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Report to the Committee on Transportation and Infrastructure, House of Representatives

October 2020

FEDERAL-AID HIGHWAYS

States and Local Governments Reported Benefits to Federal Highway Fund Swapping, but Impacts Cannot be Definitively Determined

GAO-21-88

GAO

Highlights

Highlights of GAO-21-88, a report to the Committee on Transportation and Infrastructure, House of Representatives

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FEDERAL-AID HIGHWAYS

States and Local Governments Reported Benefits to Federal Highway Fund Swapping, but Impacts Cannot be Definitively Determined

Why GAO Did This Study

The Federal Highway Administration (FHWA) provides funding to states to build and maintain the nation's roadways and bridges. States must follow applicable federal standards such as laws that require contractors to pay locally prevailing wages. States can make federal funding available to local agencies for projects, but the ability of local agencies to comply with federal requirements is a well-documented risk area. Some states have established "fund swapping" programs where local agencies swap proposed federal funding with the state in return for state dollars. FHWA does not directly oversee these programs, and no federal statutes or regulations authorize or prohibit fund swapping.

GAO was asked to review swapping of federal-aid highway funds and its impact. In this report, GAO describes: (1) the extent to which states and local agencies engage in fund swapping; (2) factors affecting whether state and local agencies engage in federal fund swapping; and (3) what is known about the impact fund swapping has on prevailing wages paid to workers and other federal requirements. GAO reviewed relevant regulations and reports; sent a questionnaire to officials in 50 states; and interviewed officials from 15 state DOTs that reported having swapped funds in the past 5 years and 3 local agencies selected for program size and other factors.

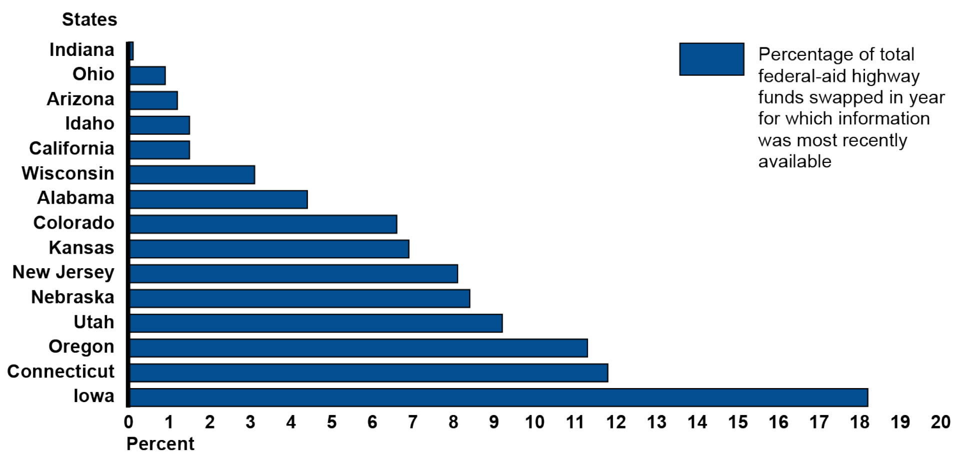
The U.S. Department of Transportation provided technical comments, which we incorporated as appropriate.

View GAO-21-88. For more information, contact Elizabeth Repko at (202) 512-2384 or repkoe@gao.gov.

What GAO Found

In the past 5 years, 15 states reported they had fund swapping programs, which allow local agencies, such as cities and towns, to swap their state's proposed suballocation of federal-aid highway funds for state transportation funds. This exchange allows local agencies to undertake local projects with state funds, rendering the projects subject to applicable state and local, rather than federal, requirements. For most states, the reported amount of federal funds swapped is a relatively small portion of the state's overall federal-aid apportionment, ranging from less than 1 percent to 12 percent. However, Iowa swapped about 18 percent (or about $97 million) of its federal-aid funds in 2019. See figure.

Percentage of States' Federal-aid Funds Swapped for State Funds



Source: GAO analysis of information from state DOT officials and FHWA data. | GAO-21-88

Note: Data are for 2019, except for Alabama, Colorado, New Jersey, and Wisconsin where GAO presents the most recent data these state DOT officials had available.

Officials GAO interviewed from state departments of transportation (DOTs) and selected local agencies said that they participate in fund swapping because it increases project flexibility for local agencies and may result in time and cost savings. Obstacles officials cited included a lack of sufficient state funds to swap with local agencies and the absence of state law authorizing fund swapping.

The impact of fund swapping on wages and other federal requirements cannot be definitively determined because, among other reasons, state DOTs generally do not track data needed to measure these impacts. For example, state officials said that federal funds swapped by local agencies are combined with other federal funds, so they cannot identify which projects were funded with swapped federal dollars. State officials offered mixed views of the impact of swapping on workers' wages and other federal requirements. For example, officials in two states that told GAO their states do not have prevailing wage laws said wages paid were not impacted by the lack of federal prevailing wage requirements because of economic conditions in their states. Officials in two other states said that the lack of a state prevailing wage law potentially enabled contractors to pay their workers less than the federal prevailing wage on swapped projects.

Contents

Abbreviations

CMAQ	Congestion Mitigation and Air Quality Improvement
FAST Act	Fixing America’s Surface Transportation Act
FHWA	Federal Highway Administration
FTA	Federal Transit Administration
DBE	Disadvantaged Business Enterprise
DOT	Department of Transportation (of a state)
HSIP	Highway Safety Improvement Program
KDOT	Kansas DOT
NHFP	National Highway Freight Program
NHPP	National Highway Performance Program
STBG	Surface Transportation Block Grant
STIP	Statewide Transportation Improvement Program
TMA	Transportation Management Area
U.S. DOT	U.S. Department of Transportation

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October 20, 2020

The Honorable Peter DeFazio
Chairman
Committee on Transportation and Infrastructure
House of Representatives

The Honorable Abby Finkenauer
House of Representatives

Each year the Federal Highway Administration (FHWA) provides around $40 billion to the states to build and maintain the nation's roadway and bridge infrastructure.[1] While states primarily administer federal-aid highway funding through their state departments of transportation (DOTs), states may choose to designate funding for federal-aid projects to be administered by local agencies such as cities, towns, and counties. In these instances, states are responsible for ensuring that local agencies adhere to applicable federal statutes and regulations. These statutes and regulations contain provisions governing design and construction of projects and administration of contracts. Other federal requirements include the Davis-Bacon Act, which requires employers to pay locally prevailing wages to laborers on federally funded construction projects,[2] and the "Buy America" provision applicable to federal-aid highway projects.[3] In January 2014 we reported that around 7,000 local public agencies were administering billions of dollars annually for federal-aid projects, according to FHWA.[4]

We also reported in 2014 that the ability of local public agencies to comply with federal requirements was a well-documented risk area and identified a range of concerns, including issues concerning the quality of

[1]Fixing America's Surface Transportation Act (FAST Act), Pub. L. No. 114-94, §1101(a)(1), 129 Stat. 1312, 1322 (2015).

