INFORMATION BRIEF
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Highway Finance

This briefing summarizes the basic finance structure for roads and bridges in Minnesota. Apart from some bonding, nearly all road funding is handled outside the state's general fund. Following a framework set in the Minnesota Constitution, revenue from three core transportation-related taxes—a motor fuels tax, a tax on vehicle registration, and a motor vehicle sales tax—is directed to transportation purposes. Bonds, along with federal aid, count among other notable sources. Highway funding distribution among state and local road systems involves multiple constitutional and statutory formulas.

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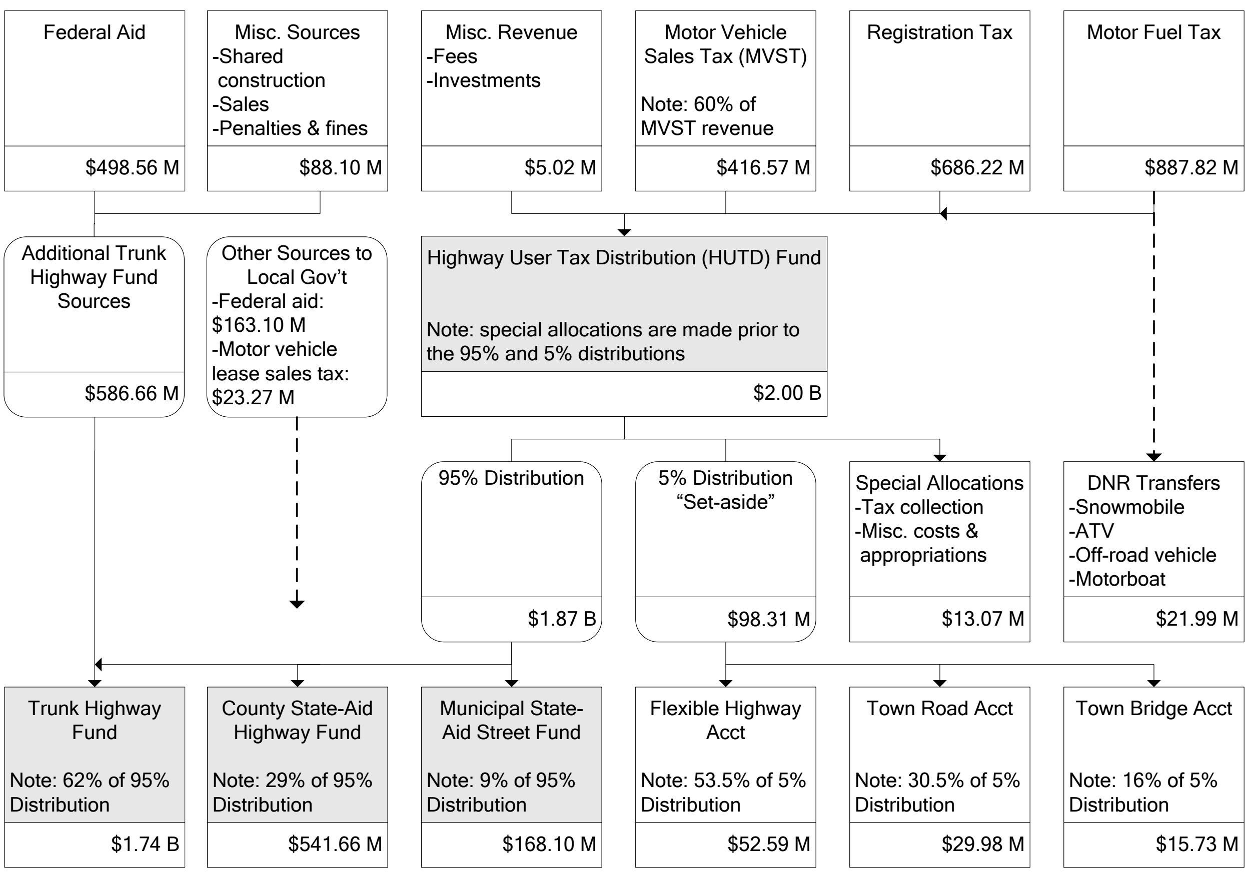
Constitutional Framework

The Minnesota Constitution is integral to the transportation finance structure, particularly as it establishes the framework for funding highways. It (1) dedicates a couple sources of funding to be "used solely for highway purposes," through authorized taxes on motor fuels, motor vehicle registration, and motor vehicle sales; (2) establishes accounting funds for transportation finance; (3) allocates tax revenues among state, county, and municipal roads; and (4) establishes requirements related to use of the funds as well as characteristics of each road system. Minn. Const. art. XIV.

