

The Outlook for Transportation Construction in 2003

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After a disappointing year in 2002, transportation construction should rebound in 2003, with highway construction growing 2 to 3 percent and other modes firming at recent high levels. Absent current state budget problems, we would anticipate even stronger growth based on the large increase in federal highway investment under TEA-21. But state cash management efforts last year may have delayed some highway construction during 2002 and the effect could repeat next year. Airport construction showed a modest increase in 2002 despite the impact of the events of September 11, 2001, and should at least maintain the 2002 pace next year. Construction work on subway and light rail projects took a giant leap in 2002 for the second year in a row and should also stabilize at or near the 2002 record construction level next year.

HIGHWAY CONSTRUCTION

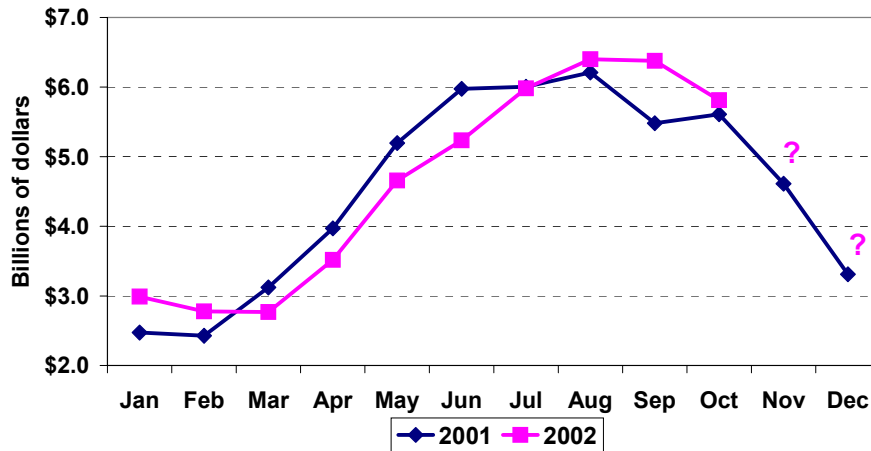
2002 has been a disappointing year so far for highway construction, but recent strengthening suggests the year may yet show a healthy increase over 2001. Through October 2002, the value of construction work performed on highway and bridge projects has shown a barely-perceptible 0.1 percent increase compared to the first ten months of 2001. This is well below the increase of 3 - 6 percent we had projected in last year's forecast. The weakness, however, was concentrated in the spring and early summer months. During the late summer, the pace of highway construction accelerated, and highway construction set new monthly records during September and October. The 2002 weakness has been concentrated in pavement construction, currently down about 1.4 percent compared to 2001. Construction work performed on bridges is actually up 4.2 percent compared to last year. Both markets are sharing in the late-season rebound.

We believe the construction shortfall so far during 2002 was largely the result of state efforts to control growing budget deficits and adjust to some temporary glitches in federal highway program funding.

State funds account for slightly more than half of all construction work performed on highways and bridges. Most state highway construction programs are financed from dedicated highway user fees, such as fuel taxes and vehicle registration fees, and thus are somewhat insulated from state budget problems. But states experiencing severe revenue shortfalls can buy time by delaying capital projects as a cash management technique. Most states operate on a July – June fiscal year. A temporary shift of highway construction work from their 2002 fiscal year into 2003 to balance state FY 2002 budgets would help explain weak construction during the March-June 2002 period shown in Figure 1 and the rebound starting July. Highway construction projects may also have been delayed in response to the delayed enactment of the FY 2002 transportation

appropriation act last year and the continuing uncertainty over the level of federal highway investment in FY 2003.

Fig. 1 - States May Have Delayed Highway Construction in 2002 to Balance Budgets



Source: ARTBA, Value of Transportation Construction Put in Place



Looking forward, if these were normal times, we would expect the strong growth of federal highway funding in FY 2001 and 2002, combined with trend-line funding at the state and local level, to generate 3-5 percent growth of highway construction in 2003. If Congress ultimately provides \$31.8 billion for highways in FY

2003, the same as FY 2002, growth would be at the high end of the range. If Congress only provides \$27.7 billion, the amount guaranteed in TEA-21, growth would be at the low end.

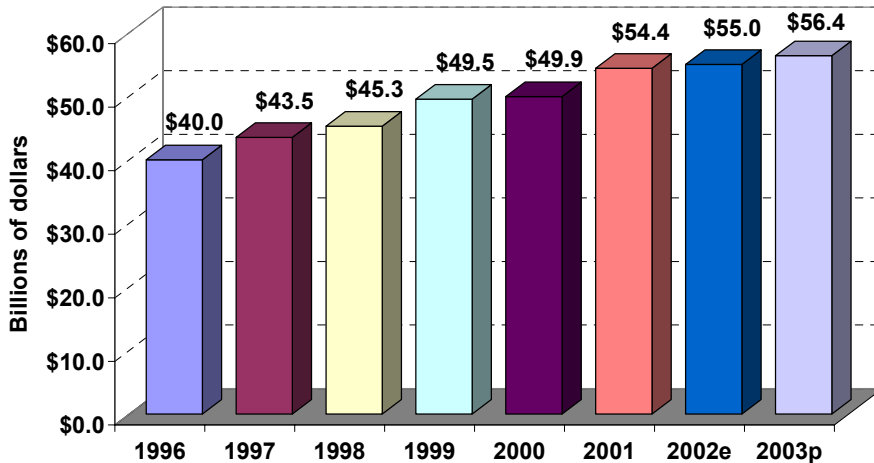
How could federal highway investment stabilize or fall in FY 2003 and construction nonetheless keep growing? Because, according to the Congressional Budget Office, federal highway investment has its strongest impact the year after the federal funds are appropriated to the states, as most highway projects take some time to plan and start. The \$4.5 billion RABA bonus in FY 2002 thus should help sustain highway construction in 2003, while FY 2003 highway funding should not have a major impact on construction until 2004.

