

I. Introduction: Factors Affecting the 2010 Enacted Biennial Highway Plan

In developing Kentucky's 2010 Enacted Biennial Highway Plan, a number of key concerns overshadowed the presentation of the final list of projects that comprise the Plan. Each of these issues helped to substantially shape the final product, and will likely continue to exert considerable influence upon the day-to-day execution of the 2011-2012 Biennial Highway Plan. A brief overview of each concern is provided in the following paragraphs.

A. The National Economy and Revenue Concerns

For the past few years, the national economy showed danger signs as construction indices and gasoline prices rose dramatically prior to 2008, then fell in equally dramatic fashion with the national economic downturn that began in late 2007. As gasoline prices skyrocketed, the housing “bubble” burst, unemployment jumped, and disposable household income dwindled, Americans used much less gasoline and bought fewer vehicles. Both the Federal Highway Trust Fund (HTF) and the Kentucky State Road Fund are heavily dependent upon gasoline tax revenues to fund basic highway programs. The State Road Fund is almost equally dependent upon the taxes generated by vehicle sales, and the highway-related revenues have been steadily worsening.

As federal revenues into the HTF have declined, Congress has had to infuse a total of \$15 billion in cash into the HTF over the past year just to keep it solvent. At the state level, the 2009 General Assembly “froze” the variable component of the state gasoline tax in order to keep revenues from “free-falling” by 4 cents per gallon in April 2009. These reactions to forces that threatened to return highway spending to pre-2000 levels were much-appreciated, but have created grave concerns about the future of fossil-fuel-based, “pay-as-you-go” highway tax systems. It is against this backdrop that the 2010 Enacted Biennial Highway Plan was developed.

B. Congressional Transportation Reauthorization

Federal transportation funding, and the rules governing the use of those funds, are traditionally set forth in a multi-year “authorization act” against which Congressional appropriations provide annual federal highway funding to the states through the HTF. The last Congressional authorization of transportation programs came in 2005 in the form of the “Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU).” That act was crafted to expire on October 1, 2009, and it has done so. Unfortunately, Congress has been unable to reach consensus on a new authorization act and, until that happens, funding is being made available to the states through a series of continuing resolutions. These continuing resolutions are very problematic as the authorized dollars have not materialized in the last two years, and the HTF has taken in considerably less revenue than expected. The states have seen a 20% reduction in federal funds and had other federal funds rescinded as SAFETEA-LU has run its course.

Congress is under extreme pressure to either create a new authorization act or formally extend SAFETEA-LU for several months while a new reauthorization bill can be developed. At this point, no one knows if federal highway funding will continue at recent levels or if it will fall to more “affordable” levels. One thing is certain: The highway needs across the country have not diminished, and any reduction in federal-aid highway funding will be very detrimental to the states' ability to keep the existing highway system in good shape, much less improve the safety and congestion issues experienced daily by roadway users.

C. State Road Fund Shortfalls

Kentucky's State Road Fund is statutorily established as the sole receptacle for dedicated revenues generated by state gasoline taxes and vehicle sales. While this has somewhat insulated the Road Fund from most of the State General Fund revenue shortfalls, it has also required that the Road Fund absorb all revenue declines through direct budgetary reductions. Thus far in FY 2009 and FY 2010, the Road Fund has experienced a \$265 million decline in anticipated revenues, necessitating that the Cabinet visit and revisit state cash flow considerations and the operating adjustments that must be made on a regular basis. Decisions about budget priorities, new project funding authorizations, and even active construction project construction have hung in the balance. The Cabinet's cash flow model routinely assesses income and outgo, and monthly adjustments are made on the basis of model projections. It is expected that the nature of today's revenue climate will continue to yield considerable pressure upon the resulting priority decisions for the use of Road Fund revenues at least through FY 2012.

D. Environmental Concerns

Recent changes in 401 KAR 10:030 Antidegradation Policy Implementation Methodology require that developing projects address protection of water resources. The regulation recognizes the General Assembly's authority for approval of projects in the Highway Plan. Projects are included in the Highway Plan only after a measured decision that the project enhances the quality of life, vitality of the Commonwealth and promotes the public good. The provisions of the amended regulation specify that the inclusion of a project in the Highway Plan satisfies the requirements for conducting an antidegradation socioeconomic benefit demonstration. Inclusion of a project is an indication of the General Assembly's conclusion that the reduction in water quality that may occur as a result of the project is acceptable given the socioeconomic benefits to be derived. Citizens who may be concerned regarding the potential for a project to affect water quality should provide information to their legislator for their consideration when evaluating projects for inclusion in the Highway Plan.