Much of highway funding follows from a combination of formulas: a constitutional distribution provides for funding to both state and local road systems, and local funds are further allocated by statutory formulas (such as in aid distribution among counties). State statutes further specify fiscal policies such as taxation rates and program requirements for local aid.

Funding and Allocation Summary

The chart below summarizes the flow of highway funding from state and federal funds (using fiscal year 2015 amounts).



Notes: chart excludes $358.9 million in expenditures from trunk highway and other general obligation bonds, and (2) some federal funds for traffic safety and enforcement.

Highway Funding Sources

Motor Fuels Tax

The motor fuels tax is imposed at a per-gallon rate and collected from petroleum distributors. The tax rate varies across fuel classifications. The state tax rate is 28.5 cents per gallon for gasoline, which is the same for diesel and some gasoline blends. Minn. Stat. § 296A.07, subd. 3. The rate for other fuel types, such as E85 and compressed natural gas (CNG), is proportional to that of gasoline based on energy content of each fuel (although aviation fuels are not discussed here). The most recent rate change results from legislation passed in 2008 that phased in an 8.5-cent tax increase. Laws 2008, ch. 152.

Period	Rate per gallon (in cents)[1]
FY 1987-2007	20.0
FY 2008-2012	20.0 – 28.0 (various)
FY 2013 and after	28.5

Constitutional language dedicates tax revenue from motor fuel "used for propelling vehicles on the public highways of this state." Minn. Const. art. XIV, § 10. Revenue is handled in a couple of ways when the fuel is not used for transportation on public roads.

- Taxes paid on fuel used in nonhighway commercial operations, principally farming, are refunded.
- A portion of tax revenue—$22 million in fiscal year 2015[2]—is attributed to fuel use in nonhighway activities, such as operating ATVs and motorboats, and transferred into various Department of Natural Resources accounts related to those activities. Minn. Stat. § 296A.18.

Motor Vehicle Registration Tax

The state imposes a registration tax (also known as tab fees) on motor vehicles domiciled in Minnesota. The annual tax applies to passenger vehicles as well as trucks and other vehicles that use public streets and highways. A more significant exception is vehicles owned by government agencies (including school buses).

For passenger vehicles, the tax depends on the vehicle's original value as well as its age. Vehicles are taxed at (1) 1.25 percent of the *base value* multiplied by a *depreciation factor*, plus (2) $10.

- The *base value* is the manufacturer's list price (without options) for a particular make and model when the vehicle was new.

[1] Rates include a debt service surcharge (in some years) and exclude (1) a "blink on" fee of 2 cents per gallon for petroleum tank cleanup (imposed part-year based on an account fund balance), and (2) an inspection fee. Minn. Stat. §§ 115C.08, subd. 3; 239.101, subd. 3.

[2] This amount represents about 2.5 percent of motor fuels tax revenue for the year.

- The *depreciation factor* is a yearly reduction following a statutory schedule.

In the vehicle's first year of life there is, in effect, no depreciation. The depreciation factor is 90 percent in a vehicle's second year. It drops by 10 percentage points each year until its 11th year, when the formula changes from a percentage to a flat $25. Minn. Stat. § 168.013, subd. 1a. Hence the minimum on passenger vehicles is $35. Legislation in 2008 modified the schedule for depreciating the base value and eliminated caps on the amount of tax due. Laws 2008, ch. 152.

Trucks are taxed on the basis of weight and age. The tax on trucks and truck-tractors depends on weight, but includes a 25 percent reduction after eight years of life. Farm trucks pay a weight-based tax that is reduced after eight years of life. Buses are also taxed on weight, with depreciation beginning in the third year of life. Motorcycles have a flat tax of $10 annually. Minn. Stat. § 168.013.

