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Turnpike Drowning in Debt?

Recently Pennsylvania's Auditor General stated that the Pennsylvania Turnpike is "drowning in debt". This characterization was disputed by the Turnpike's CEO as "simply not true" and that the Turnpike "has developed a sound, fiscally responsible approach to meet all of its financial obligations…" So which is it? Is the Turnpike's financial condition sound or is the Auditor General correct in raising a red flag? To get an unbiased picture of the situation it is important to examine the large rise in debt over the last few years and the major causes of the borrowing. A principal reason for the debt increase is a provision of Act 44 of 2007.

Act 44 was an attempt by the Legislature and Governor Rendell to find a funding solution for mass transit as well as for road and bridge repairs. The centerpiece in Act 44 was to be the tolling of Interstate 80. Control of I-80 was to be transferred from PennDOT to the Turnpike Commission for which the Commission would pay PennDOT $900 million per year for 50 years (to be phased in over three years). The Commission would toll the road and use the proceeds to make these payments. PennDOT would in turn use the money to subsidize mass transit as well as provide for road and bridge work.

As we wrote at the time (*Policy Brief Volume 7, Number 46*) this plan was sure to run afoul of Federal regulations relating to tolling Interstate highways. Indeed, permission to toll I-80 was denied. But the Commission retained responsibility for the annual payments to PennDOT, which after three years were cut in half to $450 million by legislative action.

Annual fare revenues for the Turnpike (the principal source of income) were $617.6 million in 2007 (the year before Act 44 was implemented). How were they to pay $900 million (reduced to $450 million after three years) every year to PennDOT and cover other expenses? Their answer was to borrow and pay for the additional debt service with fare hikes.

As stated in the Turnpike's 2011 Comprehensive Annual Financial Report (CAFR): "The Commission plans to debt finance its … payments to PennDOT as required under Act 44 for the foreseeable future. As a part of its financing plan, the Commission will continue to increase its toll rates on an annual basis to fund debt service payments associated with its Act 44 payment obligations…" So the plan is clear, but how long can the Commission keep it up before it runs into complications either through its credit rating and/or the debt load becomes too heavy? And how long will users of the Turnpike tolerate annual increases to the rates?

To answer the question about the debt load, we'll look at the financial statements in the CAFR to see how Act 44 has impacted the Commission so far.

In 2007, the Commission had $2.5 billion in bonds outstanding. By fiscal 2011 total debt had more than tripled to $7.7 billion fueled in large part by the $2.95 billion in payments already made to PennDOT ($750M in 2008, $850M in 2009, $900M in 2010, and $450M in 2011). While some of the debt issued was for uses other than the Act 44 payments, the majority of additional debt was issued to cover those payments. Total debt service payments rose from $179.0 million in 2007 to $352.5 million in fiscal 2011. Combined, the added debt service and the $450 million Act 44 payment represent an increase in outlays—not including changes in operating expenditures—of $623.5 million.

Meanwhile, over the same four year period, revenues including fares, oil franchise tax, motor license registration fee, investment earnings and capital contributions rose by just over $100 million from $797.5 million in 2007 to $901.4 million in 2011, thanks mostly to a $147 million jump in fare revenues created by hikes in toll rates. With total revenue rising only $103 million and the rise in combined debt service and Act 44 payment totaling $623 million, the Turnpike incurred a $520 million deficit in 2011. Looking ahead as the debt level continues to rise, the debt service costs will rise further.

To add a little perspective, the amount of total debt per vehicle (using the Turnpike) in 2007 was $13.38 and by fiscal 2011 it had risen to $40.84—an increase of 205 percent. The total debt service per vehicle rose more than doubled from $0.97 to $1.86 during that same time.

Absent a large increase in the revenues from oil franchise taxes or motor license registration, the only way to keep the Turnpike's balance sheets from deteriorating further is to continue raising its tolls. And therein lies the big question. At what level of toll rates does vehicle traffic actually drop sufficiently to more than offset the higher toll charges and thereby cause fare revenue to fall? In economics terms, at what price does the demand for Turnpike usage become price elastic? That in turn will depend on growth in the economy, fuel costs, overall inflation and the change, if any, in the availability of viable alternatives to using the Turnpike.

Data for the last ten years suggests that the vitality of the economy —or lack thereof—is a major non-price determinant of Turnpike vehicular traffic. At the same time, there is some indication that big toll increases do reduce the growth of traffic, although typically not enough to cause a decline in revenues. In 2007 passenger vehicle usage fell sufficiently, most likely in delayed reaction to the 44 percent toll charge hike in August 2004, to produce a drop in revenues from the 2006 level. By 2008, traffic and revenue had picked up again.

In January 2009, fares were raised by 25 percent and then again on January 1, 2010, the cash tolls were pushed higher by 3 percent and in 2012 they have been boosted another 10 percent. That means tolls have risen by 104 percent since August 2004. While revenues grew over the 2004 to 2011 period, the trend in total traffic has been very flat.

The warning here is that it is extremely dangerous for the Turnpike to assume that it will be able to continue the pattern of toll increases of recent years and not expect to have a negative impact on traffic. Certainly, it is not reasonable to expect to close a $500 million and growing deficit with fare hikes. That would require almost 80 percent higher tolls than are currently being imposed with no significant loss of vehicles using the system—a very unlikely development.

In sum, the requirement to continue making $450 million payments to PennDOT with no additional major revenue sources besides toll charges will likely result in serious harm to the Turnpike's long term fiscal health.

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