ASSET PRESERVATION ADVISORS

"Bridging the Gap"

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America's Crumbling Infrastructure

If you're considering a road trip this summer, you will likely see the signs of America's crumbling infrastructure first-hand. Aging roads, bridges and waterways across the United States have been on the decline for quite some time. We know that there is work to be done, the question is, how do we fund it?

Money In Your Pocket

If someone told you that they could put an extra $3,400 per year in your pocket, would you take it?

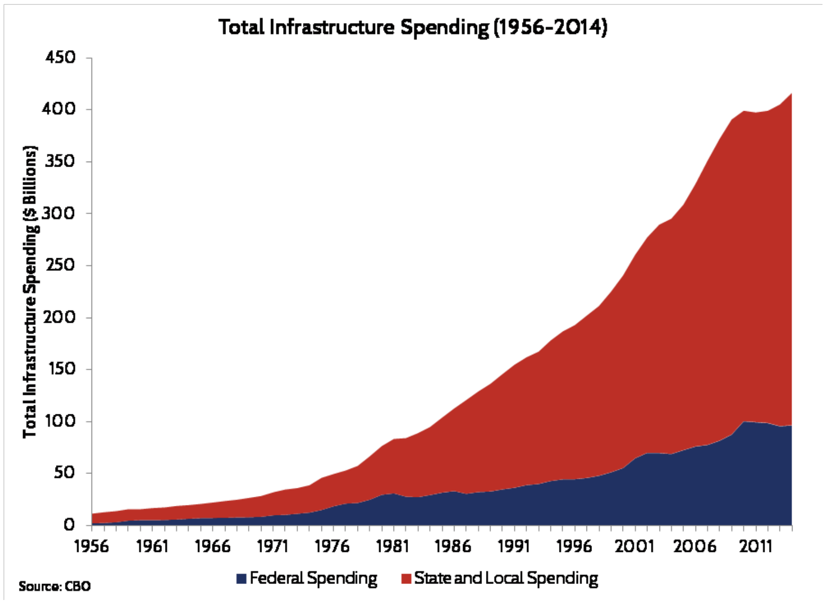
Americans are spending 5.5 billion hours in traffic each year costing $120 billion in additional fuel. Even more staggering is the $27 billion that American businesses are spending annually in extra freight costs and shipping delays. We are all directly and indirectly affected by the "underinvestment" in the American infrastructure costing each of us not only monetarily but also in excess time spent on the road. The Federal Highway Administration predicts that over the next 30 years, the number of trucks on the road will grow by about 60% in order to keep pace with business growth.

Infrastructure is defined as structures, systems and facilities serving a country, city or area, including the services and facilities necessary for its economy to function[1]. The last part of that definition, "necessary for its economy to function," should not go unnoticed. Without an efficient and updated infrastructure, the U.S. will not be able to effectively compete in world markets, and if Americans cannot transport people and goods as quickly and efficiently as our world competitors, we will be at a distinct disadvantage. The World Economic Forum ranks U.S. road conditions 18th in the world, down from 7th less than a decade ago. By spending excess time on the road, Americans face serious threats to quality of life as well as headwinds to future growth which directly impacts works economic standings. Without strong, non-partisan leadership in both the U.S. Congress and at local levels, this issue will get prodigiously worse as time goes on.

The Candidates Weigh In

The two presumptive nominees running for President share at least one view; they are both in favor of spending more on America's infrastructure improvements. Hilary Clinton has proposed the establishment of a national infrastructure bank, to be funded with $25 billion, potentially generating another $225 billion in direct loans, loan guarantees and credit issuance.

Donald Trump has not outlined any specific program at the time of this publication, but has indicated in multiple speeches his belief that spending on infrastructure is a "no brainer." While the views of the candidates have been under a spotlight during the race for the White House, the irony lies in that most infrastructure decisions are actually made by state and local officials. According to the Congressional Budget Office (CBO), public spending, including federal, state and local governments, transportation and water infrastructure, amounted to $416 billion in 2014, of which only $96 billion came from the federal government. In real terms, federal spending reflects an expenditure slightly higher than the historical average of $83 billion.[2]



The American Action Forum states that roughly three-quarters of total public spending on interstates is expended by state and local governments, net of federal grants.[2] This is a ratio that has held constant for the last 30 years. When adjusted for the federal monies diverted to mass transit, the fuel tax spending on land transportation has actually gone down.