Motor Vehicle Sales Tax (MVST)

The motor vehicle sales tax, or MVST, is a 6.5 percent tax applied to the sale price of new and used motor vehicles. Minn. Stat. § 297B.02. It is imposed instead of the general sales tax. Some older autos as well as collector's vehicles have flat tax rates instead. MVST is collected by auto dealers or when the vehicle is registered.

Historically, MVST revenue had been allocated both to the state's general fund and to transportation purposes, with periodic changes and suspension in the amount provided to transportation. Voters in 2006 approved a constitutional amendment that dedicates all MVST revenue to transportation purposes. The dedication phased in over fiscal years 2008 to 2012, and funds are currently distributed by statute between highways and transit. Minn. Stat. § 297B.09, subd. 1.

The Constitution also places allocation restrictions on the split between roads and transit, requiring that:

- "no more than 60 percent" of the revenue go to highways; and
- "not less than 40 percent" go to public transit assistance. Minn. Const. art. XIV, § 13.

Other Sources

Other notable sources of highway funding are as follows.

- **Federal aid** is a signficant funding source. It is provided through a number of federal programs that include formula-based allocations to the state as well as discretionary assistance. Fiscal year 2015 aid amounted to $661.7 million ($498.6 million for trunk highways and $163.1 million for local roads).
- The **motor vehicle lease sales tax (MVLST)** has been partially allocated to county roads as well as transit since fiscal year 2010 (and historically had gone entirely to the general fund). The tax is imposed on longer term leases of passenger vehicles and smaller trucks, at the same rate as the state's general sales tax (which is 6.875 percent,

of which 0.375 percent is constitutionally dedicated under the Legacy amendment). The funding share for county roads amounted to $23.3 million in fiscal year 2015.

- Additional **trunk highway fund sources** for the state's trunk highway system comes from various comparatively smaller sources, such as construction work performed under an agreement with local units of government, fees for permits, land and usable equipment sales, investment income, and fines.

Bonding

State bonds have historically been used to fund both state and local highway projects. There are several types of bonds, the most relevant of which are highlighted below.

- **Trunk highway bonds** are a specialized form of general obligation bonding and are constitutionally limited to capital projects that are part of, or functionally related to, the trunk highway system. Repayment of debt on the bonds comes from the trunk highway fund.
- **General obligation bonds** are sometimes provided for local roads and bridges, and are also known as local road and bridge bonding. (General obligation bonding is also regularly used for other transportation capital such as light rail and bus facilities.) The bond proceeds cannot be used for projects on the trunk highway system. Debt service is paid from the general fund. Minn. Const. arts. XI, § 5 (e); XIV, § 11.

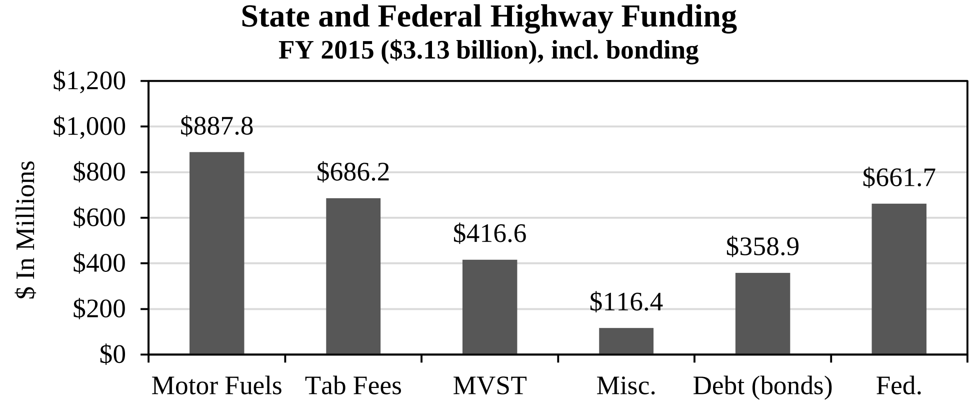
Since bonds carry an obligation of future repayment with interest, proceeds from bond issuances represent debt rather than additional or "new" revenue. Proceeds from bonds sales can nevertheless be viewed as a type of funding source. In fiscal year 2015, **bonding funds totaled $358.9 million** for state and local roads (primarily funding trunk highway system projects, at $318.2 million). This amount only represents funds *expended* in that fiscal year.