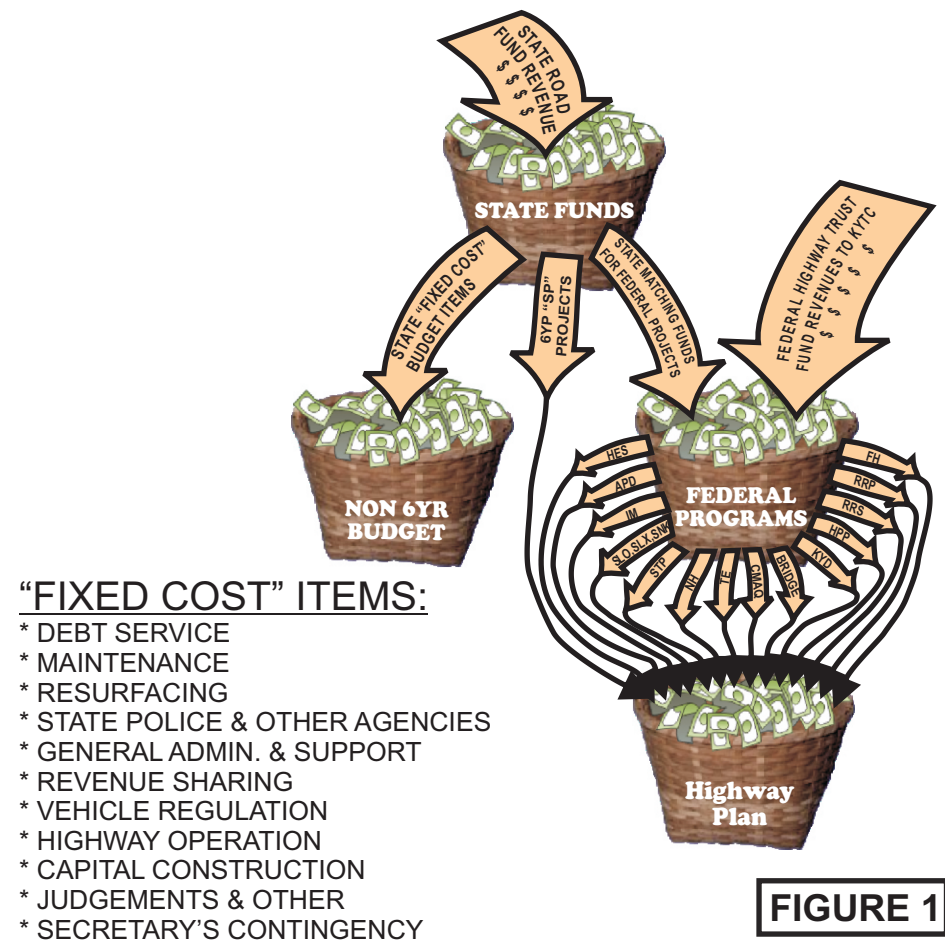


FIGURE 1

II. Revenue Estimates and Assumptions

One of the greatest challenges confronting the KYTC is “managing public expectations.” Highway maintenance costs are far from routine when a major bridge can cost \$200 million to replace, a mile of interstate highway pavement can cost \$5 to \$10 million to repair, and the overall identified highway needs across the Commonwealth total more than \$50 billion. In the face of these overwhelming basic needs, the 2009 Highway Plan was under-funded by over \$3 billion. In this funding environment, the public is often frustrated by our inability to meet all highway needs satisfactorily. Managing expectations is a difficult challenge when the needs are great and satisfaction is less than immediate.

The 2010 Enacted Biennial Highway Plan is predicated upon a number of assumptions about the revenue stream that is expected for future federal and state highway construction programs administered by the KYTC. An illustration of the funding process is shown as **Figure 1**, with the area of emphasis for this particular document being those funding elements that contribute directly to the Highway Plan. The discussion that follows is given as an overview of the scope and magnitude of these assumptions.

As shown in **Figure 2**, both federal and state Highway Plan revenue sources have been considered and projections made, based on the most reliable financial information available. The relative proportions of federal and state highway funds made available to the KYTC for major highway projects are displayed in **Figure 3**. These charts show that state road funds comprise less than one-fifth of the total dollars expected to be made available for major highway improvements in Kentucky in 2011 and 2012.

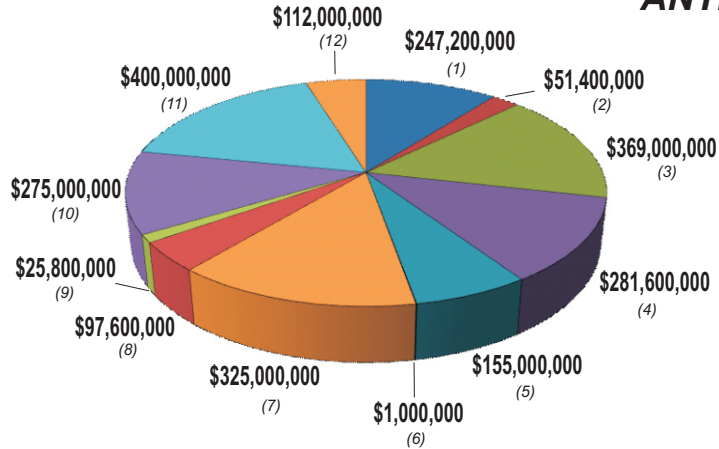
Consistent with past trends and current forecasts, this edition of the Highway Plan is being developed on the basis of the most recent federal transportation authorization act, SAFETEA-LU, and state revenue estimates consistent with projections made by the Consensus Forecast Group (CFG). The CFG is a committee of specially-designated experts whose revenue forecasts are used by the Executive Branch and the General Assembly to craft the biennial state budget.

It is important to note that the ability of the Cabinet to undertake major new state-funded projects is a function of available Road Fund cash and the careful management of Road Fund expenses “on the margin.” The Cabinet is committed to managing cash to a “floor” of \$100 million. The cash management process currently yields daily cash balances for internal use, and provides information for monthly meetings where estimated future cash outlays can be updated and project funding decisions can be refreshed. As the KYTC continues to gain experience with this process, our confidence is growing in both the methodology and the resulting cash flow decisions.