[2]Davis-Bacon Act, Pub. L. No. 71-798, ch. 411, 46 Stat. 1494 (1931). (codified as amended at 40 U.S.C. § 3141 et seq.).

[3]The Buy America provision applicable to federal-aid highway projects generally requires that the iron, steel, and manufactured products used in those projects be produced in the United States, subject to a few exceptions. 23 U.S.C. § 313; 23 C.F.R. § 635.410.

[4]GAO, *Federal-Aid Highways: Federal Highway Administration Could Further Mitigate Locally Administered Project Risks*, GAO-14-113 (Washington, D.C.: Jan. 16, 2014).

construction and administration of contracts on federally funded, locally administered projects. Our report also discussed efforts to address these challenges, including a funding exchange, or fund swapping, program initiated by the Kansas DOT (KDOT).[5] In Kansas, federal-aid was distributed to cities and counties based on formulas established by the state. Under the funding exchange program, local agencies were given the option of swapping their proposed portion of federal funds for state funds, and KDOT then used the federal funds for projects on the state highway system. According to KDOT, the funding exchange program allowed the state DOT to have more federally-funded projects administered by state officials, who were generally more knowledgeable about federal requirements than local officials. We reported that other state DOTs had expressed interest in developing such programs for local agencies in their states.

You asked us to review the prevalence of federal-aid highway funding exchange programs and the impact it has on local economies. This report (1) describes the extent to which state and local agencies engage in federal fund swapping and the categories of federal funds and types of projects that tend to be involved; (2) identifies factors officials cited that affected whether state and local agencies engage in federal fund swapping; and (3) examines what is known about the impacts fund swapping has on the payment of prevailing wages and the application of other selected federal requirements.

To address each of these objectives, we distributed a questionnaire to each of the 50 state DOTs.[6] We received a 100 percent response rate. We also conducted semi-structured interviews with officials from 15 state DOTs that we determined currently swap federal-aid highway funds and state transportation funds or have done so in the past 5 years.[7] Through these interviews, we collected testimonial evidence from the state DOT

[5]The terms “fund exchange program” and “fund swapping program” are commonly used to describe programs in which state agencies use state aid to fund local projects and reserve federal aid for state administered projects. We use the terms interchangeably in this report.

[6]We did not include the DOTs in Washington, D.C. and Puerto Rico in our survey because Washington, D.C. does not have any local agencies to which funds can be suballocated, and Puerto Rico has been responding to damage caused by Hurricane Maria.

[7]We reviewed swapping programs in states that swapped at some point since 2016. One state began a fund swapping pilot initiative in 2016 and also swapped funds in 2017; some states swapped in 2018, but no longer do, and one state began swapping in 2020.

officials on the amount of federal funds they swapped. We selected four states that swap funds—Connecticut, Ohio, Utah, and Iowa—for a more in-depth analysis of how local agencies within those states use swapped state funds. We selected the four states to include both states with a relatively large and relatively small FHWA annual apportionments compared to other states and states that had a state level prevailing wage law and those that did not. Within each of those four states, we selected one local agency that recently implemented transportation projects funded using swapped funds. We interviewed officials from three of the local agencies.[8] We also interviewed representatives from construction firms and unions involved in fund swapping in our selected states and local agencies, as well as representatives from relevant national associations representing local agencies and professionals involved with fund swapping, and officials from FHWA headquarters and three FHWA state Division Offices. In addition, we reviewed relevant federal laws and regulations, including federal and state prevailing wage laws; FHWA documentation on federal-aid funding; and various state DOTs' documentation that explained their fund swapping programs.

We conducted this performance audit from September 2019 to October 2020 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

The Fixing America's Surface Transportation Act (FAST Act) authorized about $41.5 billion of formula funding annually for fiscal years 2016 through 2020 for the federal-aid highway program through which states receive federal funding to build and maintain the nation's roadway and bridge infrastructure.[9] The federal-aid highway program is an umbrella term encompassing a collection of formula and nonformula grant programs. Seven formula grant programs comprise about 92 percent of the total funding authorized by the FAST Act for the federal-aid highway

[8]From the four selected states, we interviewed three local agencies and obtained relevant documentation from a fourth local agency.

[9]FAST Act § 1101(a)(1).

program (see table 1 for the five core, that is, highest-funded formula grant programs).[10]

Table 1. FAST Act Federal-aid Highway Core Programs

Federal-Aid Highway Programs	Description
National Highway Performance Program (NHPP)	NHPP is the largest of the federal-aid highway programs and supports improvement of the condition and performance of the National Highway System, including interstates and nearly all other major highways.
Surface Transportation Block Grant Program (STBG)	STBG has the broadest project eligibility and can be used on any federal-aid highway, bridge projects on any public road, transit capital projects, and on routes for nonmotorized transportation.
Highway Safety Improvement Program (HSIP)	HSIP supports projects that improve the safety of road infrastructure by correcting hazardous road locations or making road improvements.
Congestion Mitigation and Air Quality Improvement Program (CMAQ)	CMAQ funds projects and programs that may reduce emissions of transportation-related pollutants.
National Highway Freight Program (NHFP)	NHFP funds freight-related projects to help states remove impediments to the movement of goods.

Source: GAO analysis of Congressional Research Service information | GAO-21-88

Note: Fixing America's Surface Transportation Act (FAST Act), Pub. L. No. 114-94, 129 Stat. 1312 (2015).

The Surface Transportation Block Grant Program (STBG) is one of the largest and the most flexible of the federal-aid highway formula programs, according to FHWA. Apportioned at nearly $12 billion per year, STBG funds can be used on any federal-aid highway, bridge projects on any public road, transit capital projects, and on routes for nonmotorized transportation, among other things.[11] State DOTs are required to suballocate between 51 and 55 percent of their STBG funding among areas of the state based on their population relative to the total state population.[12] Specifically, these funds must be suballocated among three area categories based on population: (1) areas with a population of 5,000 or less, (2) areas with a population of 5,001 to 200,000, and (3) areas

[10]The other two formula grant programs are the Metropolitan Planning and the Railway-Highway Crossing Programs.