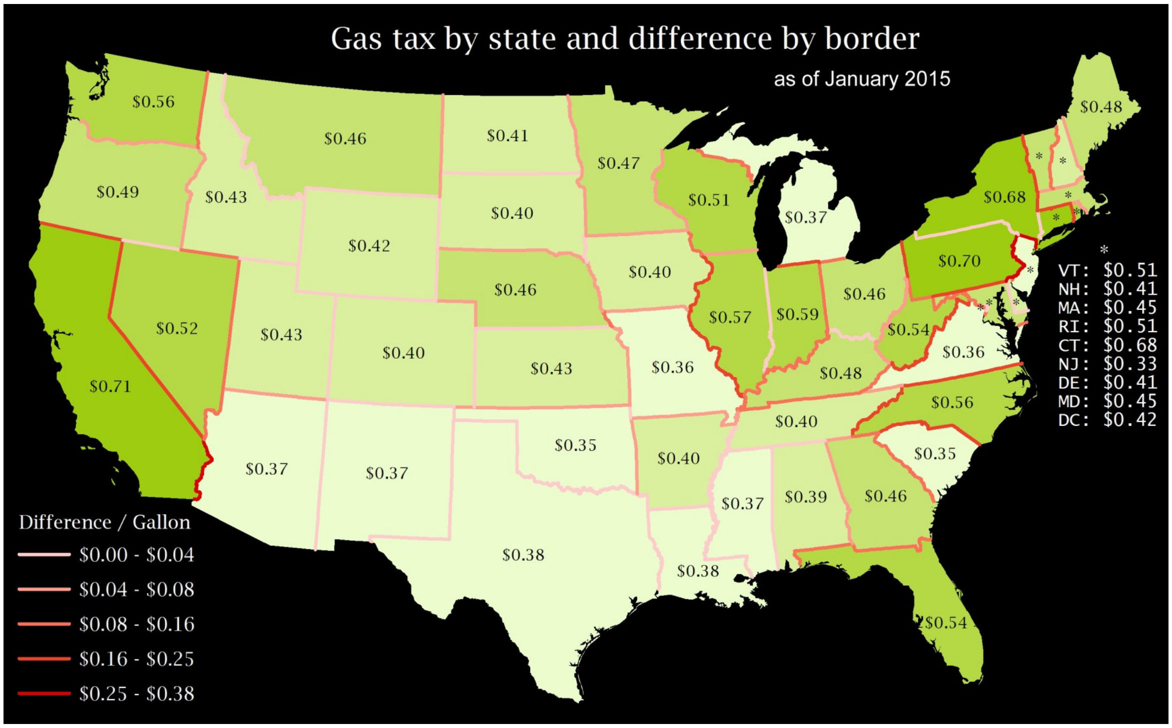
Where Will the Money Come From

The federal fuel tax has traditionally been a major source of funding for America's surface infrastructure improvement. In 1983, Reagan raised the federal fuel tax by 5 cents, creating a ruckus among conservative politicians, both Democrat and Republican alike. Currently at 18.4 cents per gallon, the federal fuel tax has not seen a rate increase since 1993. Generating approximately $34 billion a year[3], the proceeds of the federal fuel tax are mostly used for repairs, with very little allocated to accommodating the increase in road traffic. Throughout the years there have been many attempts in Congress to raise taxes on fuel, but given the anathema to tax increases, these efforts were ultimately defeated.