A. Federal Revenue Projections

The 2011 and 2012 federal revenue forecasts are based on a straight-line projection of the 2009 apportionments from SAFETEA-LU, the most recent transportation reauthorization act. SAFETEA-LU was enacted by the United States Congress in 2005 and provided identified levels of funding dedicated to each state through 2009. These state-specific levels of funding were broken down into individual program funding categories as determined by SAFETEA-LU's application to Federal Highway Trust Fund formulas. For the purposes of this edition of the Highway Plan, fiscal years 2011 and 2012 were assumed to be equivalent to those for FY 2009, the last year of

2011-2012 HIGHWAY PROGRAM ANTICIPATED FUNDING LEVELS



TOTAL ESTIMATED 2011/2012 HIGHWAY PROGRAM = \$2.3 BILLION

NOTE: FEDERAL-AID FUNDING LEVELS INCLUDE ANY PLANNED STATE MATCHING FUNDS.

*THESE ARE BOND FUNDS AND WILL BE AVAILABLE UPON THE SALE OF DESIGNATED BONDS.

FIGURE 2

FEDERAL AND STATE HIGHWAY FUNDING LEVELS AVAILABLE FOR OBLIGATION FROM 2010 THRU 2012

(as estimated by the Kentucky Transportation Cabinet)

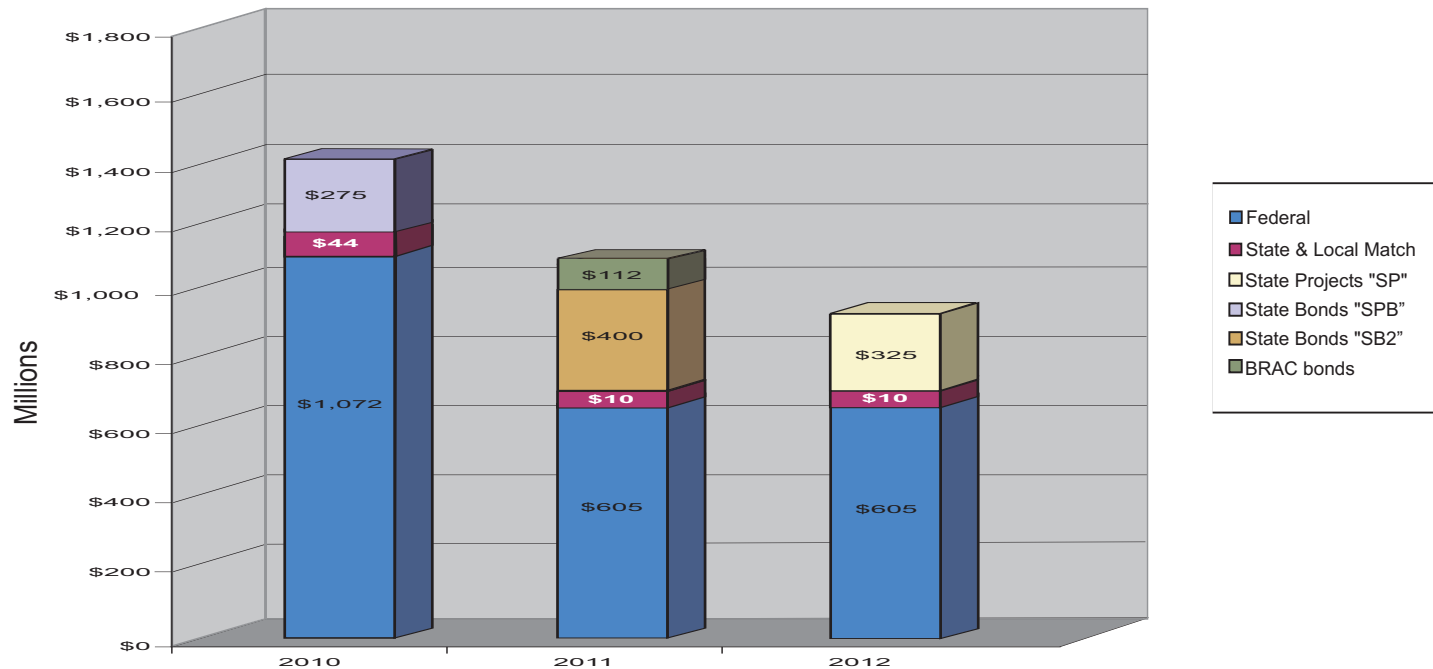


FIGURE 3

SAFETEA-LU. The 2009 Kentucky General Assembly also made available the option to use \$231 million of GARVEE (Grant Anticipated Revenue Vehicle) bond proceeds to support the Louisville Bridges Project (see Section III, Part C of this narrative) and another \$105 million of GARVEEs for the Louisville Bridges was made available by the 2010 General Assembly.

