November 4, 1997
ILR 97-C

Representative Brent H. Goodfellow
Utah House of Representatives
319 State Capitol Building
Salt Lake City, UT 84114

Subject: **Freeway Advertising**

Representative Goodfellow:

In response to your request, we evaluated the bidding process and terms of the contract awarded by the Department of Transportation (UDOT) to market, construct, and maintain the logo signs that inform motorists of available services prior to freeway exits. We found that the contract was fairly awarded and, although the initial contract could have had more favorable terms that included generating royalty revenues for the state, UDOT negotiated better terms when the contract was renewed. We compared Utah's sign policy with other states and learned that some states set high advertising fees which are paid by businesses with the intent to generate substantial revenues while other states charge minimal fees established only to recover program costs. Utah imposes moderate advertising fees on businesses and receives some royalty revenues from the contractor. While the contractor has provided maximum royalty revenues from the logo sign program under the current agreement, even more royalty revenues may be possible if the Legislature so directs. We believe that a legislative policy decision to clarify the importance of royalty revenues in relation to advertising fees with statutory changes would be helpful.

In 1989, legislation was passed allowing logo signs on Utah interstate highways. Located near exit ramps, the signs display business logos to inform motorists of essential services available adjacent to the interchange. Federal regulations limit advertising to eligible businesses that provide gas, food, lodging and camping facilities. With only one of each type of sign allowed at each interchange and a maximum of six logos displayed on each sign panel, first priority is afforded to businesses located closest to the interstate. Along with proximity to the interstate, businesses must also conform to specific eligibility requirements to qualify to

advertise on the signs. For example, to advertise on food signs, licensed businesses must be open seven days per week, operate a minimum of 14 continuous hours each day, serve all three meals, have indoor seating at tables for a minimum of 16 people, and have a telephone available. Some eligibility requirements may be waived if qualified businesses are not available to advertise. Guidelines also prescribe spacing and priority requirements and state: *"The signs may be used on any class of highway and are intended for use primarily on areas rural in character...based on a determination of motorist need..."* [**Manual on Uniform Traffic Control Devices** 2G-5.1]

Utah businesses display over 900 logos on 306 mainline signs located on I-15, I-70, I-80, I-84 and most recently on I-215. Mainline signs are erected along the freeway to indicate the specific services available at the next interchange. Monthly advertising fees are currently $77.50 per logo for mainline signs and $15.00 per logo for ramp and trailblazer signs. Ramp and trailblazer signs direct motorists to a particular service once they have exited the freeway. Currently there are 365 ramp and 100 trailblazer signs located along off-ramps and on roads off the freeway.

The sign program has generated a profit for the contractor. As you requested, we have included some basic financial information in the following figure. Listed are Utah Logos' total sales and expenses over the first six years of the contract. The company has invested approximately $2 million for signs at an average cost of $5,500 for each mainline sign and $400 for each ramp sign.

Figure I
Income & Expenses
Utah Logos, Inc

	Total	1996	1995	1994	1993	1992	1991	1990
Sales	$5,015,300	$876,394	$884,320	$839,490	$823,960	$826,272	$723,618	$ 41,246
Expenses	3,376,481	438,243	461,310	490,830	593,977	587,404	569,368	235,349
Income*	1,638,819	438,151	423,010	348,660	229,983	238,868	154,250	(194,103)
Net**	1,043,384	267,272	255,609	229,921	155,992	176,030	153,179	(194,619)

** Before Income Taxes*
*** Net Income after State and Federal Taxes*

To provide information on the logo sign program, we inspected relevant records and reports from both UDOT and the contractor. We addressed two concerns related to the contract awarded by UDOT to market, construct, and maintain the logo signs. First, that the contract was awarded after receiving only one bid for the project and second, that the contract terms may unreasonably favor the contractor. We examined relevant documents including bid proposals, the contract itself and its subsequent modifications. Additionally, we contacted other states to see whether Utah's fees and royalty revenues are reasonable in comparison and to help us evaluate the terms of both the initial and renewed contract. To address concerns that the Travel Council had received little royalty revenues from the program, we reconciled and tracked the royalty payments. We also examined signs and surveyed potential advertisers to test if the contractor had aggressively marketed the program and maximized the amount of royalty revenues returned to the state. In addition, we also determined ways that the amount of revenue could be increased if that is the wish of legislators.