[11]23 U.S.C. § 133(b)-(c), (f).

[12]23 U.S.C. § 133(d). The exact percentage is set by statute and depends on the year. *Id.* § 133(d)(6). However, before the amount of suballocated funding is calculated for each year, state DOTs are required to set aside a certain amount of funds for State Planning and Research and Transportation Alternatives (e.g., pedestrian and bicycle paths). *Id.* §§133(h), 505(a).

with a population greater than 200,000, which are also called Transportation Management Areas (TMAs). [13] For the first two population categories, the funds do not have to be allocated to particular recipients, such as cities or counties, as long as the required amount of funds is expended in each of the population categories. Therefore, if a state has four areas with a population of between 5,001 and 200,000, the state may expend the funds in any one of those areas, in all four, or anything in between. However, for the third category, each individual TMA in a state must receive a portion of the TMA category's suballocation in proportion to its relative share of the aggregate population of all of the TMAs in the state.[14] The remaining STBG funds that are not suballocated among areas of the state based on population may be expended in any area of the state, and are sometimes referred to as STBG discretionary funds.[15]

Under federal law, states select which projects will be federally financed.[16] There are several requirements that states and local agencies must satisfy for their projects to be eligible for federal-aid highway funds. For example, state and local agencies must provide matching funds, which are usually 20 percent of a project's cost. Also, at least every 4 years, each state is required to prepare a Statewide Transportation Improvement Program (STIP), which lists the surface transportation projects within the state for the next four years; the proposed categories of funding, both federal and non-federal, for each of those projects; and which agency, state or local agency, will administer those projects.[17] The STIP must include both capital and non-capital surface transportation projects proposed for federal funding and all regionally significant projects requiring an action by the FHWA as well as all regionally significant projects proposed to be funded with non-federal funds. FHWA is to review and approve the STIP to ensure the proposed projects are "fiscally constrained" – that is, that sufficient federal, state, and local funds are

[13]*Id.* §§ 133(d)(1)(A), 134(k)(1)(A); 23 C.F.R. §450.104.

[14]23 U.S.C. § 133(d)(4).

[15]*Id.* § 133(d)(1)(B). The state must set aside from these remaining funds that may be expended in any area of the state a fixed amount for off-system bridges (i.e., highway bridges located on public roads that are not federal-aid highways). *Id.* § 133(f). After this set-aside, the remaining STBG funds may be expended at the state DOT's discretion on any eligible activity or project anywhere in the state.

[16]23 U.S.C. § 145(a).

[17]23 U.S.C. § 135(g); 23 C.F.R. §§ 450.104, 450.218.

available to undertake proposed projects.[18] Once approved, the state generally selects which projects in the STIP will be subsequently scheduled and implemented.[19]

When using federal-aid, state DOTs must also comply with federal statutes and regulations applicable to federal-aid highway projects, including ensuring that projects adhere to applicable design and construction standards, and follow applicable requirements regarding the advertisement of competitive bids, awarding of contracts, acquisition of property, construction administration, and others. One of these requirements is the Davis-Bacon Act, which requires construction contractors on federally funded highway projects to pay their on-site workers at least the locally prevailing wage.[20] Another is the Buy America provision that generally requires that the iron and steel used in federal-aid highway projects are produced in the United States.[21] Also, states must comply with disadvantaged business enterprise (DBE) program requirements, which generally require states to set and meet overall goals for the use of small businesses owned and controlled by socially and economically disadvantaged individuals in DOT-assisted contracts. [22]

While states primarily administer their federal-aid highway funding, they may choose to designate funding for federal-aid projects to be administered by local agencies such as cities, towns, and counties.[23] According to FHWA, each state handles federal highway funds based on its own procedures. Some states provide federal funds to local agencies by formula or other means while, in other states, the state DOT administers most of the federal funds. When local agencies receive federal funds, these agencies must follow all applicable federal and state

[18]23 C.F.R. §§ 450.218(m), 450.220(b). The Federal Transit Administration (FTA) also reviews and jointly approves the STIP with FHWA. 23 C.F.R. § 450.220(a)).

[19]*Id.* § 450.222(b)-(d).

[20]40 U.S.C. § 3142(a)-(b). A prevailing wage is the sum of an hourly wage rate plus the amount of fringe benefits that is prevailing for on-site laborers and mechanics working on similar projects in the same local agency. *Id.* §§ 3141-3142; 29 C.F.R. § 1.1(a). Prevailing wages determined under the Davis-Bacon Act are not the federal minimum wage set under the Fair Labor Standards Act.

[21]23 U.S.C. § 313; 23 C.F.R. § 635.410.

[22]FAST Act § 1101(b) (codified as amended at 23 U.S.C. § 101 note); 49 C.F.R. pt. 26.

[23]For more information, see GAO-14-113.

laws,[24] and states are responsible for overseeing and ensuring that the local agencies' expenditure of federal-aid complies with those laws.[25] Also, federal law requires a state to determine that a local agency to which it is providing funds has adequate project delivery systems to perform the project it is undertaking and sufficient accounting controls to properly manage project funding.[26] In contrast, when state DOTs provide state funds to local agencies for transportation projects, local agencies must comply with applicable state and local laws rather than the federal laws that would have applied if they had used federal-aid highway funds.

Federal fund swapping programs are arrangements in which state DOTs allow local agencies to exchange their state's proposed suballocation of federal-aid highway funds for state transportation funds. By swapping funds, local agencies complete a project with state funds instead of the federal funds that state DOTs have traditionally given local agencies. When swapping occurs, local agencies must comply with applicable state and local requirements, and not federal requirements, which, as we have reported, may be less or more stringent than the federal requirements.[27] Concurrently, the state DOT applies the swapped federal funds to projects administered by the state, and, as a result, the state administers a greater amount of federal funds apportioned to it than it would have before the swapping occurred. As we reported in 2014, state DOTs tend to be more familiar with federal-aid requirements than local agencies since states regularly administer federal-aid projects.[28]

Fund swapping programs generally share a number of common characteristics. For instance, to establish a fund swapping program, states generally have enacted legislation that authorizes fund swapping or developed guidelines and policies governing fund swapping in the state, or both.[29] States must also ensure they have sufficient state funds

[24] 2 C.F.R. § 200.101(b)(1); 23 C.F.R. § 1.9.