Figure 4 shows the final federal fund target amounts used to fiscally balance the 2010 Enacted Biennial Highway Plan. According to these estimates of category-by-category funding expectations, the total federal-aid dollars flowing to the Highway Plan in FY 2011 and FY 2012 is anticipated to be about \$1.2 billion. Combined with the remaining federal FY 2010 funds, the federal projects in this document total about \$2.3 billion. It is possible that the final federal appropriations may be altered significantly over the next two years if Congress fails to enact adjustments to the Federal Highway Trust Fund. Beginning in FY 2009, the projected Highway Account balance is below the amount needed to keep the program running at current levels and could result in a cut of 40% to FY 2010 funding levels alone. Such a reduction would return Kentucky's federal-aid highway program to pre-1998 levels. Each year that Congress allows the situation to continue, the problem will deepen. **It should be understood that all of the federal**

programs outlined in this edition of the Highway Plan are predicated upon the assumption that Congress will address the Federal Highway Trust Fund problem, as the failure to do so will lead to potentially catastrophic results to the nation's highway system.

Kentucky's federal highway program will be largely matched with "toll credits." These credits are attributed to Kentucky by federal highway law in accordance with calculations that consider past levels of state fund investment, such as state-sponsored toll roads, in the federal highway system. Toll credits do not generate cash and cannot be accounted as such. They do, however, permit the KYTC the

Funding Category	FY-2010	FY-2011	FY-2012	2010-2012 TOTAL FUNDING
Appalachian Development (APD)*	220.0 •	48.8	48.8	317.6
Bridge Replacement On-System (BRO)**	103.0 •	56.0	56.0	215.0
Bridge Replacement On/Off (BRX)**	19.0 •	9.9	9.9	38.8
Bridge Replacement Off (BRZ)**	19.0 •	11.6	11.6	42.2
Congestion Mitigation (CMAQ)**	26.2	12.9	12.9	52.0
Forest Highways (FH)	0.5	0.5	0.5	1.5
Interstate Maintenance (IM)**	130.0 •	123.6	123.6	377.2
National Highways (NH)**	157.0 •	140.8	140.8	438.6
Rail Protect. Devices (RRP)	1.2	1.8	1.8	4.8
Rail Separation (RRS)	2.0 •	1.8	1.8	5.6
Hazard Elimination (HES)	24.3	22.1	22.1	68.5
STP-Henderson (SHN)	2.5	0.5	0.5	3.5
STP-Louisville (SLO)	24.2	13.7	13.7	51.6
STP-Lexington (SLX)	14.1	4.6	4.6	23.3
STP-Northern Kentucky (SNK)	7.8	5.2	5.2	18.2
Surface Transportation (STP)***	175.0 •	147.2	147.2	469.4
Transportation Enhancement (TE)	12.8	13.3	13.3	39.4
High Priority Projects (HPP)****	134.9	0.0	0.0	134.9
Kentucky Appropriations Earmarks (KYD)****	42.8	0.0	0.0	42.8
Subtotal Federal Program	\$1,116.3	\$614.3	\$614.3	\$2,344.9

*Includes 20% state match

**Reflects 2% takedown for SPR; toll credits for match

***Reflects 2% takedown for SPR; 10% set aside for TE Program & inclusion of full Equity Bonus funds

****No projected estimated amounts for future Congressional HPP and KYD earmark funding

• Includes use of pre-financing (advance construction) techniques

FIGURE 4

flexibility to use 100% federal funding on federal-aid projects. By doing so, the KYTC can allocate more of its own funding for state “SP” projects under complete state control and supervision, as defined below in “Section III, Part B.”

B. State Project (“SP”) Fund Projections

A forecast of \$325 million in state Road Fund cash is expected to be available to support new “SP” project obligations over the life of the 2010 Enacted Biennial Highway Plan. This amount is based on a number of assumptions about project cost payouts, revenues accruing to the Road Fund, non-Six-Year Plan costs, state matching fund payouts, unexpected cost increases, and project change orders. It would be too exhaustive to attempt to describe each of these issues in detail and, for the purposes of this document, it is important to underline that the “SP” obligation targets derived through this model are only targets. The actual decisions about when to obligate “SP” dollars and how much “SP” work can be afforded at any point in time will be made by the Secretary of Transportation and based on monthly cash management evaluations he receives from the KYTC’s “Authorization Review Team (ART).”

