Memorandum

To: Chair and Commissioners **Date:** March 29, 2004

From: Diane C. Eidam **Reference Number 4.7**
Action

Ref: **Transportation Funding Alternatives**

Issue:

Should the Commission commend the document, "Transportation Funding Alternatives," to the Legislature and Business, Transportation and Housing Agency for their consideration?

Recommendation:

Commission staff recommends that the Commission accept the document, "Transportation Funding Alternatives," pursuant to suggested changes and authorize the Chair to provide the final review prior to submittal of the final document to the Legislature and Business, Transportation and Housing Agency.

Background:

Consistent with the Commission's charge to provide policy advice to the Legislature and the Administration through the Business, Transportation and Housing Agency, the enclosed document was developed in collaboration with a working group convened by the Executive Director to explore transportation funding alternatives.

TRANSPORTATION
FUNDING ALTERNATIVES

PROBLEM DEFINITION

The suddenness and severity of the cash crisis that brought the stoppage in the state transportation construction program is unprecedented, the symptom of a broader and longer term structural problem in California's system of transportation financing. An effective transportation program cannot survive when resources are suddenly advanced and withdrawn on an annual basis.

In recent years, there have been $5.9 billion in state transportation funding postponements, suspensions and borrowings, including over $3 billion in State Transportation Improvement Program (STIP) funding. The total Fiscal Year 2003/04 mid-year spending reduction proposal and the Governor's 2004/05 Budget Proposal would remove about another $2.1 billion from the transportation program to the General Fund over a two year period.

Proposition 42 promised a boost in state transportation funding that was much needed, even if relatively modest. Proposition 42 cannot be relied upon as a predictable ongoing fund source for transportation, as demonstrated by actions taken beginning with the enactment of the proposition, the 2002/03 budget, the proposed Fiscal Year 2003/04 mid-year reductions and the Governor's 2004/05 Proposed Budget.

Impacts:

> *State Transportation Improvement Program* – Typically, $2 to $2.5 billion between the STIP and State Highway Operation and Protection Program (SHOPP) is allocated each year.
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> Due to the borrowings, transfers and suspensions no STIP project allocations have been made since June 2003, and only $250 million of the estimated $800 million needed for SHOPP projects were allocated by the end of March 2004.
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> At the end of March 2004, there were requests for funding in amount of $661 million for projects ready to go to construction but were held back for lack of funding – this figure could climb to over $1.6 billion by June 2004.
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> According to the 2004 STIP fund estimate, the new STIP will need to delay $5.4 billion in projects from the current STIP, an average of two to three to years.
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> For fiscal year 2004-05, STIP allocations are estimated to be zero with the exception of approximately $275 million in Federal Transportation Enhancement projects that could go forward.
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> If adopted, the administration's proposal to suspend Proposition 42, will create further uncertainty. If suspended for fiscal year 2004-05, at least $316 million in existing State Transportation Improvement Program projects would have to be deprogrammed.

Traffic Congestion Relief Program - Of the $4.9 billion made available for the TCRP, only $1.494 billion in funding has been allocated due to borrowings, transfers and suspensions.

To meet the expected expenditures on allocations made through fiscal year 2004/05, $490 million is needed - $264 million in 2003/04 and $225 million in 2004/05.

In addition, $6 million is needed in 2004/05 for projects approved under the Letter of No Prejudice arrangement (reimbursements for Letters of No Prejudice occur as a lump sum payment upon completion of work).

Minimum cash needs to keep the allocated TCRP and STIP projects going through the current and budget year:

STIP: $184 million in Fiscal Year 04/05

TCRP: $489 million, $264 in Fiscal Year 03/04, $225 in Fiscal Year 04/05

ALTERNATIVES

NEAR TERM ALTERNATIVES - STATE

(!) Deficit Recovery Bond

Background

The deficit recovery bond encompassed in Propositions 57 and 58 provides $15 billion in resources, if approved by the voters in March 2004, to address accumulated general fund obligations established in prior years. This proposal will subsume the $10.7 billion bond enacted by the legislature in 2003 and restructure the state's financing mechanism pledged to make the bond payments. There is an estimated $3 billion in capacity in bond proceeds that has not been attributed to specific general fund obligations. It appears that this "capacity" is intended to address any additional general fund deficit that accumulates by June 30, 2004.