[25] 23 U.S.C. § 106(g)(4); 2 C.F.R. § 200.331(d).

[26] 23 U.S.C. § 106(g)(4).

[27] GAO, *Federal-Aid Highways: Federal Requirements for Highways May Influence Funding Decisions and Create Challenges, but Benefits and Costs Are Not Tracked*, GAO-09-36 (Washington, D.C.: Dec. 12, 2008).

[28] GAO-14-113.

[29] Some states have also developed a pilot project or signed a memorandum of understanding to establish a fund swapping program.

to provide local agencies in exchange for the local agency's proposed suballocation of federal-aid. Many states have large state-funded highway programs that provide sufficient funds for swapping. [30] Additionally, states generally establish an exchange rate to swap state funds with federal funds. For example, some states provide local agencies 90 cents of state funds in exchange for $1 of federal funds, while others have a dollar-for-dollar exchange rate.

According to FHWA, because no federal statute or regulation expressly authorizes or prohibits fund swapping programs, the agency does not play an active role in fund swapping programs or directly oversee these programs.[31] States determine which projects will be federally financed and must include this information in their STIPs because only the projects in an approved STIP are eligible for federal-aid highway funding.[32] After a state's STIP is approved, the state submits the plans and cost estimates for projects from the STIP to FHWA for its formal approval of federal-aid highway funding. FHWA then executes a project agreement with the state that constitutes its legal obligation to pay the state for the federal share of the approved project's cost.[33] FHWA remains accountable for ensuring that the federal-aid highway program is efficient and effective, and administered consistent with applicable statutes, regulations, and policies.

[30]According to FHWA, in 2013, the latest year for which data are available, the federal government funded 45 percent of highway capital expenses, and the remainder was funded through state and local sources.

[31]There is pending legislation that would authorize states to implement fund swapping programs, provided that they have state laws comparable to the Davis-Bacon Act and federal Buy America requirements and that those comparable state laws apply to the projects that would have been federally funded if not for the fund exchange. H.R. 2, 116th Cong. § 1106(b) (2020). Furthermore, the bill would require the U.S. DOT to publish on its website the amount and type of program funds swapped each year. *Id.* § 1106(a).

[32]23 U.S.C. § 145(a); 23 C.F.R. §§ 450.218(i)(3), 450.222(a).

[33]23 U.S.C. § 106(a) (b).

Since 2016, Fifteen States Reported They Swapped a Portion of Federal Funds to Administer Local Road and Bridge Projects

From 2016 through 2020, 15 states reported they swapped federal-aid highway and state transportation funds. In 2019, the amounts of federal funds the state reported swapping for state funds to be given to local agencies ranged from about $4.5 million to about $97 million.[34] Officials from five state DOTs told us that individually they swapped about the same amount of federal funds annually. However, officials from four state DOTs said their swapped amounts varied from year to year.[35] For example, officials from Indiana DOT told us that while they swapped funds in 2016, for two consecutive years after that, they did not swap at all, because sufficient state funds were not available. Also, officials from Connecticut said they swap about $45 million to $74 million in federal funds annually.[36] Swapped federal funds constituted a relatively small percentage of a state's total federal-aid apportionment in 2019, ranging from less than one percent to about 12 percent, according to state DOT officials and FHWA data. However, one state, Iowa, swapped about 18 percent (or about $97 million) of its federal-aid funds in 2019, its first year of swapping. This is about 50 percent more than the next closest state, Connecticut, which swapped about 12 percent of its federal-aid funds (about $64 million) in 2019.[37] See figure 1.

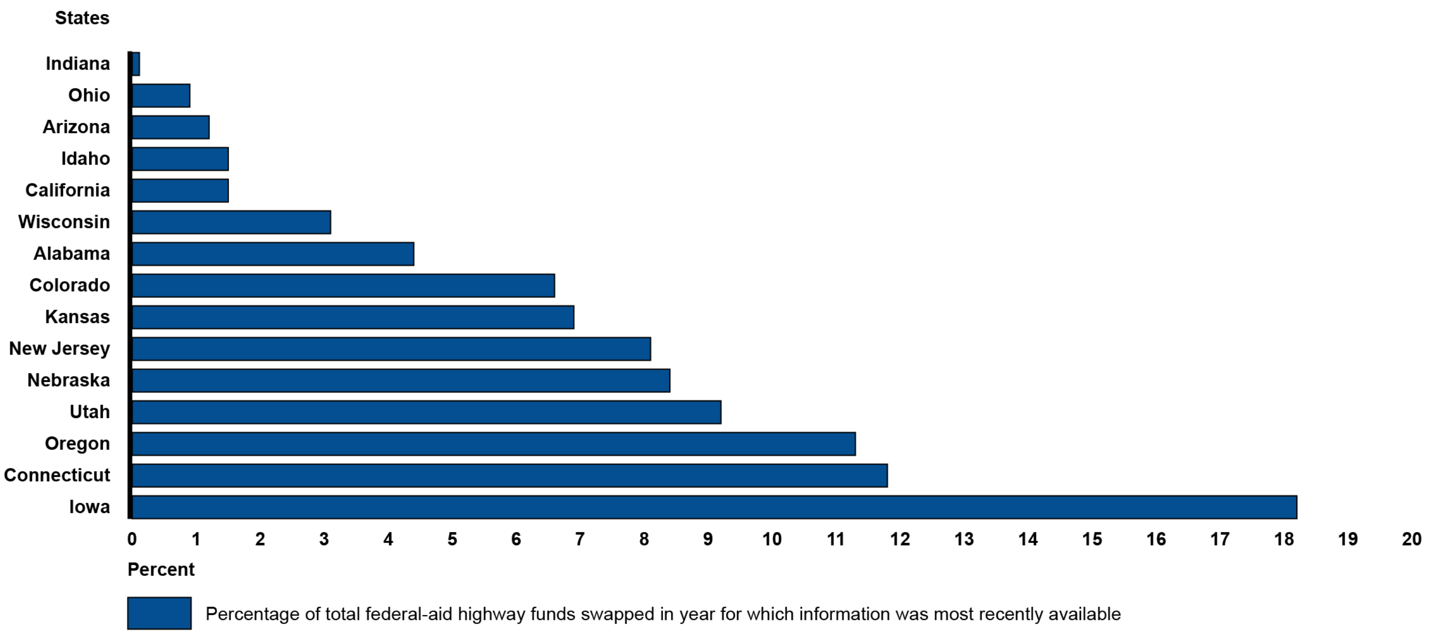
[34]The figures listed are the federal funds that state DOTs swapped from local agencies. Unless there is a dollar for dollar exchange rate with the local agency, the federal dollar amount that state DOTs received will be higher than the state dollar amount that local agencies received in exchange.

