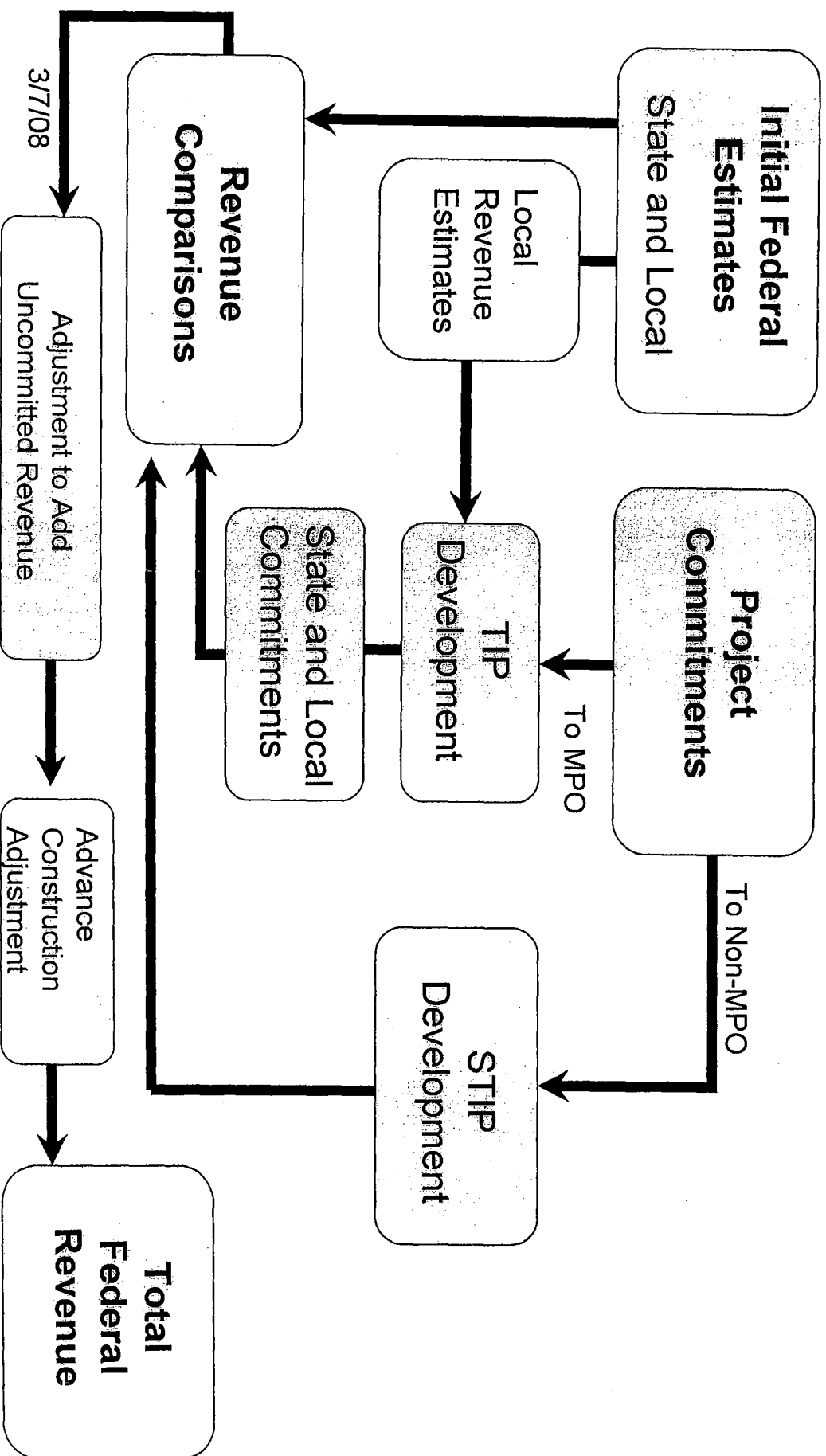
Enclosure(s)