Discussion

- The Governor's 2004-05 budget proposal would suspend Proposition 42, with an impact on state transportation programs of $954 million and local government subventions of $184 million. The budget also calls for eliminating the statutory reference to the AB 2928 (2002) TCRP list of transportation projects, the key recipients of Proposition 42 in its first five years.
- The TCRP program has an estimated $486 million in cash needs through the end of 2004-05 to maintain progress on outstanding project contracts, including environmental, design and construction.
- The general fund has accumulated obligations to various transportation programs due to prior year borrowing that is estimated to exceed $2.2 billion, with statutory repayment scheduled to be made between 2006 and 2009.

- The CTC has made no new TCRP allocations since December 2002 and no new STIP project allocations since June 2003. SHOPP allocations were suspended from June through December 2003 and have since resumed only on a limited basis. By the end of this fiscal year, up to $1.6 billion in STIP and SHOPP projects may be ready to be advertised for construction.
- The $1 billion contemplated in this proposal could be used to offset the amounts needed to maintain progress on TCRP projects and support the STIP in conformance with the 2004 Fund Estimate.

Recommendation

Dedicate $ 1 billion, ($500 million in 04/05 and $500 million in 05/06) in the bond proceeds from the untapped "capacity" to keep the fund estimate whole and to fund TCRP cash flow needs until Proposition 42 transfers can be resumed in 2006/07. Repay the remaining $1.4 billion dollar of loans back to transportation in $200 million dollar increments beginning in 2006/07.

(2) Grant Anticipation Revenue Vehicles (GARVEE Bonds)

Background

The Administration has endorsed the use of federally and state authorized GARVEE bonds as a means to provide immediate resources to initiate construction contracts for several key transportation projects distributed throughout the state.

GARVEE bonds are revenue bonds pledged against future federal highway program receipts. The state's annual debt service costs for STIP projects are counted against STIP county shares. This allows large and significant projects to move ahead even if the STIP county share is not of sufficient size to accommodate the project in a single STIP on a pay-as-you-go basis.

The 2004-05 state budget not only recognizes debt service for the bonds issued in 2003-04, but would appropriate $800 million in proceeds for another bond issuance in 2004-05.

Discussion

- The $800 million in the budget proposal for 2004-05 creates both an expectation and a limitation on CTC action for project bonding in the coming year. The CTC's policy and master indenture for GARVEE bonds permit the Commission to issue bonds up to a limit of 15% of legally available federal revenues, half of the amount that was permitted under statute. This equates to roughly $3 billion in bonding capacity, with this capacity available over 12 years, the expected annual bond term, or an average of about $250 million per year. The first bond issuance, in 2003-04, was for about $650 million, about 20% of the 12-year capacity.
- Financial constraints require that the upcoming 2004 STIP, to be adopted in August, delay $2.7 billion in STIP projects from 2004-05 to later years. This, together with the reduction in SHOPP allocations for 2003-04, means that there will be a backlog of priority transportation projects that could be sustained through GARVEE bonding.

- A more aggressive approach to GARVEE bonding, as permitted under the CTC policy and indenture, could increase the amount of new construction hitting the street in the next 12-18 months, with the associated economic benefits that would attach.
- The annual appropriation of a specific amount of future GARVEE bond proceeds in the budget, made before the development of the STIP, could in future years create expectations for bonding that are inappropriately high, creating pressures to bond for projects inappropriately and drawing down bonding capacity prematurely. Bonding at inappropriately high levels could also reduce the size of pay-as-you-go funding capacity and cause undue delays for projects in counties without bonded projects.
- Properly used, GARVEE bonding is a tool that can be used to provide an immediate economic boost when other resources are inadequate and to allow major projects to proceed without delaying other projects elsewhere. Improperly used, it could cause project delays in some areas in order to advance projects in others.

Recommendation

Remove the appropriation of specific amounts of GARVEE bonding from the state budget. Permit the CTC to exercise its judgment through the programming process to determine the appropriate timing and amounts of GARVEE bonding, considering the overall availability of funding, project delivery, and the constraints of statute, policy, and the bond master indenture.

(1) Capture savings out of Caltrans corporate structure

Background

The department has been permitted to grow its base budget significantly over the decade leading up to 2001-02, particularly in its administration and corporate, or Headquarters', functional areas. Not only does this growth add to the overall cost structure of the base budget at the expense of funds available for capital investment, but also it adds to the complexity of decision-making and centralization of authority from the regional implementing organizations within the department.