[35]The other six state DOTs reported differing experiences. One state DOT began swapping funds in 2016 for 14 projects under a pilot program; a second state DOT ended its fund swapping program in 2018 after swapping funds for 1 year; a third state DOT has two fund swapping programs—swapping the same average amount of federal funds annually in one program and swapping varying amounts annually in the other program; a fourth state DOT began swapping funds in 2019 but says it intends to swap about $125 million in federal funds annually; a fifth state DOT began swapping in the first quarter of 2020 but says it intends to swap about $35.7 million annually. We were unable to confirm whether one state DOT's annual amount swapped was about the same each year or varied.

[36]Connecticut DOT officials said they attempt to make swapped amounts equal to federal funds suballocated to urbanized areas with population over 200,000 and areas with population of 5,001 to 200,000.

[37]We present 2019 data (see exceptions in the note to figure 1 below) as it was the most recent data available when we began interviewing some state DOT officials.

Figure 1: Percentage of States' Reported Federal-aid Highway Funds Swapped for State Transportation Funds



Source: GAO analysis of information from state DOT officials and FHWA data. | GAO-21-88

Note: The data presented are for 2019, except for Alabama, Colorado, New Jersey, and Wisconsin where we are presenting the most recent data these state DOT officials had available.

Of the 15 states that swapped federal funds over the past 5 years, officials in two states, New Jersey and Wisconsin, told us that they ended their fund swapping programs in 2018.[38] Additionally, 37 states reported that they do not currently have a fund swapping program; however, seven of those states responded that they were or may be interested in establishing one.[39]

Each of the 15 States Swapped STBG Funds

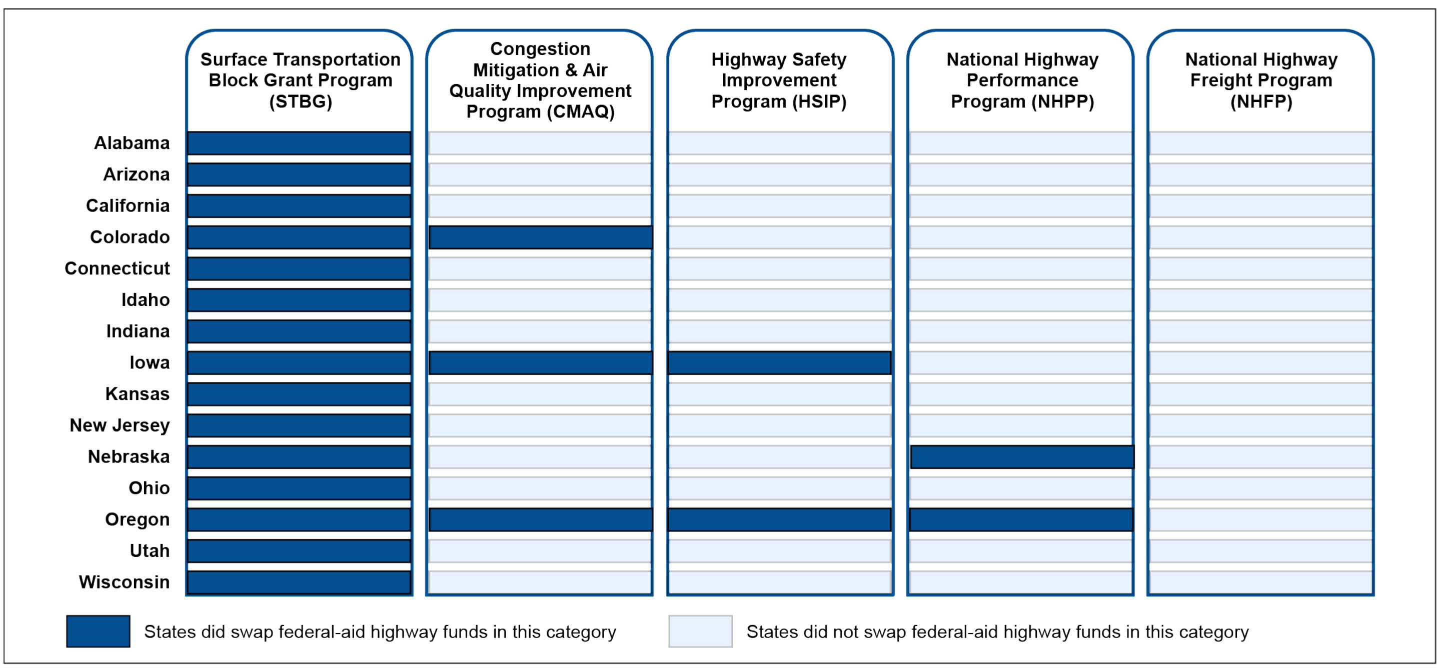
The primary source of federal funds used in state fund swapping programs is the portion of each state's STBG program funds that must be suballocated to areas of a state based on population. Officials from each of the 15 state DOTs that swapped funds said that they swapped STBG

[38]New Jersey state DOT officials said the reasons they ended their swap program included insufficient funds and lack of projects. Wisconsin state DOT officials said they ended their swap programs because the state's authorizing legislation ended.

[39]The total number of states is 52 because New Jersey and Wisconsin are included among the 15 states that have swapped in the past 5 years and the 37 that currently do not swap.

funds. Nine of the 15 states swapped STBG suballocated funds, three states swapped STBG discretionary funds, and three states swapped both, according to state DOT officials we interviewed. In addition to swapping STBG funds, officials from four state DOTs said they also swapped federal funds in three of the four other core highway programs. One state, Oregon, swapped funds using funding from four of the five federal-aid highway core programs and was the only state to swap funds in as many core programs. An Oregon DOT official told us that they swap funds from four federal-aid highway funding programs because having local agencies develop projects with state instead of federal funds reduces the amount of state resources needed for oversight. Figure 2 shows the federal-aid highway funding categories involved in the 15 state DOTs fund swapping programs.