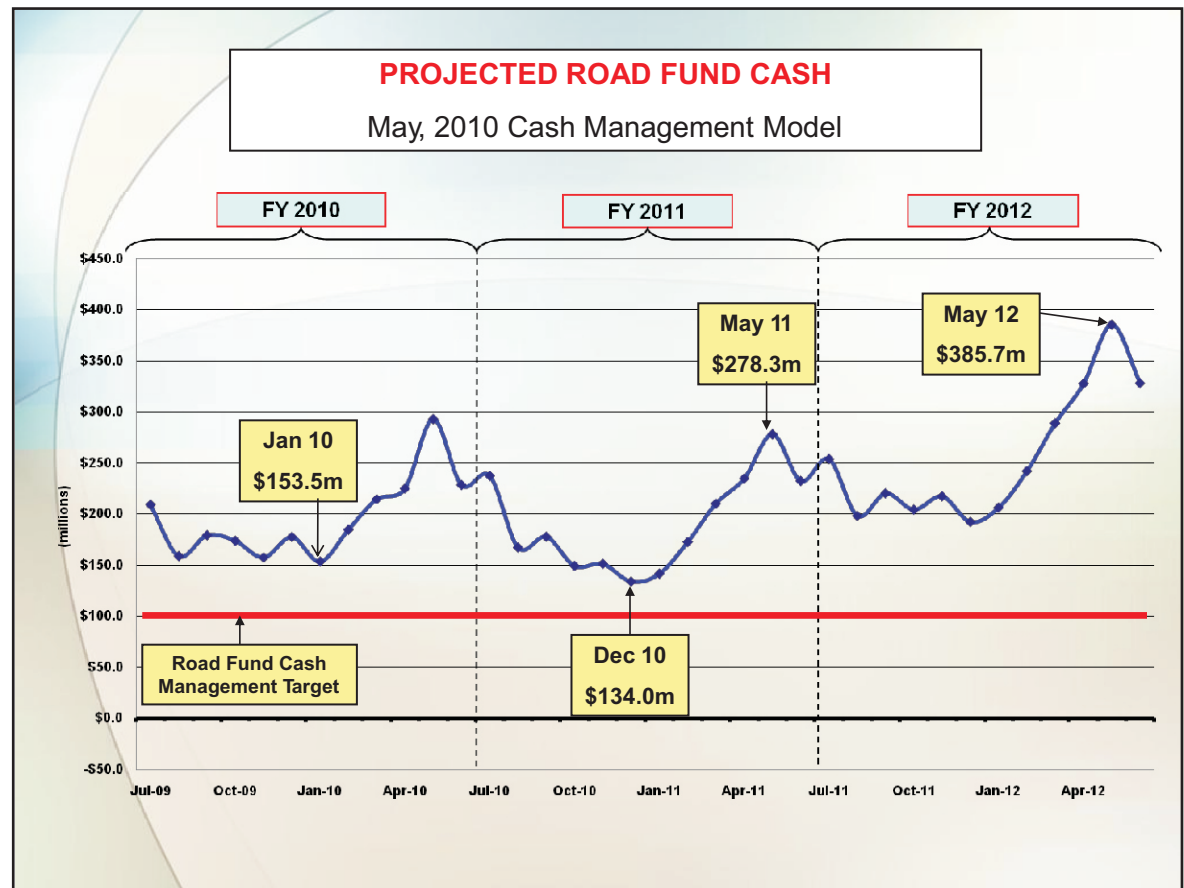


FIGURE 5

The ART consists of the Cabinet’s Chief of Staff, the State Highway Engineer and his deputies, and the KYTC Budget Director. These individuals meet on a monthly basis to carefully evaluate actual expenditures for the prior month and planned expenditures for upcoming months relative to the future fiscal capacity calculated from ongoing project and program cost projections. Every planned “SP” project funding decision undergoes a rigorous two-part assessment in which the following questions are asked: (1) is the project ready to move forward from the project development standpoint, and (2) can we afford to move the project forward considering the cash flow implications of doing so? Only a satisfactory response to both questions permits a project to move forward in the funding process.

During the past two years, the ART has permitted the authorization of \$1.24 billion in construction awards, as well as millions of dollars more in preconstruction, maintenance, and other highway program activities. **Figure 5** shows that the current monthly Road Fund cash balance is running at about \$180 million, but as already authorized project costs are paid in the months ahead, we expect to see a considerable dip in the cash availability. The ART is taking the necessary steps to reassess all planned program outlays and will determine the optimum manner to assure that appropriate levels of cash are maintained. Necessary actions may require the de-obligation of active projects, expedited closing of old, completed projects, or stretching out the payments for some of the larger projects being constructed. Our goal is to keep the cash balance at or near the \$100 million baseline.

In summary, all of the KYTC's best projections of revenues and program costs indicate that "SP" obligations will be minimal through 2011, with improvement beginning in 2012. The anticipated amounts for use on "SP" projects are as follows:

2011	\$0 Million
2012	<u>\$325 Million</u>
Total for Biennium	\$325 Million

In addition to the "SP" funds contained in this Highway Plan, the 2009 General Assembly authorized \$400 million of state bond projects to be financed in FY 2009 and FY 2010. The projects to be funded are identified by the acronym "SPB" and were over-programmed by the General Assembly by approximately 25% to allow for projects whose schedules may slip. Recognizing that federal programs are unstable due to the national economy, the 2010 Enacted Biennial Highway Plan is including an additional \$400 million of highway bonds to ensure that needed highway improvements can be pursued while the future of the federal highway program is resolved. The impact of this additional \$400 million in state bonds on the KYTC's debt service budget is shown on **Figure 6**.