Fairly Awarded Contract Provides Revenues

We found UDOT awarded the contract fairly using established competitive bid procedures. Although we believe the initial contract could have had terms more favorable to the state because it excluded provisions for royalty revenues to be paid by the contractor, UDOT negotiated better terms for both the state and business community when the contract was renewed. Our examination also demonstrated that the contractor aggressively markets the program to Utah businesses. Finally, while the contractor's royalty payments are current, some funds were not transferred from UDOT to the Travel Council.

Contract was Awarded Fairly

UDOT followed established competitive bid procedures when it awarded the contract for the logo sign program. Acknowledging its limited resources and inadequate marketing capabilities, UDOT issued a request for proposals (RFP) to contract the sign program. UDOT solicited bids from six companies, three from within the state, and placed advertisements in the **Salt Lake Tribune** and **Deseret News** on two successive weekends. Three out-of-state contractors submitted bid proposals. An eight-member selection board evaluated each proposal and selected the contractor best suited for the project. On June 7, 1990, UDOT awarded a five-year contract to Utah Logos, Inc., a subsidiary of a national company, Interstate Logos, Inc. Utah Logos was selected because its parent company appeared more experienced and financially capable and

agreed to install most signs within one year.

Utah's decision coincides with many other states that have since elected to contract their programs. Half of the forty-four states with logo sign programs privately contract some portion of their programs. Eighteen of these states, including Utah, contract with subsidiaries of Interstate Logos, Inc.

Initial Contract Terms Were Later Improved

Some of the initial contract terms were modified to include terms more favorable to the state. Initially, businesses were required to pay $90 per month to display their logo on a mainline sign and $15 for each ramp or trailblazer sign. In an attempt to keep fees to businesses low, the initial contract did not require any royalty revenues be returned to the state. After questions concerning these royalty revenues arose, the contract was modified. Effective November 1992, the contractor agreed to pay a monthly royalty of $2.50 for every mainline logo based on their collected billing.

Also included as part of the contract terms are three five-year renewal options that requires UDOT to make a substantial cash outlay to purchase the signs should it terminate prior to expiration or not extend the contract. A "buyout" factor was agreed upon to protect the contractor's investment during the early years of the contract. The factor declines over the four five-year periods of the contract. If UDOT had canceled the contract during the first five years, it would have paid 3.5 times the contractors most recent gross annual income to purchase the signs. During the second five years, the factor is 3 times, then 2 and 1. After twenty years, UDOT will assume ownership of the signs without making any payment. After ten years, the contractor must make an additional investment to replace the background panels. After this work is completed, the buyout factor favors UDOT.

In 1996, the department negotiated terms more favorable to the state and renewed the contract for a second five-year term. Although the contract expired in 1995, it was extended for one year while contract modifications were negotiated. Improved terms included reducing the fees paid by advertising businesses from $90 to $77.50 per month for each logo displayed on a mainline sign and also increasing the royalties returned to the state from $2.50 to $5.00. Ramp and trailblazer fees remained $15. In return, UDOT allowed the contractor to expand the program to include signs on I-215. These more favorable terms increased annual royalty revenues available to the Division of Travel Development from approximately $21,000 to $53,000. Royalties may be less than this amount over the next several years because some signs have been removed for the I-15 construction.

Contractor Aggressively Markets the Program

Along with the improved contract terms, we found that the contractor has aggressively marketed the sign program to eligible businesses and returns maximum royalty revenues to the state under current contract provisions.

We examined signs at selected interchanges to test the accuracy of the number of logos reportedly displayed on each sign and also contacted potential advertisers to determine why advertising space was still available. If all six logo spaces were not occupied, we located and contacted some of the qualified businesses in the immediate vicinity that were not advertising. We learned that, generally, the contractor had solicited their business but they had elected not to advertise for various reasons. For example, one business manager decided not to advertise because a gas station located closer to the exit was franchised with the same company. He felt displaying his logo would only attract business for the other gas station. Another restaurant manager told us he did not advertise because, in his opinion, the investment return was insufficient. Others told us they planned to advertise in the future. When we discussed our concerns about specific interchanges with Utah Logos' manager, he knew which businesses were not advertising and their rationale. He told us he attempts to visit every interchange in the entire state every month. We concluded that the contractor has marketed the program aggressively because businesses have been contacted and the contractor appeared knowledge- able about the market.

Our conclusions were substantiated when we compared Utah's average number of logos per sign with the average in other states. Each sign displays from one to six business logos. Utah currently averages 2.97 logos per mainline sign (908 logos/306 signs) while a 1994 study notes an average of 1.84 logos for state administered programs and 1.96 for states with contracted programs. In other words, Utah's signs display an average of three logos on every sign while signs in other states generally display only two logos.