Figure 2: Federal-aid Highway Program Funds that Have Been Swapped for State Department of Transportation (DOT) Funds



Source: GAO analysis of information from state DOT officials. | GAO-21-88

Local Agencies Used Swapped Funds to Primarily Develop Road and Bridge Projects in Rural Areas

According to state DOT officials and documentation, local agencies primarily chose to administer road and bridge projects with swapped funds. According to officials and documentation, about half of the 15 state DOTs, local agencies used swapped state funds to develop some combination of road and bridge projects, while officials for the remaining state DOTs said local agencies used swapped funds to develop other projects in addition to road and bridge projects.

Local agencies that used swapped state funds undertook roads and bridge projects such as road resurfacing and maintenance or bridge rehabilitation. For example, DOT officials in one state said local agency officials used swapped funds on bridge projects because many bridges on the local system needed replacement or rehabilitation. The officials in this state explained that using swapped state funds enables them to more easily develop the bridge projects because state requirements apply, which officials thought were less stringent than federal requirements. Among the states where local agencies developed other types of projects, an official in one state told us that in addition to including road and bridge projects, local agencies developed Americans with Disabilities Act-compliant projects and projects for signage and lighting. Another state DOT's official also mentioned road maintenance projects. Other less common project types that local agencies developed with swapped state funds included bike lanes, pedestrian crosswalks, and sidewalks, according to some state DOT officials.

According to about half of the state DOT officials we interviewed, local agencies tended to use swapped state funds to develop projects in rural areas. Officials from one state DOT explained that its fund swapping program is limited to counties, and 92 percent of the state's county roads are located in rural areas. Another local agency official told us that most swapping occurs in rural areas because these projects are smaller and less complex, and that developing them in conformance with federal requirements would unnecessarily increase their cost. While about half of officials cited projects in rural areas, some state DOT officials told us that local agencies developed projects in both urban and rural areas, or in urban areas only.

State DOTs and Local Agencies Cited Flexibility and Other Anticipated Benefits and Obstacles such as Lack of Funding As Influencing Their Participation in Fund Swapping

Officials GAO interviewed from state DOTs and selected local agencies said that they choose to participate in fund swapping because it reduces the risk that local agencies will not comply with federal requirements, increases project flexibility and control for local agencies, and may result in project delivery time and cost savings. The obstacles officials cited to participating in fund swapping included a lack of sufficient state funds to swap with local agencies, as well as the absence of state law authorizing fund swapping.

Officials Cited Mitigating Noncompliance Risks, Increasing Flexibility for Local Agencies, and Potential Savings as Among Anticipated Benefits

State DOTs and selected local agency officials identified several potential benefits that factored into their decision to establish or participate in a fund swapping program.

Reduces the Risk of Noncompliance with Federal Requirements

According to state and local officials, state DOTs and local agencies may choose to swap funds because swapping has the potential to reduce the risk of noncompliance with federal requirements. When using swapped state funds, local agencies must comply with applicable state and local requirements instead of federal requirements. According to officials from 12 of the 15 state DOTs and some of the local agencies we interviewed, local agencies tend to be better equipped to comply with state rather than federal requirements. The local agency officials we interviewed said they find their state's process more streamlined and better suited to local projects.

Moreover, as we previously reported, noncompliance with federal requirements by local agencies is a well-documented risk area. Many local agency officials have experienced challenges administering federal-aid projects and complying with applicable federal requirements.[40] Also, many of the state DOT officials we interviewed said some local agencies have limited resources or expertise with the federal-aid process, which

[40]GAO-14-113.

can make complying with federal requirements challenging. Officials from two state DOTs added that this was particularly true in rural areas, and, as noted above, many local agencies develop swapped projects in rural areas. Fund swapping concurrently puts more federal-aid in state DOT hands, and officials from most of the state DOTs we interviewed said the state tends to be more familiar with the federal-aid process since they regularly administer federal-aid projects.

Provides Agencies Greater Flexibility and Control over Local Projects

According to officials from six state DOTs and some local agencies, fund swapping can provide local agencies greater flexibilities in the use of state funds when compared to their use of federal funds. In addition, officials from four state DOTs and some local agencies reported that their state's fund swapping programs better met the local agencies' needs. For example, officials from two state DOTs told us that their fund swapping programs allow local agencies to pursue projects with state funds that they could not otherwise pursue with federal funds due to eligibility requirements. An official from Alabama DOT said the state's fund swapping program expands project eligibility to all county roads classified as minor collectors, which have limited eligibility under the federal STBG program. According to the official, 36 percent of Alabama's county roads eligible for STBG funds are minor collectors and the mileage on these roads is much greater than the percentage of federal-aid allowed to be spent on them. In addition, a few state DOT officials reported their state's fund swapping program allows more local agencies to take advantage of available funding. For example, an official from Idaho DOT said some local agencies may not have the required matching funds to be able to use federal funds, which, as mentioned previously, generally is 20 percent of a project's cost. The official added that fund swapping could fill a gap for local agencies unable to provide the required matching funds to pursue federal-aid projects, since Idaho's swapping program does not require local agencies to provide matching funds to use swapped state funds.[41]

Officials from several of the local agencies and state DOTs we interviewed also said that swapping funds and the resulting need to follow

[41]The Idaho Transportation Department prefers to call its program a fund exchange program. As noted previously, we use the terms "fund exchange program" and "fund swap program" interchangeably in this report.

state and local requirements instead of federal requirements provides local agencies more control over their projects. For example, several states allow local agencies to preference local contractors when using state funds, which is prohibited when using federal funds.[42] According to an Arizona DOT official, some local agencies requested establishing a fund swapping program so they could hire local contractors and reinvest in their communities. The official added that some local agencies in rural areas also benefit by not paying for state contractors to travel long distances for small projects that local contractors could complete. Additionally, according to a Kansas DOT official, local agencies can design projects better suited to their needs when following state requirements.

However, a local agency may choose not to participate in fund swapping because it prefers to maintain the state's involvement that accompanies the state DOT's oversight over the use of federal-aid, according to a few state DOT officials. Officials from two state DOTs said that some local agencies, such as in smaller communities, may struggle or lack the capacity to complete even state funded projects. For example, an official from Indiana DOT said smaller communities without an engineer on staff might prefer the state DOT to administer the project with federal-aid.