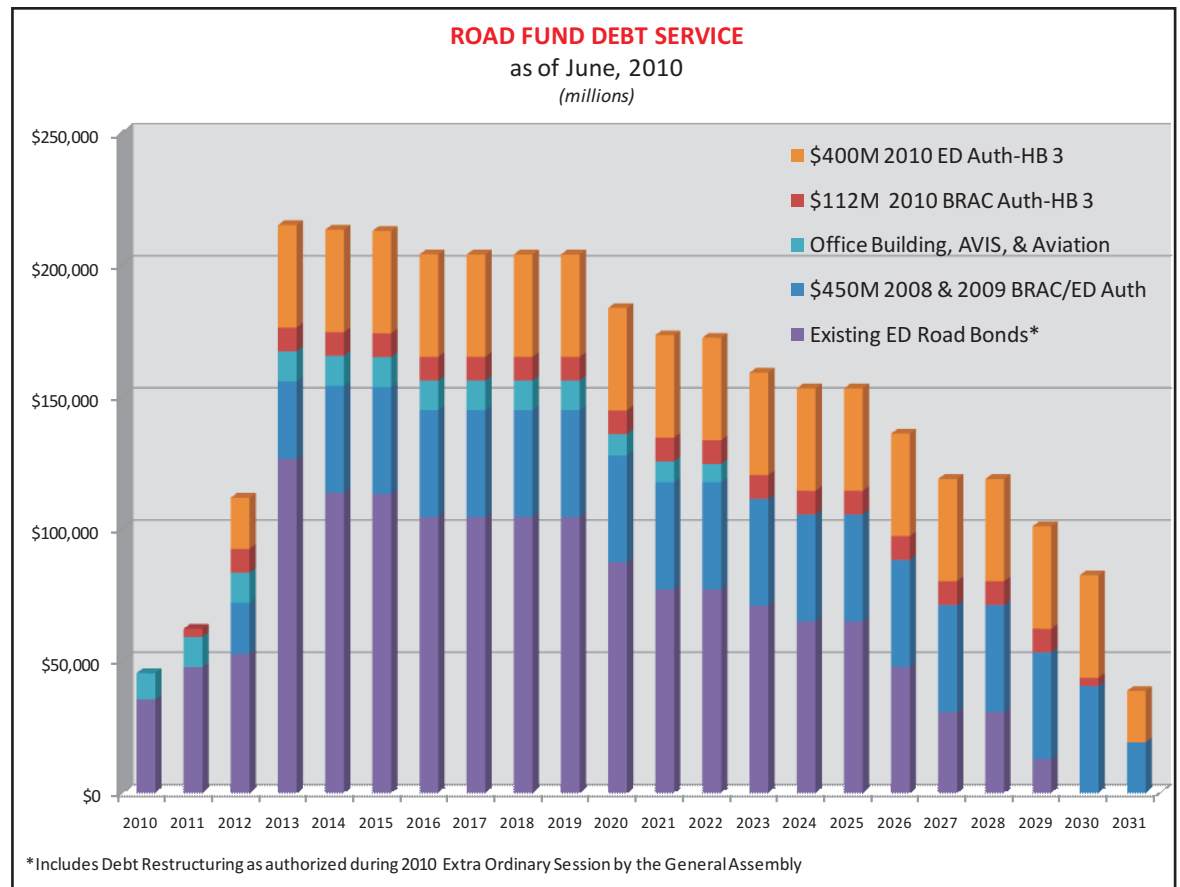


FIGURE 6

C. Federal and State Fund Interaction

Federal and state highway project funding for FY 2011 and FY 2012 totals \$2.3 billion. If we add the carry-over state and federal funding from FY 2010, the total revenue expectation that supports projects in this edition of the Highway Plan is \$4.1 billion. It is important to note that Kentucky has utilized federal pre-financing provisions heavily and continues to roll a consistent level of these carry-forward obligations from year-to-year. At the end of FY 2009, Kentucky had pre-financed some \$200 million in federally-funded projects, supporting the associated project billings from State Road Fund cash until the federal share of these costs can be billed to the federal government the following year. By using this funding mechanism, Kentucky has maximized its ability to return federal dollars to the state more quickly, while at the same time accelerating many federal highway projects. Federal pre-financing requires that the Road Fund keep approximately \$50 million on hand to cover the advance state fund outlays in support of the federal program acceleration. The Cabinet must continually monitor the “net cash balance” which results from month-to-month consideration of this federal program flexibility.

It is also important to note that the KYTC will explore all opportunities to use innovative financing options permitted under federal transportation law. In particular, we will seek to continue the use of GARVEEs (Grant Anticipated Revenue Vehicles) to accelerate federal funding of major projects where those projects buy essential improvements that we would otherwise have to save for to be able to afford. GARVEEs use the principle of guaranteed future federal-aid highway revenues as a mechanism to support the sale of revenue bonds for specific projects. The status of \$440 million of GARVEE projects authorized by the 2005 General Assembly is outlined in Appendix A of this document. As we look forward, it is the KYTC's goal to continue to exercise this program when prudent, such as our recent decision to use \$100 million in GARVEEs to support the Louisville Bridges Project. The funding horizon indicates that we may desire to use \$131 million of GARVEEs in 2010 to finance another portion of the Louisville Bridges Project. The 2009 General Assembly authorized the use of \$231 million of GARVEE bonds for the Louisville Bridges and the 2010 General Assembly authorized an additional \$105 million of GARVEEs for the Louisville Bridges project. In FY 2011 and 2012, GARVEE bonds will be needed to help finance the \$330 million necessary to fund the US 68/KY 80 bridges over Kentucky Lake and Lake Barkley. The projections for the debt service required for these projects in FY 2011 through FY 2012 are listed as appropriate in this document under Jefferson, Trigg, and Marshall Counties.

Appendix B of this document contains a report on the status of Road Fund bonds authorized by the 2009 General Assembly. This \$400 million in road bonds was sold for the expressed purpose of funding state priority projects, many of which had been presented in previous Highway Plans. These funds have not yet been fully obligated to projects.

Appendix C of the 2010 Recommended Highway Plan contains a status report for “Mega-Projects” that the KYTC is involved with at this time. These “Mega-Projects” are (1) the Louisville Bridges, (2) the I-75/71 Brent Spence Bridge in Northern Kentucky, (3) the proposed routing of I-66 through Kentucky, and (4) the proposed I-69 improvements through western Kentucky. A discussion of the funding and project development parameters for each “Mega-Project” is provided in Appendix C.