After concluding that the contractor had marketed the program well, we addressed concerns that the Travel Council had received little royalty revenues from the sign program since its inception. We reconciled the royalty payments and confirmed that the contractor has paid all royalties due to the state. However, we discovered several fund transfers from UDOT to the Division of Travel Development had either not occurred or were transferred to an incorrect account number. These difficulties appear to have been resolved during the course of our review.

Royalties began accruing in November, 1992 with the first quarterly payment made in 1993. Royalties are calculated as a flat fee, now $5 per logo per month, for every mainline logo sold instead of a residual amount *"in excess of costs"* as referred to by statute [**Utah Code** 27-12-136.4 (3) (b)]. After collecting from the advertising businesses, the contractor makes quarterly royalty payments to UDOT. Additional royalties are not collected for ramp and trailblazer signs. Figure II lists all royalties the contractor has paid to the state. To date, UDOT has not deducted any of their administrative costs before transferring the royalties to the Travel Council.

Figure II
Contractor's Royalty Payments

Year	Payments
1993	$ 19,347.50
1994	20,247.50
1995	21,222.50
1996	25,392.50
1997	28,862.50*
Total Royalties Paid	**$115,072.50**

**** Payments thru June 1997***

Legislative Direction Would be Helpful

Although the contract has generated royalty revenues, it would be helpful for the Legislature to clarify if it expects more royalty revenues than the state currently receives from the logo sign program. Other states have established advertising fees based on sign costs, the number of signs, and the amount of revenues expected from the program. While additional royalty revenues are possible, if the Legislature so directs, fees to businesses may have to increase and/or the program may need to expand to include additional highways. While Utah's contract was awarded fairly and renewed with more favorable terms, we believe the initial contract terms could have been more favorable and provided more royalty revenues to the state if UDOT had been directed that the program was also expected to generate royalty revenues. Statutes may need additional wording to clarify these expectations before UDOT considers its alternatives when the contract expires in the year 2000.

Does the Legislature Want the Program to Generate Additional Royalty Revenues

Utah's sign program could possibly generate additional royalty revenues if the Legislature so directs. However, some confusion endures about the royalty revenues expected from the sign program in relation to the advertising fees charged to businesses. Intending to keep fees low, UDOT excluded any mention of royalty revenues when it first contracted the sign program. Later, after discussions with the Travel Council indicated revenues were expected, the contract

was modified to include a small royalty payment. Upon renewal, the contractor proposed increasing its annual royalty payment from $21,000 to over $96,000. Instead, the department also responded to concerns from local businesses that Utah's fees were higher than some surrounding states and that small locally owned businesses could not afford to advertise. Although the department still negotiated to increase the royalty, much of the potential royalty revenues were sacrificed to reduce the advertising fees. Some confusion persists because legislators continue to inquire about additional royalty revenues. We believe it would be helpful if the Legislature clarified the balance it expects between fees and royalty revenues.

As the Legislature decides if additional royalty revenues are expected, it may want to consider fees and revenues in other states. We reviewed other states' sign programs and found that some states set high advertising fees to businesses intended to generate substantial revenues while other states have minimal fees established only to recover program costs on a nonprofit basis.

Figure III presents a range of fees charged by states for both contracted and state administered programs. More information was available for contracted programs because of Utah's affiliation with Interstate Logos, the company that contracts with most of these states. We also included the number of logos because the size of a state's program may also influence fees. A smaller program may require higher fees to remain self-supporting while costs spread over a larger number of signs will tend to reduce the fees.

Figure III
1997 Fee and Size Comparison
Logo Sign Program

State	Annual Fee*	No. Logos**	State	Annual Fee*	No. Logos**
New Jersey	$3000-3900	460	Kentucky	$1,200	2,245
Indiana	$3,312	n/a	Mississippi	1,200	1,665
Arizona	3,168	834	S Carolina	1,200	1,321
Montana	2,664	n/a	Texas	1,150	2,599
Wisconsin	2,520	n/a	Kansas	1,150	1,287
Nebraska	2,400	464	Florida	1,000	1,410
Oklahoma	2,280	756	Tennessee	999	2,316
Utah	2,220	908	Georgia	900	5,323
Nevada	2,208	318	Virginia	750	3,750
Missouri	1,500	3,963	Idaho	550	692
Ohio	1,500	2,818	Oregon	550-800	2,794
Minnesota	1,320	1,649	Colorado	500	300
Michigan	1,320	771			

