January 15, 2013 Policy Brief: Volume 13, Number 3

Turnpike Tolls Continue to Rise to Pay for Bond Debt

For the fifth consecutive year, the Turnpike Commission welcomed 2013 with an increase in tolls, ten percent for cash customers and two percent for electronic customers (E-Z Pass). These toll increases are necessitated by the obligation of the Commission to pay $450 million annually to PennDOT as a result of Act 44 of 2007. As we noted in a *Policy Brief* a year ago (*Volume 12, Number 5*) the Turnpike Commission's strategy is to pledge toll revenues to cover the issuance of debt in order to satisfy the Act 44 obligation. We warned that such a strategy is fraught with danger as the Commission is risking the Turnpike's long-term fiscal health by continuing to take on larger and larger debt levels.

One very important consideration is whether or not the Commission can keep raising tolls every year without reaching a point at which revenues begin to decline. As mentioned above, tolls have increased every year beginning with the 2009 boost. The last rate hike prior to 2009 occurred in 2004. According to data in the Turnpike's Comprehensive Annual Financial Report (CAFR) for fiscal 2012, overall traffic on the system, the Mainline and the smaller spurs such as the Mon-Fayette Expressway and Findlay Connector, has been flat for the last few years. In 2008 overall traffic reached 189.5 million vehicles (all classes). The following year, the first of the successive toll increases and the start of the recession, traffic decreased by just under two percent to 186.2 million before climbing back up to 189 million in 2011. That number held in 2012.

While traffic levels have been flat, the amount of gross fare revenue has been increasing due to the toll increases. Gross fare revenue in 2007 was $617.6 million and $619 million in 2008. For 2009 gross fare revenues increased to $638 million on the heels of a 25 percent increase in tolls despite the recession and decrease in overall traffic. For fiscal 2012 gross fare revenues reached $797.8 million—an increase of 29 percent since 2007 thanks largely to the to the 56 percent rise in tolls since 2008.

The rising tolls and subsequent increasing of revenues indicates that drivers using the Turnpike system are not very responsive (demand is inelastic) to the toll increases. But how long will this last? At what point do drivers become more responsive (demand becomes elastic) and decrease their usage of the system sufficiently to reduce toll revenue? While the mainline Turnpike is still the best route for crossing the southern part of the state, traffic might be declining significantly on certain stretches of the road. Recently a newspaper story, using Turnpike data measuring traffic between interchanges, noted that commercial traffic between the Ohio state line and Westmoreland County's Donegal exit has been declining since 2008. On a sixteen mile stretch between New Stanton and Donegal, truck traffic declined fourteen percent from 2008 to 2011.

Demand may be inelastic for longer runs but more elastic for shorter runs. A number of factors will contribute to the difference. Availability of a viable substitute route, extra travel time on the alternative compared to the Turnpike, and the dollar costs savings, if any, factoring fuel and driver expenses, etc. Some commercial drivers travelling relatively short distances apparently have made the calculation that there are other ways to transit those distances that lead to net savings for them. As tolls rise further, it is likely that more will join them and some will seek alternatives for even longer stretches of Turnpike use. Of course, this process will be limited by the additional congestion and slowing of traffic on the alternative routes. Nonetheless, the decline in truck traffic over the shorter distances is a warning sign for the Turnpike as it plans to continuously raise tolls to pay for Act 44 debt issuance.

As mentioned above, the primary reason for the toll increases is to fund the Turnpike's obligation to PennDOT under Act 44 which currently stands at $450M. The Commission's strategy to issue debt every year to make the annual outlay and then use revenue from toll increases to cover added debt service payments has worked so far, but it is not sustainable.

In 2007, the year Act 44 went into effect, the Commission had $1.7 billion in Mainline bonds outstanding issued against toll revenue. By fiscal 2012 that amount had quadrupled to $6.7 billion. Keep in mind that the Commission also has bonds outstanding linked to their share of the Oil Franchise tax and the Motor License Registration fee (both for capital improvements on the Mon/Fayette Expressway and the Southern Beltway). In all the total debt outstanding at the end of fiscal 2012 reached nearly $8 billion. The debt issued to make the Act 44 payments are linked to the Mainline bonds, which are backed by toll revenues.

Debt service payments from the Mainline debt nearly tripled from $111.5 million to $313.3 million from 2007 to 2012, an increase of $201.8 million. Meanwhile, gross toll revenue during the period rose only $180.2 million. Thus, the rise in gross revenue, despite four toll hikes through fiscal 2012, did not keep pace with the jump in Mainline debt service. Looking at the change from fiscal 2011 to 2012, debt service climbed $44.7 million while toll revenue was up by only $33.9 million. To its credit, the Turnpike has focused on reducing expenses in order to make up for the revenue shortfall. However, the bottom line is that revenues from toll hikes are not keeping up with the increases in the Mainline debt service—and this does not bode well for the future. For instance, a major recession or extended period of economic weakness would likely lead to serious problems for the Turnpike's finances.

This is a very slippery slope for the Turnpike Commission. They need to keep raising tolls to keep up with the rising debt service payments resulting from the annual bond issue needed to satisfy their Act 44 requirements. While a substantial negative impact on overall traffic has yet to occur as a result of the annual toll increases, traffic has been flat, and there are warning signs that higher tolls could have significant negative impacts on short haul local commercial traffic.

At some point, and probably quite soon, the Legislature will have to amend the Act 44 provision requiring the Turnpike to pay PennDOT $450 million per year. Extracting more and more money from Turnpike users to subsidize other road and bridge maintenance has a limit of usefulness. There is a level of tolls at which there will be a reduction in the Turnpike's positive contribution to and support of the state's economy.

Frank Gamrat, Ph.D., Sr. Research Assoc. **Jake Haulk, Ph.D., President**

Allegheny Institute for Public Policy
305 Mt. Lebanon Blvd.* Suite 208* Pittsburgh PA 15234
Phone (412) 440-0079 * Fax (412) 440-0085
E-mail: aipp@alleghenyinstitute.org