The Louisville Bridges Project has been under development for many years and has progressed to the point that substantial capital outlays will be required if this project is to continue forward to completion. The 2009 General Assembly provided for the creation of a bi-state authority whose purpose is to develop a reasonable funding concept for the Louisville Bridges. Much work is to be done to take

advantage of this opportunity as the bi-state authority looks for innovative ways to generate the \$4.1 billion necessary to fund the project. As mentioned previously in this section, the KYTC anticipates using \$231 million in GARVEE Bond proceeds to help support these costs during the FY 2010 and 2011. There is also an additional \$105 million of traditional federal Interstate Maintenance (IM) and National Highways (NH) funding which may be made available after the year 2010 to augment the use of GARVEE Bonds. We have also included in this Biennial Highway Plan \$132.5 million of “Innovative Financing” for this project that is expected to be provided through funding concepts developed by the aforementioned bi-state authority. For the Louisville Bridges Project, 2010 through 2012 funding amounts from all sources total almost \$468.5 million, and are tabulated in **Figure 7**.

As the 2010 Enacted Biennial Highway Plan was developed, it was recognized that the state-funded “SP” projects in the Plan do not match expected state fund revenues for FY 2011-2012. The “SP” projects in this edition of the Plan carry forward all previously enacted projects as the “SP priorities of record” to manage future revenues against. During the 2009 Legislative Session, the General Assembly prioritized over \$400 million of “SP” projects to be paid for with new state bond proceeds. These projects are listed with the fund source “SPB.” Even with the addition of two new years worth of state and federal funding, the revenue gap is still a huge problem and must be recognized as state and federal cost accountability issues are considered. To this end, the 2010 Enacted Biennial Highway Plan was developed with the decision to recommend an additional \$400 million of state bond sales. Projects prioritized under this heading are noted by the acronym “SB2.” The 2010 General Assembly also identified priorities for available remaining state funds in the biennium by using the acronym “SPP,” which stands for “State Priority Project.” Approximately \$370 million of “SPP” projects have been thus prioritized.

Of particular concern on the federal program side, is the application of “fiscal constraint” to the federal-aid highway element of the Highway Plan. The federal portion of the Plan is required by federal law to be fiscally balanced. Immediately upon completion of the state legislative process, the KYTC will seek to incorporate the subset of federal projects from the 2010 Highway Plan into a new Statewide Transportation Improvement Program (STIP) and present those to the Federal Highway Administration (FHWA) for approval. Fiscal constraint is an increasingly important consideration for federal agencies, and the STIP is the document through which fiscal constraint is measured. Any state legislative efforts that result in the over-programming of the federal element of the Highway Plan cannot be accommodated by

Louisville Bridges Projected Outlays (\$ Millions)				
TRADITIONAL FUNDS	2010	2011	2012	TOTAL
Interstate Maintenance (IM)	0.0	24.0	22.5	46.5
National Highways (NH)	0.0	29.4	27.5	56.9
Surface Transportation (STP)	0.0	1.6	0.0	1.6
GARVEE BONDS	99.8	131.2	0.0	231.0
TOTAL	99.8	186.2	50.0	336.0
INNOVATIVE FINANCING	2010	2011	2012	TOTAL
Innovative Finance (IF)	0.0	0.0	132.5	132.5
COMBINED FUNDING	2010	2011	2012	TOTAL
GRAND TOTAL ALL SOURCES	99.8	186.2	182.5	468.5

FIGURE 7

the federal rules governing the STIP process. Failure to gain FHWA approval would result in the suspension of the annual federal-aid program and its \$605 million (approximate) annual budget to Kentucky.

III. The 2010 Enacted Biennial Highway Plan

As mentioned throughout this narrative, the development of the 2010 Enacted Biennial Highway Plan requires the recognition of many factors which threaten both the fiscal balance of the document and the delicate balance that must be struck to maintain the condition of Kentucky's highways. In these financially difficult times, it is hard to define "reason"; whether looking to fund mega-projects or simply trying to determine a reasonable expectation for funding traditional types of projects. To achieve a highway program that has the potential to continue moving Kentucky forward, we have sought to consider the following concepts.

A. Maximizing Reasonable Opportunity

The 2010 Enacted Biennial Highway Plan represents a blend of managing expectations by perhaps underestimating the potential for a strong federal reauthorization while, at the same time, recommending a \$400 million state road bond issue to help keep the highway program moving in Kentucky if federal reauthorization doesn't come soon. We simply do not know if Congress will pass a highway reauthorization bill that lives up to, or even exceeds, the funding provisions of SAFETEA-LU. Having seen \$151 million of SAFETEA-LU funding promises rescinded by Congress in 2009 then returned in 2010, the only certainty is that nothing is "absolute" about the federal highway program at this moment. Accordingly, Kentucky has estimated that the federal program will move slowly along at least for another year or two as Congress sorts out a number of issues arising from the current national economic woes.

As we seek to maximize reasonable opportunities for the 2010 Enacted Biennial Highway Plan, we believe it is necessary to infuse \$400 million in additional state bond revenues into the funding mix to ensure that construction program funding levels can be maintained through the upcoming biennium. We are also optimistic about possibilities for the Louisville Bridges bi-state authority, and the potential for Kentucky and Indiana to work together to find a funding solution for this project. The 2010 Enacted Biennial Highway Plan is about maintaining highway program delivery during extraordinarily difficult times, while enabling maximum opportunity for success with less traditional, more innovative revenue options.