Using estimates provided by the American Petroleum Institute (API), Pennsylvania leads the nation with a state fuel tax of 50.4 cents per gallon. In Alaska, the average gallon of fuel is taxed at just 12.3 cents, the lowest in the nation. In the 15 years ending in 2014, 21 states made no changes whatsoever to their tax rates and only 5 states increased the rate by more than 5 cents per gallon.[4]

In our view, it is critical to separate the investment in road maintenance from that of capital spending. Much of the hundreds of billions of federal state and local spending is consumed by just keeping existing structures operating as smoothly as possible, not necessarily expanding these vessels. According to Joseph Kane, a researcher at the Brookings metropolitan policy program, many of our facilities are reaching the end of their useful life, "so by necessity we are pumping more money into operation and maintenance as opposed to capital projects."

Funding the Solution



Source: American Petroleum Institute (API)

Fuel tax revenues have served as the main source for infrastructure funding since the 1930s. However, according to the Energy Information Administration, the amount of fuel used in the U.S. in 2014 was 4% lower than the 2007 peak of 3.39 billion barrels a day. As a result, federal fuel tax collections have fallen. In 2013, some $19.4 billion in fuel taxes were allocated for highway spending, down from $21.2 billion in 2012. Not only are we driving less, but our cars and trucks are more efficient and battery powered vehicles have become increasingly more popular.

We conclude, that despite the need for sensitivity in fostering the growth of and the migration to renewable transportation options, a user fee might just be the most equitable answer to the problem. Yet, if history is any indication, the allocation of the proceeds of the fees and taxes may be even more important. According to David Stockman, former Director of the Office of Management and Budget, referring to the 5 cent increase in the federal fuel tax passed in 1983, "twenty percent of the nickel/gallon fuel tax increase went to mass transit, thereby breeching the 'user fee' principle at the get-go, and paving the way for endless diversion of fuel taxes to non-highway uses." Today, an estimated 40% of highway trust fund revenues go to mass transit, bicycle paths and other sundry earmarks and diversions.

Since the majority of spending on infrastructure occurs at the state and local levels, we conclude that the proceeds from any increase in the federal fuel tax implemented by Congress, should be sent back to the state and local governments to address their critical needs in new infrastructure and repairs of existing systems. With proceeds flowing back to the states, infrastructure improvement programs could benefit from a more efficient process, reducing the potential for diversion of funds to non-infrastructure uses, and placing the funds in the coffers of those making the decisions for the most critical infrastructure needs.

One Possible Solution

One possible solution to solving the U.S. infrastructure funding problem might look something like this:

- An increase in the Federal Fuel Tax totaling 20 cents, to be phased in over a three year period, which would raise about $33 billion per year and potentially support up to $700 billion in bond issuance. Additionally, user fees implemented for battery powered vehicles may be a small contributor in the near term, but would likely grow over time.
- The proceeds of the tax would be transferred directly to the states, with the stipulation that the funds only be used for surface infrastructure improvement or expansion. The states would then issue bonds with future payments as collateral.
- Bond structure would be non-callable but include a sinking fund provision in an effort to attract institutional buyers like pension or mutual funds.
- Given the fuel tax is regressive, the earned income credit for low income families would be adjusted.

Using public investment to drive economic growth– often derisively called "capital fundamentalism"- has long been out of favor among development experts. Looking forward, investment in infrastructure will be an important driving force for economic growth and an absolute necessity as our existing infrastructure fades.

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KWoods@AssetPreservationAdvisors.com, (404) 261-1333

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[1] Wikipedia The Free Encyclopedia; June 9, 2016; https://en.wikipedia.org/wiki/Infrastructure
[2] American Action Forum, Trends in Federal Infrastructure Spending; June 4, 2015; www.americanactionforum.org/research/trends-in-federal-infrastructure-spending/; accessed June 9, 2106
[3] The Hill, "Senate Bill Would Nearly Double the Gas Tax", August 6,2015; http://thehill.com/policy/transportation/250411-senate-bill-would-nearly-double-the-gas-tax
[4] American Petroleum Institute; www.api.org/oil-and-natural-gas/consumer-information/motor-fuel-taxes/gasoline-tax; accessed June 10, 2016