Discussion

- The Administration function within Caltrans relies on more than 1300 pys, costing $300 million annually.
- The Planning function has more than 800 pys, valued at nearly $150 million.
- Paring back any of these, or other, departmental cost centers will generate savings that can be applied as additional funds available to capital contracts in the SHOPP and STIP.

Recommendation

Support the current BT&H review of functional areas within the department with the goal to free-up resources. If a restructuring of the department emerges from this effort, the discipline to maintain the re-based budget should aid in resisting in re-growing the department, generating resources that can be applied to new capital investment capacity over the 2004, five-year STIP period.

NEAR TERM ALTERNATIVES – FEDERAL

(1) Treatment of Ethanol taxation

Background

The mandated use of an oxygenate in California under the Federal Clean Air Act has produced a situation that dramatically undermines federal transportation funding for California. Because the amount of federal aid directed back to California is largely based on the amount of highway taxes paid by California motorists, the shift to ethanol-based gasohol, which is taxed at nearly one-third less than gasoline, has already had a profound effect on the development of the 2004 STIP. Since the STIP must be prepared pursuant to estimates based on current law, the 2004 STIP fund estimate reflects the effect of the mandated use of ethanol, and some $3 billion in federal aid has been factored out of the 2004 STIP fund estimate.

Discussion

- The Governor has already come out strongly in support of relieving the mandated use of ethanol. This past week he publicly requested the reconsideration of a waiver request made to US EPA, based on their relief provided to the state of New Hampshire.
- Congress has taken preliminary steps to resolve the associated federal funding issue associated with the use of Methanol throughout the country. Their solution would, first, take back receipts from 2.5 cents per gallon of gasohol that goes to the US Treasury and instead deposit them in the federal highway trust fund. This is supported by the White House. Additionally, they have also drafted a legislative fix to the tax treatment of gasohol that would make the federal highway trust fund whole while still offering incentives to the ethanol producers.

Recommendation

Aggressively support both the recapture of the 2.5 cents per gallon and the proposed new tax treatment of gasohol. A victory on the waiver request would be a key first step, but would not address the lost federal aid entirely since use of ethanol will continue to grow in the state.

(2) Early reauthorization of federal highway and transit programs

Background

The federal six-year transportation program expired October 2003, the end of Federal FY 2004, and was extended through the end of February 2004. A resurgence of congressional attention has been focused on moving a reauthorization bill though before that expiration date.

Discussion

- The heavily anticipated re-authorization of the federal transportation program ran into mixed expectations, with key committees officials seeking significant increases above what the White House had signaled they would endorse. This produced the temporary continuation of expiring program.

- But with the temporary extension also came a limit on the amounts of federal aid to be authorized in the short term. Completion of the reauthorization would have the benefit of "turning on the spigot" in Washington since the federal administrators would have a predictable basis to project funding levels.

Recommendation

Actively support the adoption of an early reauthorization of the federal transportation program.

(3) Transportation Equity Act (TEA – 21) Demonstration Projects

Background

The expiring federal transportation authorization act, called TEA – 21, contained a large number of demonstration projects. These are projects that were incorporated into TEA 21 at its enactment and reflect efforts by Congressional Representatives to assist their local citizens in meeting transportation needs. Many projects thus enacted did not include full federal funding, relying on state and local resources to round out funding to bring them to completion.

A precise accounting of the stage of completeness of the demonstration funding projects has not been maintained, but it would appear, anecdotally, that many have not reached construction stages.

Discussion

- Demonstration projects that have not been completed at the expiration of the authorizing legislation are subject to some vulnerability, with Congress potentially looking to recapture the funds for additional demonstration projects or to augment programs.

Recommendation

Direct Caltrans to prepare an analysis for the status of all pre-existing federal demonstration projects to determine the magnitude of vulnerability of these federal earmarked funds.

If the magnitude warrants, advocate maintaining the fund for use by California.

LONG TERM FUNDING ALTERNATIVES

(1) Statewide half-cent Sales Tax

Background

Since 1984, most urban counties in the state, and a few rural counties, have adopted local voter-approved sales taxes dedicated to transportation programs. At present, sixteen counties operate with this supplemental funding source.

Typically, the funding mix approved by voters includes about one-fourth of the proceeds for transit, one third for local streets and roads maintenance, and the balance for major highway improvements. Over the course of the emergence of this alternative funding source, the amount dedicated collectively for state highway improvements has come to provide nearly fifty percent of the new capacity improvements to the state system.