B. Program Sustainability: An Eye to the Future

Over the past five years, the KYTC has experienced "new highs" and "new lows" for construction program delivery. As **Figure 8** shows, the dollar volume of highway construction project awards increased dramatically in 2006 to \$1.0 billion, topped \$1.5 billion in 2007, and then plummeted to \$410 million in 2008. Even though we rebounded to near \$800 million in 2009, damage was done to an entire industry that geared up to absorb \$2.6 billion of work in two years, only to see the bottom fall out the very next year.

Although it is incredibly difficult to achieve, it is imperative for adequate industry competition and for competitive construction prices that KYTC work to establish a sustainable level of construction awards into the future. It is true that materials prices fluctuate and that buying power has decreased dramatically over time, but the industry needs to know that “feast or famine” is not our preferred course. The people of Kentucky deserve a highway construction industry that is capable of surviving economic downturns, and a consistent, coherent highway program is the best assurance that our highway infrastructure will be adequately maintained and improved into the next decade. Our goal is to target annual lettings to provide not only for the current year, but succeeding years as well. Through this strategy, we can sustain jobs and help keep this sector of Kentucky’s economy healthy.

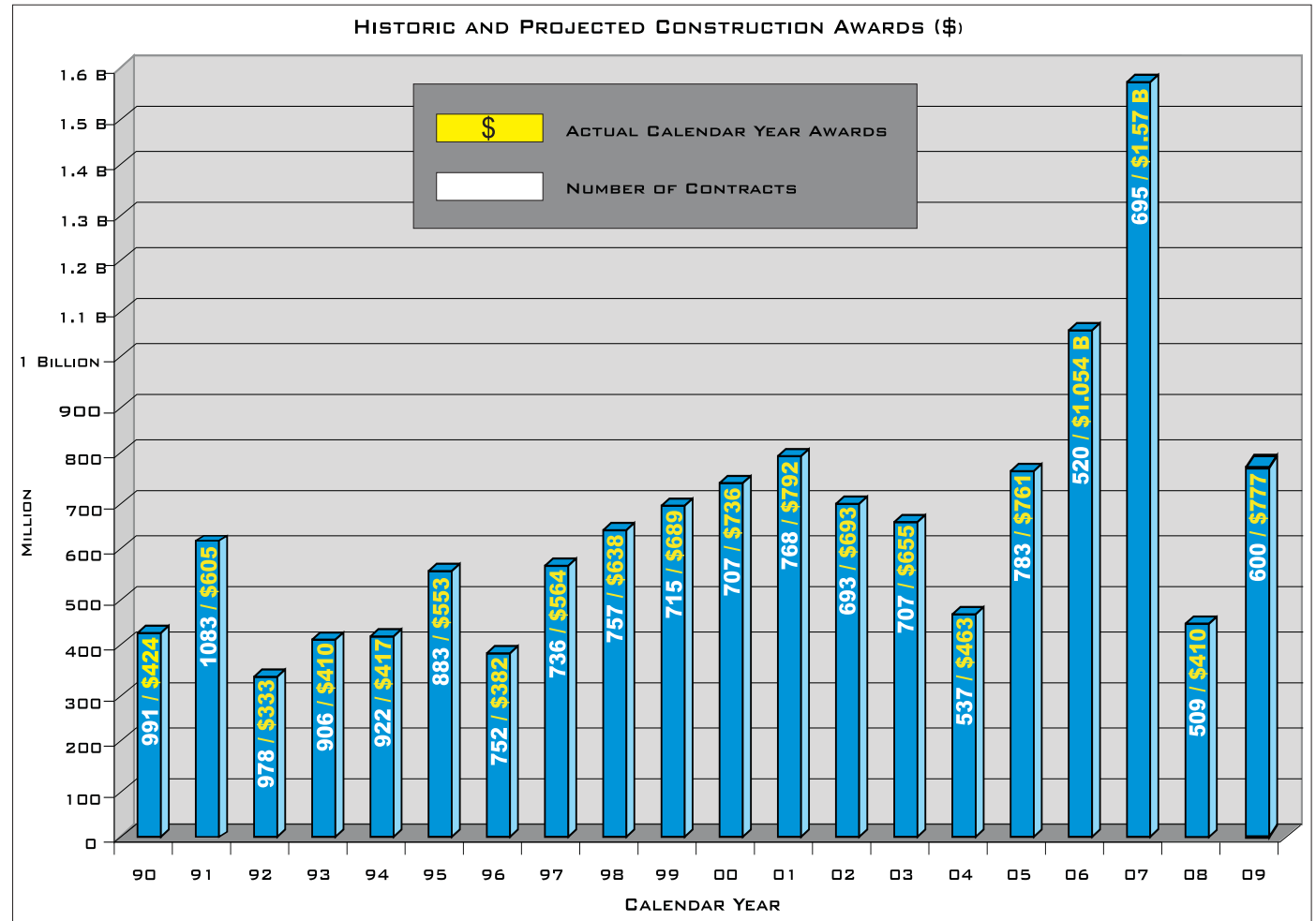


FIGURE 8

APPENDICES

Appendix A: “GARVEE” Status

Appendix B: 2009 State Bond (“SPB”) Program Project Status

Appendix C: Kentucky’s “Mega-Projects”