Puts Agencies in Better Position to Save Time and Money on Project Delivery

Officials from all selected local agencies and 13 of 15 state DOTs we interviewed said a benefit or potential benefit of fund swapping is that local agencies can complete projects in a shorter amount of time. This is in part due to the requirements attached to state funds, which tend to be less stringent than federal requirements, according to most state DOT officials. Some of the local agency officials also said they tend to be more familiar with state requirements and more capable of administering state projects, which they say streamlines the process and helps projects move faster. An official from one local agency we interviewed estimated that swapped projects saved 1 year on average based on early program

[42]Generally, certain services, such as engineering, for a project using federal-aid highway program funds must be procured using the qualification-based selection method described in the Brooks Act, 40 U.S.C. §§ 1101-1104. 23 U.S.C. § 112(b)(2). Under this method, state DOTs are prohibited from considering in-state or local preference when evaluating, ranking, or selecting a firm competing for the contract. 23 C.F.R. § 172.7(a)(1)(iii)(C).

analysis, because local agencies have more control over projects when funded with swapped state funds.

In addition to time savings, officials from 10 of the 15 state DOTs interviewed said a potential benefit of fund swapping is that local agencies can experience cost savings on projects funded with swapped funds. For example, one state DOT official said that local agencies could save money because they would not have to hire consultants to prepare formal reviews that would otherwise be needed to comply with certain federal requirements. As we have previously reported, local agency officials have noted that federal-aid projects cost more than comparable locally or state-funded projects due to compliance with federal requirements.[43] Further, as we have reported, because federal requirements apply to all projects regardless of scope and size—the amount of effort and costs for meeting such requirements for lower-cost projects can be disproportionate to the overall project costs.[44]

Some state DOT officials reported that since fund swapping creates efficiencies, local agencies may get more value by using state funds rather than federal funds. Even with an exchange rate for swapped funds at less than dollar-for-dollar, officials from five state DOTs said that local agencies can experience cost savings on projects. According to a local agency official speaking through a national association, a $0.75 on the dollar exchange rate is a good deal in Alabama, because local agencies no longer have to pay additional administrative costs to the state DOT and contractors that they require when local agencies use federal funds.[45]

Most state DOT officials also identified ways in which the state frees up resources by fund swapping. According to most state DOT officials interviewed, fund swapping reduces the amount of state oversight of local agencies, because local agencies are administering fewer federal-aid projects. When local agencies use federal funds, the state DOT is responsible for overseeing those projects and ensuring federal requirements are met, and officials from about half of state DOTs interviewed said this can be a strain on the state's resources. For example, an Iowa DOT official said that prior to fund swapping there

[43]GAO-14-113.

[44]GAO-14-113.

[45]For example, Alabama DOT requires local agencies pay the state a 13 percent fee to cover costs associated with bid letting when local agencies use federal funds according to a state official.

might have been as many as 150 locally administered federal-aid projects at one time, which was challenging for the state to oversee. Iowa DOT officials, along with officials from several other state DOTs, reported less involvement by state staff in local projects as a result of fund swapping. An Arizona DOT official added that fund swapping can free up state staff to work on other highway projects.

Officials Cited Lack of Sufficient State Funds and State Laws Preventing Fund Swapping as Among Obstacles

Lack of sufficient state funds was the most frequently reported obstacle to fund swapping. In response to our questionnaire, officials from 10 of the 50 state DOTs said that their state did not have sufficient state funds to exchange for local agencies' federal funds. Moreover, some of these officials noted that their state DOT struggled to find enough state funds for the required 20 percent match to accept federal-aid for state administered projects alone. In addition, New Jersey and Michigan ended their fund swapping programs, in part, because they lacked sufficient state funds to swap or there was uncertainty regarding the sufficiency of state funds, according to state DOT officials. And as noted above, Indiana DOT officials reported swapping funds only in years when sufficient state funding is available.

Officials from eight state DOTs identified state law or budget process as an obstacle to implementing a fund swapping program. For example, Missouri law prohibits the use of state road funds on roads not owned by the state.[46] According to the Missouri DOT, this effectively prohibits fund swapping since local agencies would be using state funds on their own local projects, likely involving non-state owned roads. Several other state DOT officials reported similar restrictions on how state funds may be used. In addition, Washington DOT noted that the state's two-year budget cycle does not allow for the flexibility to swap funds.

Officials from seven state DOTs characterized features of their transportation programs that would make fund swapping impractical in their state. In Delaware and several other states, state DOT officials told us that local agencies do not regularly receive federal-aid, which would be necessary for fund swapping. According to the North Carolina DOT, the state maintains a vast majority of North Carolina's major roads, so the state DOT administers most of the federal-aid projects. In addition, local agencies in North Carolina are largely responsible for administering federal transportation alternatives funds on bicycle and pedestrian

[46]Mo. CONST. art. IV, § 30(b); Mo. ANN. STAT. § 226.220.

projects; however, North Carolina law prohibits the use of state funds on bicycle and pedestrian projects.[47] For these reasons, according to the North Carolina DOT, fund swapping would be impractical.

Limited Data Exist to Assess the Impacts of Fund Swapping and Officials Had Mixed Views on the Impacts

The impact of fund swapping on the payment of prevailing wages and the application of other federal requirements cannot be definitively determined due to limited data availability and for other reasons. As part of measuring the impact of swapping, one might want to compare the number and type of project each of the 15 state DOTs administered with swapped federal dollars to the number and type of projects local agencies administered with swapped state dollars. For example, using fund swapping, a state could initiate additional projects with the federal funds swapped from local agencies, resulting in more projects being subject to federal requirements. Alternatively, a state could be increasing the federal share on the same number of federal-aid projects, which could result in fewer projects being subject to federal requirements.

However, data to assess these impacts are limited because officials from the 15 states we interviewed generally do not track which state administered projects were funded with swapped federal funds.[48] For example, officials from most of these states said that within the STBG program, the federal funds swapped by the local agencies are combined by the state DOT with the other federal funds from that same federal-aid highway program. The suballocated STBG funds swapped by local agencies are combined with the other suballocated STBG funds that the state already has and plans to use on state administered projects. According to state DOT officials, the swapped federal funds are not delineated as having been swapped when mixed with the rest of the suballocated STBG funds. Therefore, because of the way state DOT’s track these data, it is not possible to know which specific projects were funded either in whole or part with swapped federal dollars versus non-swapped federal dollars.

Moreover, assessing the impacts of fund swapping is further complicated because it is not possible to know if a local agency would have implemented the same number and type of projects with state DOT funds

[47] N.C. GEN. STAT. ANN. § 136-189.11(d)(3)(c).

