# TESTIMONY ON PENNSYLVANIA TURNPIKE DEBT

## SENATE AND HOUSE TRANSPORTATION COMMITTEES

**Auditor General Jack Wagner**

**September 25, 2012**

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Department of the Auditor General
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Good morning, Chairman Rafferty, Chairman Wozniak, Chairman Geist, Chairman McGeehan and members of the Senate and House Transportation Committees. Thank you all for being leaders in advocating for infrastructure and transportation investments in Pennsylvania.

Also, thank you for the opportunity to discuss the Pennsylvania Turnpike Commission's ongoing debt problems, an issue I first spoke out about and communicated in writing about to the turnpike commission earlier this year.

As Pennsylvania's independent fiscal watchdog, the Department of the Auditor General is responsible for making sure that the tax dollars of hard-working Pennsylvanians are spent efficiently, effectively and for their intended purpose. The department audits government agencies and programs at the state and local level that receive state funds, and federal funds that are passed through state government.

The Department of the Auditor General issues thousands of audits each year, many of them mandated by state law. We audit the state's 500 school districts and 165 charter and cyber-charter schools, as well as the commonwealth's 650 liquor stores, 26 state correctional facilities, 14 universities under the State System of Higher Education, and thousands of municipal liquid fuel and pension funds, volunteer firefighter relief associations, local government offices such as magisterial district judges that collect funds on behalf of the state, as well as all executive branch agencies of state government.

That includes the Pennsylvania Turnpike Commission. Our June 2008 audit recommended that the Turnpike Commission appoint an executive-level safety director to coordinate and oversee all aspects of roadway safety and improve accountability. I made this recommendation after our audit found weaknesses in the turnpike commission's collection and analysis of accident data, making it difficult to accurately assess the turnpike's safety record. At that time, the responsibility for roadway safety on the turnpike was dispersed to various internal and external groups with no single administrator designated to hold ultimate operational responsibility. I believed and still believe that a lead administrator who is responsible for overall safety on the turnpike best serves the public and ensures accountability for safety. The Commission agreed with my recommendation and hired a safety director in September 2009.

From the opening of the National Road (Route 40) in the early 1800s to the 1940 opening of the Pennsylvania Turnpike, the nation's first superhighway, Pennsylvania has led the nation in transportation infrastructure, because we have long understood that these investments are vital to economic expansion.

However, in the last several years, we have lost that leadership role and our infrastructure has fallen into disrepair. Our bridges are crumbling and the condition of our roads has reached a crisis level.

Pennsylvania has nearly 6,000 structurally deficient bridges and 8,452 miles of highway rated as poor. According to Transportation for America, a Washington, D.C.-based advocacy group, 26.5 percent of Pennsylvania bridges are rated as structurally deficient, which is the highest percentage of any state in the country. In addition, the group says Pennsylvania has had the highest percentage of deficient bridges each year since 2007. And, according to a 2011 analysis by Mainstreet.com entitled, "The Worst Roads in the U.S.," Pennsylvania ranked as having the 8th worst roads in the country.

In November 2006, Gov. Ed Rendell's Pennsylvania Transportation Funding and Reform Commission identified a $1.7 billion annual shortfall in funding for the commonwealth's transportation infrastructure and mass transit services. In 2010, Gov. Rendell's State Transportation Advisory Committee produced a report that estimated the state's unfunded transportation needs at approximately $3.5 billion. The report stated that the gap is growing and will reach an estimated $7.2 billion in 10 years if nothing is done. The gap is growing because of continued decline in fuel tax revenue due to vehicle efficiency, reduced buying power due to inflation, and the Pennsylvania State Police's consumption of a bigger slice of the Motor License Fund.

To help address the need for additional funding, the General Assembly passed Act 44 on July 18, 2007, creating a "public-public partnership" between the Turnpike Commission and the Pennsylvania Department of Transportation to provide funding for roads, bridges and transit throughout the commonwealth. When it was signed into law by Gov. Rendell in 2007, Act 44 was declared by supporters to be a solution for the state's transportation funding problems. However, it has been insufficient to meet the state's needs while saddling the turnpike commission with debt.

In retrospect, this solution is the very definition of the cliché, "Robbing Peter to Pay Paul." Without the state having the ability to toll Interstate 80, Act 44 is not generating enough new revenue to comprehensively address our need for infrastructure investment – and it is saddling the Pennsylvania Turnpike with crushing debt that may ultimately fall on the shoulders of Pennsylvania taxpayers.

Under Act 44, a Lease and Funding Agreement was entered into by the turnpike commission and PennDOT on Oct. 14, 2007 for a period of 50 years, extending until 2057. This agreement fundamentally transformed the turnpike commission from a self-sustaining entity charged with operating and maintaining a toll road system, to one responsible for issuing and paying off debt for another state agency.

The funding agreement required the turnpike commission to make scheduled annual payments of at least $900 million to PennDOT for funding for roads, bridges and transit. The turnpike commission's obligation to pay the annual debt service on any special revenue bonds on a timely basis is also part of its payment obligation under the agreement. In addition, Act 44 gave the turnpike commission the opportunity to toll Interstate 80 in Pennsylvania as another source of additional revenue, pending approval by the Federal Highway Administration.

However, FHWA prohibited the tolling of I-80 on April 6, 2010, lowering the turnpike commission's funding obligation to $450 million a year, while leaving the commission with the options of raising turnpike tolls and increasing borrowing as the only funding mechanisms for meeting its funding obligations to PennDOT.