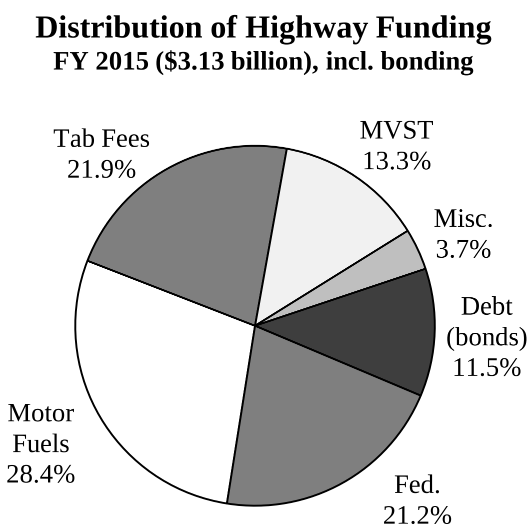
Legislative *authorizations* to issue bonds are distinct from expenditures and generally occur in a prior year. Projects can take place over multiple fiscal years following the year of bonding authorization, whereas associated bond proceeds expenditures reflect project costs in each year. (Bonds are issued based on anticipated cash flow needs of bond-funded projects, in amounts designed to cover upcoming project costs until the next bond sale.)

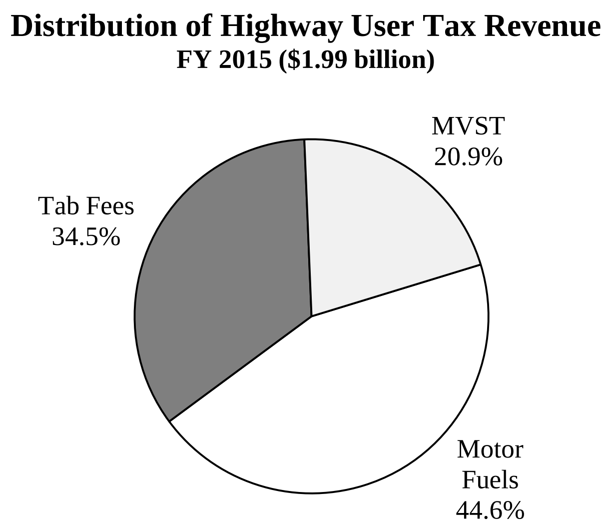
Another aspect worth highlighting about bonding is that paying off bonds takes place over the course of several years via taxes collected in the future. This can be compared to a "pay as you go" structure as with the primary transportation-related taxes. A key difference then, is in highway construction costs borne by the current populace (from current taxes) or a future populace (from future collections for debt service, which also reduces available funds for other projects at that time).

Highway Funding Levels

The charts below summarize fiscal year 2015 highway funding from both state and federal levels—for the trunk highway system as well as aid to local government. A couple treat debt (that is, bonds) as a form of funding.







Notes – all charts: (1) "Motor fuels" category includes revenue for fuel attributed to nonhighway uses; (2) "MVST" category only contains highway fundng; (3) "Misc." category is primarily trunk highway system revenue and includes some motor vehicle lease sales tax (MVLST) revenue; (4) both "Debt" and "Fed." categories include state and local funds; and (5) excludes some federal funds for traffic safety and enforcement.

Revenue Allocation

Constitutional Formula

Revenue from the primary state taxes (that is, the motor fuels tax and the motor vehicle registration tax, along with a portion of the motor vehicle sales tax) initially goes into the highway user tax distribution (HUTD) fund. The HUTD fund is constitutionally established and mainly serves as a passthrough in the distribution to other highway-related funds.