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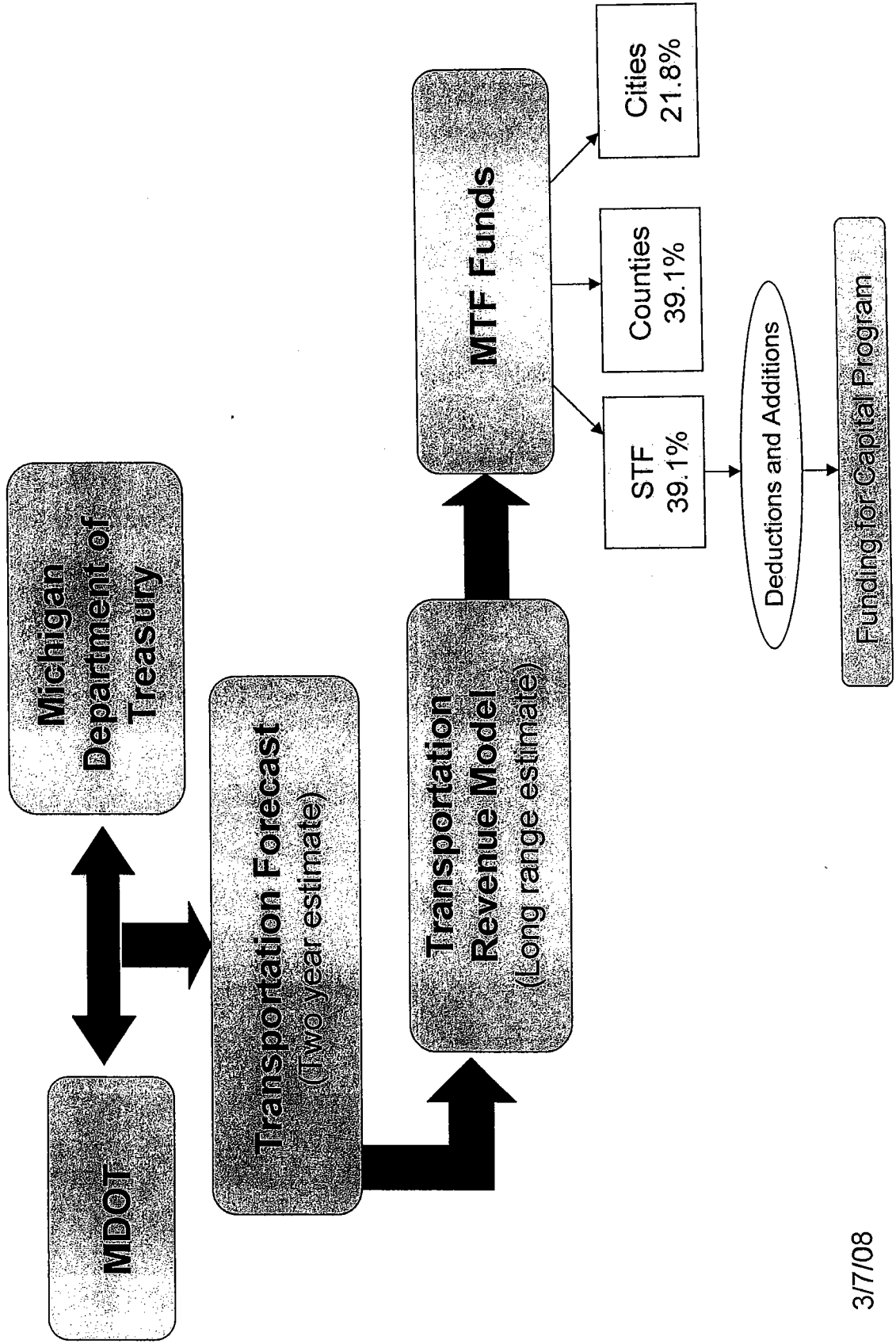
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cc: Leon Hank
Denise B. Jackson
Mark Kloha
Amy Lindstrom
Dal McBurrows
Marsha Small

Federal Revenue Estimating Process



State Revenue Estimating Process



MDOT's Use of Advance Construction (AC)

March 7, 2008

Definition of AC

Advance construction (AC) is an innovative finance funding technique which allows a state to initiate a project using non-federal funds while preserving eligibility for future federal-aid funds. Eligibility means that the Federal Highway Administration (FHWA) has determined that the project technically qualifies for federal-aid however, no present or future federal funds are committed to the project. After an AC project is authorized, the state may convert the project to regular federal-aid funding provided federal funds are made available for the project.

Types of AC

As a part of its business practices, the Michigan Department of Transportation (MDOT) utilizes AC financing in several ways. They can be generally described as early let, project specific and financial AC.

Early Let AC -

Early let AC is undertaken at the end of the fiscal year in order to proceed with October and November bid lettings. Generally, at the point where October/November projects are ready for authorization, obligation authority has been exhausted for the fiscal year. In order for the projects to proceed on schedule, MDOT will AC these projects. These projects are converted in the new fiscal year when funds become available.