Court judgments and a constitutional measure, Proposition 218, have altered the local voter approval threshold, from majority to two-thirds. With most of the local measures adopted under the majority vote threshold, this shift in the threshold has threatened the renewal of existing, adoption of new sales tax programs. In 1999 and 2000, Senator Burton unsuccessfully pushed SCA 3, a measure that would have reduced the threshold for voter approval to fifty percent. More recently, a collaborative of private construction management and labor, in combination with the existing sales tax counties have researched the feasibility of pursuing an initiative to lower the threshold to fifty percent. At this writing, the research demonstrates that statewide voter support is not there at the level needed to fund such an attempt.

Discussion

- In 2002, Riverside and Alameda produced the first successful renewals of major sales tax programs. Santa Clara also adopted a new sales tax program in 2002, leveraged largely on the TCRP, but there were a number of notable losses in other counties that year as well.
- San Diego and San Bernardino are the most advanced in their planning for a renewal vote at the two-thirds level in 2004. San Francisco did astonishingly well, with a minimal campaign this past November. Elsewhere, several other counties are also taking the requisite steps to get ready in 2004: Solano, Sacramento, Contra Costa, and San Joaquin are the furthest along, with Napa, Marin, and Ventura also looking.
- The two-thirds voter threshold is daunting, and several legislators, most notably Senator Torlakson, have introduced legislation to reduce the hurdle. SCA 5 would cut the threshold to 55%, but tie up 25% of the funds under this scheme to support "smart growth" solutions.
- Most rural counties do not have the access to the sophisticated campaigning and level of funding that is necessary for a successful attempt at passing the two-thirds vote threshold.
- One idea that has not been exhaustively tested is the concept of imposing a statewide half-cent sales tax, constructed in a manner such that it absorbs the elements of the already existing sales tax measures on a county-by-county basis. This would have the benefit of consolidating all renewals and new measures into one statewide majority vote measure, rather than through the sequential process of seeking statewide voter approval to reduce the local threshold, and then conducting numerous local campaigns.

Recommendation

Support and sponsor a one-time measure for an upcoming ballot that would impose a statewide sales tax for transportation programs; this would be structured so as to absorb existing sales tax programs, extending soon-to-expire programs by majority vote, as well as providing smaller counties with local funding programs as well.

Such an effort would require that the lessons learned from the recent major successful campaigns be incorporated such as: a sunset date, cap on administration expenses, and requirement for a locally adopted expenditure plan to trigger access to funding.

(2) State gas tax legislation

Background

The purchasing power of the state gas tax, which largely funds the activities of Caltrans and local streets and roads, has continued to erode as more efficient vehicles and alternative fuel vehicle come on line in the state. Vehicle travel has continued to rise, adding significantly to the demand for services at the same time.

Since 1980, the gas tax has been increased twice: 1982, two cents per gallon, with half dedicated to locals, and in 1990, when voters approved a phased-in doubling of the tax to 18c cents per gallon, with only two cents to cities and counties. Consequently, maintenance and rehabilitation of the existing system is falling behind, particularly for cities and counties.

In view of the significant borrowing of transportation resources and the suspension of Proposition 42 in 2003-04 and proposed for 2004-05, coupled with the great difficulty in seeking voter approval of renewed or new local option sales taxes, legislators interested in funding transportation infrastructure have developed two different approaches to increasing the state sales tax.

In the first instance, one concept under development is a traditional gas tax, estimated to be 5 cents per gallon, to be imposed for some temporary period of time, say five years. At $150 million per cent, this would raise $750 million annually and would be used to offset the revenues lost to the STIP and locals under the suspension of Proposition 42 in the current year and for the next couple of budget cycles. Locals would argue that a minimum of one cent, but preferably, two cents per gallon should be dedicated to local streets and roads; this would provide up to $300 million to locals, with the balance of $400 million dedicated to the SHOPP and STIP.

The other approach would be a "user" fee developed under the nexus requirements of the so-called "Sinclair Paint" decision, which held that user impacts may be mitigated by fee programs. Senator Torlakson is the main proponent of this approach, since, as a user fee, it could be passed by the legislature with a basic majority vote. His concept would earmark 9 cents per gallon to transportation, and index the user fee rate. An additional one-cent per gallon would be earmarked to mitigate clean air impacts of motorists, with the funds directed to heavy vehicle engine replacement.