**** Advertising fee is for two mainline and two ramp signs.***
***** Count is for mainline logos only***
n/a = Information not available.
NOTE: Shaded areas are state administered programs

The above figure shows the significant variation in state fees. New Jersey's fees are five or six times higher than fees in Colorado or Oregon. Generally, if a sign program is expected to return revenues to the state, fees are set higher. For example, New Jersey established high fees because, in addition to the contractor's profits, the state expected substantial revenues from the program. New Jersey receives 20 percent of the contractor's gross income or a minimum of

$12,500 each month. Similarly, South Carolina is currently changing the focus of its sign program. It is negotiating for more revenues both by increasing fees and expanding the program into urban areas. Other factors are also involved in setting fees. Missouri has moderate fees but receives substantial revenues because the state has financed the costs of the signs instead of the contractor.

Some other states do not expect any revenues at all from the program. For example, Virginia continues to emphasize low fees and does not require the contractor to return any revenues to the state. While we expected states that do not require revenues to have lower fees, this is not always the case. For example, Arizona's fees are high even though its contractor does not return any revenues.

It appears that state administered programs set lower fees than contracted programs. State administered programs are where the state administers the program rather than a private contractor. Idaho and Colorado have set minimal fees sufficient only to recover program costs. Colorado's fees only cover maintenance costs because signs are constructed and installed at the expense of the advertising businesses. Idaho's fees also recover the cost of sign structures but spread the expense over a long period of time. We were told Idaho's costs may inadvertently be subsidized with state funds because of inaccurate cost reporting. These inaccuracies would also contribute to lower fees. The program, established in 1983, recently broke even and so the fees may be reduced even further to avoid any profits.

Several methods to increase Utah's royalty revenues are possible. Based on our examination of other states' balance of fees and revenue, we believe additional royalty revenues are possible, if the Legislature so directs. One way to increase revenue is to amend the royalty payment formula. From 1990 to 1996, contractor's profits (before taxes and depreciation) were 51 percent of sales while royalties averaged 1.7 percent of sales. We found other states that receive a higher portion of sales. For instance, Nebraska receives proportionally more revenues than Utah with only slightly higher fees. We were interested in Nebraska's contract because it was agreed upon the year before Utah completed its agreement with Interstate Logos. Nebraska's contract requires the contractor to return 10.5 percent of its gross sales as a lease payment. In Figure IV we applied Nebraska's formula to Utah's gross sales and compared the calculated amount to the actual royalties Utah received over the first six years of the contract. If Utah had initially incorporated Nebraska's formula in its contract, Utah would have received five times more royalty revenues. Although in 1997 Utah improved its contract terms to expand the program and double the royalty revenues, we estimate royalty revenues returned to the state would still be almost two times more using Nebraska's formula because royalties still only average about 5.5% of sales instead of 10.5%.

Figure IV
Alternate Revenue Formulas
Utah vs. Nebraska

	Utah's Gross Sales	Nebraska's 10.5% Formula	Utah's Per Logo Formula (0, $2.50, $5.00)	Difference
Actual 1990-1996	$5,015,300	$ 526,607	$103,345	$423,262
Estimated 1997	972,000	105,060	53,000	49,060

Another way to generate additional royalty revenues may be with higher advertising fees. However, it is not clear how much royalty revenues would increase because higher fees could possibly reduce the number of businesses participating in the program. When the contract was renewed, UDOT was directed to negotiate reduced fees to businesses because $90 per logo per month was higher than some surrounding states and because smaller locally-owned businesses could not afford the fee. The number of logos increased about seven percent in the nine months following the fee reduction. Utah Logos manager attributes this increase to a reduction in turnover of locally owned businesses responding to the fee reduction and also to economic growth resulting in new businesses purchasing logos. He suggested increasing fees only in urban areas since more motorists see the signs located in urban areas than in rural areas (200,000 in Salt Lake County compared to 4,000 in Sevier County). Oregon has developed a fee structure based on sign location. While reducing Utah's advertising fees appeared to increase the number of logos, it is unknown if increasing fees would also reduce the number of businesses participating in the sign program and any potential increase in royalty revenues.