MDOT uses this AC strategy to allow for the program to proceed as scheduled, which is especially important to successfully delivering the program. MDOT has a performance delivery target of letting 90 percent of the program to bid in the first six months of the fiscal year. Meeting this target helps both the industry and suppliers better plan for each year and allows many of our projects to be completed in one year. As a result, we have realized savings in project costs and user delay savings by completing a project within one construction season.

Early let AC projects are not specifically identified in the State Transportation Improvement Program.

Planned AC -

Large, multi-year projects may be authorized as AC in order to utilize the partial conversion of AC technique. This enables MDOT to convert a costly project in stages rather than all at once. This is especially helpful where the project is so large that all-at-once conversion will consume large portions of obligation authority in the year of conversion and could impact progress on other federal-aid projects planned for that year.

At MDOT, planned AC projects have been identified by leadership and scheduled year(s) of conversion are identified and implemented by the Planning and Finance Bureaus. Generally, the phased conversion of projects to regular federal funding begins when significant costs start to accrue and the funds are available. Planned AC is infrequently used in program development.

Planned AC projects are specifically identified on the STIP in the year that they are authorized and listed in the year that they are converted. However, the funds required for conversion are deducted from the available conversion year funds so that new commitments do not exceed revenues available.

Financial AC -

MDOT uses financial AC in its day-to-day operations to manage cash flow. Projects with significant cost estimates are typically established as AC projects. As significant costs are incurred on a project, it is either partially or completely converted. This allows for more efficient utilization of federal-aid and maximizes the flow of federal-aid to MDOT. In the event that obligation authority and apportionment are available at year-end, projects may be converted regardless of costs incurred in order to not lapse funds or obligation authority.

MDOT may also utilize AC to fund projects considered to be indirect GARVEE projects. These projects are either completely or partially converted as funding is needed to make debt service payments.

In addition, MDOT will utilize AC for projects that are funded with multi-year federal funding allocations (earmarks). These projects are partially/completely converted as the funding becomes available.

Internal Controls for Managing AC

MDOT is very conscientious and diligent in managing its program including AC. Some of the controls that are in place include the Revenue/Uses Report, Program Cash Flow Model, and Executive Level Monthly Meeting.

Revenue/Uses Report -

This report estimates total revenue (federal and state) available for MDOTs Capital Highway program on an accrual basis for the current fiscal year. Sources of revenue (federal-aid, Michigan Transportation Fund, State Trunkline Fund, Bond, etc.) are identified and estimated to determine total revenues available for both the local and MDOT programs. Uses of revenue (non-capital and local) are then identified and estimated in order to determine the amount available for MDOTs Capital Highway program. This amount is then compared to MDOTs anticipated fiscal year Capital Highway program to determine an overage or shortfall in revenues.

MDOTs Bureau of Finance and Administration staff, as well as staff from the Bureau of Transportation Planning, is responsible for the estimates that populate this report. This team meets monthly to update and confirm estimates for both the sources and uses of revenue.

Program Cash Flow Model -

This spreadsheet estimates fiscal year end cash balances for a ten year period. This program level model was developed through the combined efforts of MDOTs Bureau of Finance and Administration and the Bureau of Transportation Planning. It allows for the analysis of a Capital Highway program size that can be accomplished with a given funding amount, or conversely, the amount of funding necessary to produce a given program level.

The model incorporates the process of receiving federal-aid for projects after MDOT pays for the projects, and submits to FHWA for reimbursement. The expenditures schedule is based on averages and does not try to forecast expenditure schedules for *individual* projects. AC gets no reimbursements in the year they are authorized, but two years of reimbursements when they are converted (which is one year after authorization), the remaining years continue reimbursement according to the schedule. Reimbursements for the regular (non-AC) obligations are lagged across several years.

Executive Level Monthly Meeting -

Meetings are held monthly with the Director of the Bureau of Finance and Administration, the Director of the Bureau of Transportation Planning, the Director of the Bureau of Highway Delivery, MDOTs Chief Administrative Officer, the federal-aid Highway Program specialist, and support staff. At these meetings results from the Revenue/Uses Report and the Program Cash Flow Model are reviewed and analyzed. Discussions regarding AC balance and strategy may also take place. Resulting from these discussions and analysis, decisions are made to maintain the status quo or make adjustments to the current year or future year highway program.

Estimated Year End Balance of Non-GRAVEE AC

The range for the last several years has been between \$350M and \$450M.