To pay for these required payments, the turnpike commission has had to issue debt and increase its tolls. In fact, the agency's long-term debt has increased by 181 percent, from $2.6 billion to $7.3 billion, since Act 44 was implemented. Since 2009 the turnpike commission's total net assets plunged 997 percent, from a surplus of $156 million to a deficit of $1.4 billion. (Net assets are total assets less total liabilities of an organization. Assets include things such as cash, equipment, investments and buildings; liabilities include things such as accounts payable, interest payable, bonds payable etc.).

The turnpike commission, with debt in excess of $7 billion and growing, is clearly drowning in debt due to the burdens placed on it by Act 44. Yet, when I sent a letter to Chairman Nutt this January expressing my deep concern about the commission's rapidly growing debt problem, I was told that the commission is "not facing financial crisis" and is "in a healthy position." I disagree, and the turnpike commission's own numbers support my belief.

According to the commission's August 2011 "Act 44 Financial Plan Amendment for Fiscal Year 2012," prepared by the PFM Group, the commission is projected to issue $10.1 billion in debt between fiscal years 2012 and 2057 to meet its capital needs and Act 44 obligations. Including the $3.4 billion it has already issued since Act 44 was signed into law, the turnpike commission estimates it will issue $13.5 billion to make the required Act 44 payments. However, the total debt service on this borrowing – interest and principal –is an estimated $32.3 billion. Putting that in perspective, $13.5 billion in debt is over one-third higher than the entire Commonwealth of Pennsylvania has accumulated in debt over two centuries of existence! And $32 billion of debt obligation is over 10 percent more than the commonwealth's entire budget for the current fiscal year. This is unacceptable.

As bad as this seems, it should be considered a "best case scenario" because when making this estimate, the turnpike commission assumes there will be years in which it will not need to issue debt, which I find hard to believe given the amount of the yearly payments along with its capital needs.

As the commission's debt increases, its bond rating is dropping. In 1998, the Pennsylvania Turnpike Commission was awarded with the highest bond rating of any turnpike agency at that time by one of three bond rating companies, and by 2008, this same bond rating company downgraded the Turnpike's bond rating, stating that it had "raised a caution flag about the Pennsylvania Turnpike's financial future because of the transportation funding bill that the state Legislature passed last summer [Act 44]."

I would argue that, with the passage of Act 44, the Pennsylvania Turnpike Commission has been placed in a position where its very existence is at risk because it can't continue to operate with significant increases in long-term debt and the continued serious depletion of assets caused by Act 44. In fact, the commission's own independent auditors stated in the May 31, 2010 audit report that "Act 44 is an operating, accounting, financial, and legal challenge for the commission."

Along with the rapidly increasing debt, turnpike travelers are dealing with continually increasing tolls. For drivers with an E-Z Pass, tolls have risen 31 percent since the enactment of Act 44. It's much worse for those travelers who pay with cash, as they have seen tolls increase a staggering 48 percent in less than five years.

In addition to the problems associated with Act 44, the turnpike commission is gambling with taxpayer money through risky interest-rate swap agreements.

A swap is a financial contract between two parties betting on which way interest rates will move. The party that guesses correctly gets paid and the party that guesses incorrectly must pay the other party. The amount of cash being swapped is determined by the size of the debt being financed by bonds with variable interest rates. The higher the debt, the costlier the bet.

My department conducted a review in 2010 of the turnpike commission's use of swaps. At that time, we found that the commission had more than $2.23 billion in debt tied to 26 active interest-rate swaps. If the Turnpike Commission had to terminate all of the swaps, it would lose $145.7 million, according to our review of the commission's financial report for the fiscal years ended May 31, 2009 and 2008.

At that time, I sent a letter to Joseph Brimmeier, the Pennsylvania Turnpike Commission's former chief executive, recommending that the commission stop using swaps. In my letter to Brimmeier, I asked the turnpike commission to stop using swaps, conduct its own financial assessment to determine the financial impact of its swaps, and to hire financial advisers through a competitive selection process. In 2009, the turnpike commission terminated several swaps and made other changes, and as a result its swaps position has drastically improved but I continue to urge them to unwind the rest of their swaps.

The fundamental guiding principle in handling public funds is that they should never be exposed to the risk of financial loss. Swaps have no place in public financing and I believe the General Assembly should ban them immediately.

In conclusion, Pennsylvania has a serious problem with its transportation infrastructure. It’s obvious that this issue must be addressed soon before we have a major tragedy like the bridge collapse in Minneapolis in 2007. Gov. Corbett’s Transportation Funding Advisory Commission released a report that included funding proposals to bring in $2.5 billion per year for infrastructure projects. Now is the time for the governor and the General Assembly to adopt a funding plan, while at the same time repealing Act 44, because the Pennsylvania Turnpike Commission cannot keep borrowing itself deeper and deeper into debt over the next 45 years.

I will end with one final thought in regard to the financial picture of the Pennsylvania Turnpike. All of you recall that not long ago Gov. Rendell tried to lease the turnpike, and the highest bid was $12 billion. Soon, the turnpike's debt will exceed its value. When your value is less than your debt, your financial future is bleak, and you are most likely headed for bankruptcy. Let us commit today to change the direction of our country's first superhighway and put it back on track to a sound fiscal future.

Thank you for the opportunity to speak today and I will be happy to answer your questions.

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