A third way to generate additional revenue is by continuing to expand the program into new areas. While signs have not been allowed on the busy metropolitan portion of I-15 between Midvale and North Salt Lake because sign spacing is limited, UDOT recently allowed the contractor to expand the program to I-215 to help offset reduced advertising fees. Utah may also want to expand the program to include other highways. Federal guidelines state that *"signs may be used on any class of highway..."* Logo signs could be placed on state highways with controlled access intersections and tourist oriented directional signs (TODS) on highways with two-way traffic. Colorado, Oregon, Arizona and other state programs include these signs. While the programs have not necessarily returned substantial royalty revenues back to the state, they provide valuable information to motorists. However, UDOT engineers believe

the TODS program would create conflicts that would not be justified by either the informational

value to motorists or the small amount of revenues generated.

Logo signs are intended to provide a service to motorists and in the process may return royalty revenues to the state. We believe the confusion about royalty revenues would be alleviated if the Legislature specified its revenue expectations in relation to fees as well as its intent for program expansion.

Changing the Statute Would Help Clarify Legislative Intent

Current statutes do not indicate legislative intent concerning the expected balance between royalty payments, advertising fees and program expansion. As a result, past royalty revenues were non-existent or low. Developing additional statutory language may alleviate the confusion and lead to additional royalty revenues if that is the intent of the Legislature.

We believe past royalty revenues were low partly because the statute did not clearly identify what the Legislature intended regarding royalty revenues. Statutory language directs that advertising fees be *"sufficient to cover the costs of erecting, administering, and maintaining the signs or sign spaces."* [**Utah Code** 27-12-136.4]. Statutes address the disposition of royalty revenues without directing if the department should attempt to obtain maximum royalty revenues and the relation these royalty revenues will have to advertising fees. Lack of direction allows various options. UDOT could negotiate a contract with high fees and either no royalty revenues, as in Arizona, or substantial royalty revenues, as in New Jersey, and still comply with the statute. Royalties are transferred to the Utah Travel Council to promote tourism. If the Legislature is interested in maximizing royalty revenues, changes to the statute's wording would help provide direction.

Other states have statutes that specify their expectations. For example, Colorado's statutes state: *"In no case shall the required fee exceed the actual cost of erecting the sign, maintaining the sign, and administration of the program."* [**Colorado Code** 43-1-420 (2)] The department is only allowed to contract the program if private business can do so at a lower cost. Nebraska law states: *"The department shall charge an annual fee in an amount equal to the fair market rental value of the sign site and any other cost to the state associated with the erection, maintenance, or servicing of specific information sign panels. If such sign is erected by a contractor, the annual fee shall be limited to the fair market rental value of the sign site."* [**Nebraska Code** 39-206 (4)].

We believe that a legislative policy decision to clarify the importance of royalty revenues in relation to advertising fees would be helpful. As pointed out earlier, department managers were not clear about legislative direction. Initially, the contract did not require the state to obtain any

royalty revenues. When the contract was renewed, advertising fees were reduced rather than royalties maximized because the UDOT managers responded to concerns that the fees should be kept low. Legislation related to the following three questions would be helpful:

1. At what level should royalties be set?
2. At what level should business advertising fees be set?
3. Should the program be expanded to state roads?

Evaluate Alternatives Before Contract Expires

Once the Legislature has clarified its expectations concerning fees and royalty revenues, we believe UDOT needs to evaluate contracts from other states and consider various options before renewing its contract in the year 2000. Other state contracts include various options. For example, we were told Virginia's contract does not include a buyout factor even though the contractor made a substantial investment to assume the state's program. Missouri finances its own sign costs and contracts only for the marketing aspects of the program at a set fee. This may be a viable option for Utah since most signs are in place and the buyout factor has been reduced.

Another option UDOT may consider is to open the contract for bids in lieu of renewing the contract. A local company expressed an interest in presenting a bid proposal for the program before the contract was renewed the first time. The department engineer negotiating the contract told us he would have been interested in considering alternative proposals but he was not informed of that interest from the other bidder. While we agree that Utah's agreement appears reasonable, UDOT may again want to solicit bid proposals.

Recommendations:

1. We recommend that after UDOT has provided some evaluation of the alternatives, the Legislature clearly indicate by statute if a primary expectation of the sign program is to obtain royalty revenues for the state and clarify the intended balance of:
   a) royalty revenues
   b) advertising fees paid by businesses
   c) further program expansion.

2. We recommend that UDOT thoroughly evaluate alternatives, such as modifying the existing contract further or opening the contract for bid before its logo sign contract expires in the year 2000.

We hope this letter provides you with the information you need on this issue. If you have any questions or need additional information, please contact us.

Sincerely,

Wayne L. Welsh
Auditor General

WLW:SV/lm