But these are not normal times. The factors that may have weakened highway construction this year are still lurking in the wings. Foremost are the continuing budget problems at the state level. If the states react by delaying some highway construction to help alleviate budget pressures, the highway construction season in 2003 could be stretched thin as it was this year, repeating the pattern evident in Figure 1. An ARTBA survey of 25 of the larger state DOTs found that most states are trying to maintain level highway construction programs in 2003 or even provide some growth, which is encouraging. But with more than 30 states experiencing budget difficulties, no program is safe.

In addition, Congress has postponed final action on the FY 2003 transportation appropriation bill until January 2003 at the earliest and is, once again, portioning out highway funds a bit at a time under continuing resolutions. Furthermore, the ultimate

level of funding for FY 2003 is still up in the air. The fact that new contract awards for highway and bridge projects in October 2002 was about \$800 million less than in October

Fig. 2 - After Modest Growth in 2002, Highway Construction Should Grow 2-3 Percent in 2003



Source: ARTBA, Value of Transportation Construction Put in Place



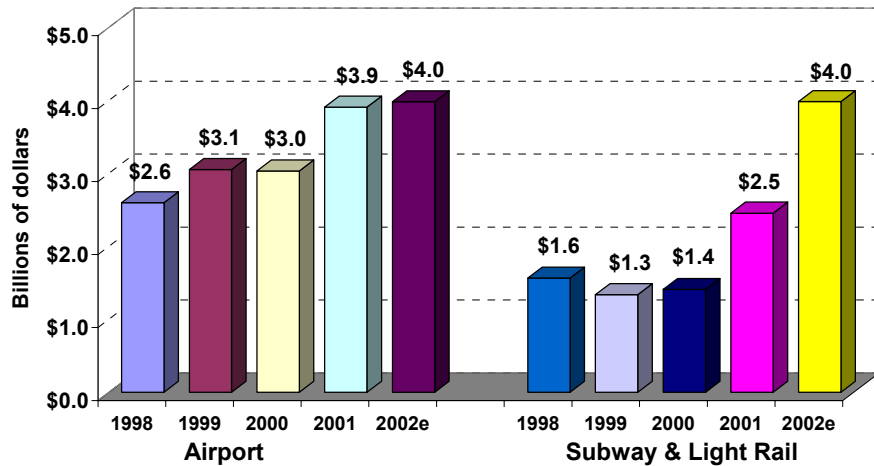
2001 suggests these federal funding problems continue to disrupt the highway construction process.

As a result, we anticipate modest 2-3 percent growth of highway construction next year to a level in the range of \$55-\$56 billion (see Figure 2).

AIRPORT CONSTRUCTION

The value of construction work on airport runways and related projects has grown 2 percent so far this year, following an impressive 30 percent increase in 2001 (see Figure 3). This is now a \$4 billion market. The growth of airport construction was propelled by the large Airport Improvement Program (AIP) funding increase in the Aviation Investment and Reform Act for the 21st Century (AIR-21)—from \$1.8 billion prior to

Fig. 3 - Airport Runways, Mass Transit Grow to \$4 Billion Construction Markets in 2002



Source: ARTBA, Value of Transportation Construction Put in Place



AIR-21 to an average of \$3.3 billion for FYs 2001 through 2003.

There was some concern that the decline in air travel following the events of September 11, 2001, would reduce the need for airport construction. The fact that construction work on airport runways and related projects

in fact rose this year suggests that the backlog of airport needs is severe enough to justify projects even with reduced air travel.

Looking forward, the good news is that Congress will provide \$3.4 billion for airport improvement grants in FY 2003 as promised in AIR-21. This should continue to support airport construction in 2003 and beyond. But airports channeled a significant chunk of their FY 2002 AIP money into airport security and will probably do the same in FY 2003. Hopefully, this will not have a big impact on construction but clearly it will have some impact.

MASS TRANSIT CONSTRUCTION

Subway and light rail construction has been a bright spot during the past two years, with the value of construction up 75 percent in 2001 and another 59 percent so far this year. For 2002, subway and light rail construction should total close to \$4 billion, equaling airport runway construction for the first time. Much of the construction increase is due to the solid growth of federal funding for mass transit under TEA-21.

Another year of spectacular subway and light rail growth would be unlikely. But a number of new projects have recently gotten underway, so this market segment should stabilize at the \$4 billion level or even show modest growth in 2003.