[48] Officials from two states said they could track at least some of the federal-aid swapped back to the state from the local agencies. However, an official from Connecticut said that one project may receive federal-aid from several federal aid programs over multiple fiscal years, making it challenging to isolate and assess the impact associated with the swapped federal funds.

that it implemented with federal-aid funds. For example, two local agencies said the benefit of swapping was the increased flexibility to do projects that may not be eligible for federal-aid, so local agencies may be developing different projects with swapped state funds than they might have done with federal funds. Consequently, it is not possible to determine whether and to what extent any potential impacts would have occurred in the absence of swapping.

Without the information discussed above, it is not possible to compare the number of projects in a given state subject to federal requirements with and without swapping. Thus, the impact of swapping on project delivery, as well as the number of projects subject to federal requirements, such as the Davis-Bacon Act and the Buy America requirement, cannot be definitively determined. Even if such data were available, an analysis comparing the number of projects in a given state subject to federal requirements with and without swapping is difficult because one project might receive federal-aid from several federal-aid programs over multiple fiscal years, making it challenging to isolate and assess the impact associated with the swapped federal funds, even within one project. Moreover, about half the states engaging in fund swapping do so with less than 6 percent of their federal-aid funds, which may limit the extent of potential impacts such an analysis might find.

However, the federal-aid highway program requirements suggest the following:

- First, the same amount of federal-aid highway funds — the expenditure of which is subject to federal requirements and is made available to the state by law — should be expended statewide with fund swapping as would be expended without swapping. Further, according to state DOT officials in states with fund swapping programs, they ensure that federal funds are expended in compliance with federal requirements.
- Second, even with fund swapping, the amount of suballocated STBG funds in areas with populations exceeding 200,000 (TMAs) should remain the same. This is because, according to STBG program requirements, each TMA should have its formula amount of the TMA suballocation expended within it. Officials we interviewed from the Kansas DOT said that they do not swap TMA funds for that reason.
- Third, for areas with a population of 200,000 or less, fund swapping could increase or decrease the amount of suballocated STBG funds expended in a given area. This is because for these non-TMA

population categories, federal law requires that those STBG suballocated funds be expended in each population category, not in all areas or individual local agencies in that category. Thus, for example, if a local agency swaps some of its federal funds, the state may choose to spend the federal-aid on a project in another area of the state in the same population category. Should a state make this decision, fewer projects in the original local area may be subject to the federal prevailing wage and other federal requirements, depending on what state laws are applicable in that state. In contrast, the area that received the swapped funds would experience an increase in the number of projects subject to these requirements.

We attempted to collect data from the 15 state DOTs to determine what is known about the impact fund swapping has on project delivery, the use of local contractors, and wages. However, no state DOT we contacted collected this type of information. In the absence of available data, state DOT officials offered mixed opinions on the impact of swapping in their states. For example, state DOT officials were split in their opinions about the impact of swapping on the number of projects subject to federal requirements. Officials from five state DOTs that engage in fund swapping stated they believed that swapping did not reduce the number of projects subject to federal requirements, while officials in five states thought it did. Officials in five states said they did not know. The state DOT officials that thought that swapping might reduce the number of projects subject to federal requirements explained that projects funded with swapped state dollars tend to be smaller and more numerous, whereas the federally funded projects tended to be larger and fewer. Further, officials from the state DOT in Utah said that when they engage in swapping, they do so to consolidate federal funds on existing federal-aid projects. They noted they would not initiate a swap that would put federal funds on a project that was not already planning to use them, which could potentially result in fewer projects in Utah subject to federal requirements.

Most, but not all, state officials stated that the impact on prevailing wages is minimal. Just under half of the states that swap funds told us that they have a state prevailing wage laws, applicable to non-federally funded projects.[49] Officials in four states that told us they do not have state

[49]State prevailing wage laws vary, according to the U.S. Department of Labor. For example, one state DOT official said the locally prevailing wages determined under the law of its state was higher than the locally prevailing wages determined under the Davis-Bacon Act.

prevailing wage laws said that the wages paid on their state-funded swapped projects were not impacted by the lack of federal prevailing wage requirements under the Davis-Bacon Act. Officials from two of these four states elaborated that they paid local wages in line with the federal prevailing wages because of economic conditions in their states. However, officials from two other states said that because the state did not have a prevailing wage law that applied in absence of the Davis-Bacon Act, it potentially lowered the cost because contractors and local agencies could pay on-site workers' wages lower than the federal prevailing wage, particularly in rural areas. An organization representing labor groups in Iowa similarly said that swapping in states that do not have a prevailing wage law may result in lower wages paid to workers.

State DOT officials said that the potential impact of swapping programs on other federal requirements varied depending on what requirements each state had in place. Officials from a few states, for example, stated that they have laws similar to federal requirements such as Buy America, while officials from a few other states said they do not. Ohio state DOT officials said that their state has a law similar to Buy America.[50] Opinions on swapping programs' potential impact on federal Disadvantaged Business Enterprise (DBE) program requirements similarly varied. In Connecticut, state DOT officials said that the state has a similar small business enterprise rule, which local agencies are required to follow when implementing a state-funded transportation project.[51] Connecticut officials said that the state law may increase opportunity for these businesses. Officials from Utah DOT said that the state does not have requirements similar to those under the federal DBE program. They also said they were not aware of how, if at all, using swapped state funds may have affected the project participation of small businesses owned and controlled by socially and economically disadvantaged individuals.

Agency Comments

We provided a draft of this product to the U.S. Department of Transportation for comment. The U.S. Department of Transportation provided technical comments, which we incorporated as appropriate.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the appropriate congressional committees, the Secretary of the U.S. Department of

[50]OHIO REV. CODE ANN. §§ 153.011, 5525.21

[51]CONN. GEN. STAT. ANN. § 4a-60g.

Transportation, relevant state Departments of Transportation, and other interested parties. In addition, the report will be available at no charge on the GAO website at https://gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-2384 or RepkoE@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix I.

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Appendix I: GAO Contact and Staff Acknowledgments

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Staff Acknowledgements

In addition to the contact named above, Steve Cohen (Assistant Director); Sarah Jones (Analyst-in-Charge); Jennifer Clayborne, Sarah Green, Delwen Jones, Ned Malone, Mary-Catherine P. Overcash, and Malika Rice made key contributions to this report.

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