Following some transfers and special allocations (such as for tax collection costs), the bulk of HUTD fund money is allocated in two parts following a constitutional formula. Minn. Const. art. XIV, § 5.

95 percent distribution. First, 95 percent is distributed into dedicated highway funds, as outlined in the following table. This is a constitutional formula.

Percent	Allocation	Use
62%	Trunk highway fund	Trunk highway construction, maintenance, and administration
29%	County state-aid highway (CSAH) fund	County roads in the state-aid system; apportioned to counties based on two statutory formulas. Minn. Stat. § 162.07.
9%	Municipal state-aid street (MSAS) fund	City streets in the state-aid system; apportioned to cities based on a statutory formula. Minn. Stat. § 162.13.

5 percent "set-aside." Second, allocation of the remaining 5 percent of the HUTD fund is somewhat less constricted. Under the Constitution, the money is directed by law but must only go into the three core highway funds (the trunk highway fund, CSAH fund, and the MSAS fund). Funds are currently put into the CSAH fund and then divided as follows, based on requirements that are set in state statute. Minn. Stat. § 161.081.

Percent	Allocation	Use
53.5%	Flexible highway account	(1) Twin Cities metropolitan area county highways[3], (2) trunk highways being turned over to cities or counties, (3) safety improvements on local roads, and (4) routes of regional significance
30.5%	Town road account	Town roads; allocated to counties proportionally based on town road miles, to be distributed to towns. Minn. Stat. § 162.081.
16%	Town bridge account	Town bridges

Another constitutional provision specifies that the split within the 5 percent set-aside cannot be changed more than once every six years. The latest change went into effect July 1, 2009.

[3] Under a provision established in 2008, 50 percent of a portion in the flexible highway account must be allocated to counties in the Twin Cities metropolitan area. Based on the statutory language, the formula being used for distribution among Twin Cities metropolitan counties is proportionally based on population, but excluding the populations of Minneapolis and St. Paul. The portion allocated to metropolitan counties, identified as the "excess sum," is essentially a measure of new funding stemming from legislative changes to transportation finance made in the mid to late 2000s. The amount is composed of revenue within the flexible highway account resulting from: (1) the motor fuels tax at a rate above 20 cents per gallon (the tax rate on gasoline before the 2008 legislation); (2) new revenue from the registration tax above an amount collected in fiscal year 2008 and adjusted for inflation (designed to identify increased revenue due to changes made in 2008); and (3) MVST revenue above the amount yielded by the allocation to the flexible highway account in fiscal year 2007 (the last year prior to commencing a phase-in of all MVST revenue to transportation). Minn. Stat. § 161.081, subd. 3.

Motor Vehicle Sales Tax (MVST)

Since fiscal year 2012 (following the constitutional dedication phase-in), MVST revenue has been divided between highways and transit as follows. Minn. Stat. § 297B.09.

Percent	Allocation	Use
60%	Highway user tax distribution fund	State and local highways The funds are further allocated by the constitutional formula (as outlined above)
36%	Metropolitan area transit	Transit in Twin Cities metropolitan area
4%	Greater Minnesota transit	Transit in Greater Minnesota

Motor Vehicle Lease Sales Tax (MVLST)

Following allocation shifts in recent years, motor vehicle lease sales tax revenue is distributed as described below.

Portion	Allocation	Use
First $32 million	General fund	Nondedicated state revenue (a portion covers the requirements of the Legacy amendment)
50% of remainder[4]	County state-aid highway fund	Some Twin Cities metropolitan area counties[5]
50% of remainder	Greater Minnesota transit	Transit in Greater Minnesota

For more information about highway finance, visit the transportation area of our website, www.house.mn/hrd/.

[4] Forecasted fiscal year 2016 revenue is $26.1 million. (Actual distribution to counties is on a calendar year basis and will not match fiscal year collections.) From Minnesota Management and Budget, *Consolidated Fund Statement, 2015 November Forecast*, January 15, 2016.

[5] The funds are allocated separately from most state-aid dollars. Following state statute, revenue does not go to Hennepin or Ramsey counties and must be distributed proportionally based on the populations of the other five metropolitan counties. Minn. Stat. § 297A.815, subd. 3.