Discussion

- A gas tax would be a difficult concept to sell in this environment. A straight gas tax would meet resistance from Republicans, and thus the two-thirds vote for legislative adoption would come into play.
- On the other hand, a mitigation fee approach would generate significant business opposition as well as the opposition of the major oil companies. They collectively ran an unsuccessful initiative to overturn the Sinclair Paint decision and have determined to resist any new fees to be imposed at the state level.
- Simple indexing would offset the erosion of the power of the existing gas tax since the tax would increase as demand increased. But transportation interests would not see the offset for the foregone revenues and voters and legislators alike would have difficulty in

accepting the new tax as long as other transportation resources were being redirected in the budget process.

- The feasibility of the gas tax is presently being reviewed by the Transportation Research Board (TRB), which is charged with analyzing fuel efficiency standards and their impact on projected tax receipts.

Recommendation

Direct BT&H to undertake a review, with stakeholders, of the feasibility of continuing to rely on the gas tax as a capital funding mechanism.

(3) Value-pricing

Background

Managing transportation demand through the implementation of value pricing, or congestion pricing, concepts is re-emerging as a high interest alternative with some real capabilities. In essence, this is the marriage of technology, through the use of transponders and other electronic systems, and policy. Examples presently operating in California include the SR 91 system in Orange County and the I-15 managed lanes in San Diego County. Unused capacity in HOV lanes is "sold" to single occupant vehicles with the "cost" to access the lanes for all users subject to variable prices. Higher prices are charged for higher demand periods to sustain reasonable flow in the HOV lanes.

At the national level, these concepts are taking hold in the discussions surrounding the reauthorization of the transportation act, while in California; at least three different regional entities are seeking legislative approval to expand their authority, San Diego, Santa Clara, and Alameda counties. As growth in demand continues to outpace our ability to provide additional new capacity, value pricing may emerge as one mechanism to help manage that demand.

Discussion

- The SR 91 project has left a bitter taste in lawmaker's mouths. With the advent of the transfer of the facility to OCTA there have been price increases in the fee schedule three times in the last year alone.
- In contrast, the I-15 project has met with reasonable receptivity in the region. These managed lanes use the proceeds raised by the fees to provide enhanced transit service within the corridor.
- The issue for many lawmakers will be the notion that somehow congestion priced travel is tantamount to providing "Lexus lanes" benefiting only those with discretionary income. This attitude will have to be overcome in order for new congestion pricing authority can be adopted.

Recommendation

Embrace congestion pricing as both a demand management tool and a source of corridor–based funding augmentation for capital and for transit operations. Support legislative efforts expected to be introduced in 2004.

(4) Vehicle usage fee as replacement for gas tax

Background

In the mid 1990's considerable original research was undertaken to identify a true user based source of funding to replace the gas tax as the principal source of resources for California's transportation program. The California Transit Association, Caltrans and others, concerned over the erosion of the purchasing power of the gas tax, looked at a variety of alternatives. A conceptually promising solution emerged in the form of a Vehicle Miles Traveled (VMT) tax. This would be an annual fee levied on motorists based on roadway usage and would be initially calibrated to be generally revenue neutral in replacing the gas tax.

Discussion

- Under Governor Wilson a blue ribbon panel recognized the potential that VMT held as a self indexed funding mechanism.
- Issues arose with technology and privacy concerns related to self-reporting versus some form of government tracking. Other issues arose with the manner of collecting the revenues: a single payment with registration could be a hardship for many motorists and feel like a virtual "car tax", in spite of the offsetting reduction in the gas tax.
- New research on the feasibility of user based taxation schemes will most likely be considered in the TRB analysis currently under way on the feasibility of the continuation of the current gas tax.

Recommendation

Direct BT&H to undertake a review, with stakeholders, of alternatives to the gas tax, such as a VMT based user fee system.

(5) Examination of the State's role in transportation funding

Background

Two years ago the Davis Administration declared the "end of the freeway" as they dedicated the opening of Route 30 in San Bernardino County. This attitude reflected their conclusion that most of the state's key freeway extensions and completions had been accomplished and that the focus on the future would be to address congestion and connectivity in key corridors, and generally improving throughput of people and goods.

In that view of transportation system development, the state would focus on long range planning, maintenance and rehabilitation of the existing system and specialized services such as bridge construction, and emergency response and repairs. Regional transportation entities would be responsible for local congestion relief and interconnectivity with the state system. At the same time, the Davis administration made an unprecedented effort through the 2000 Transportation Congestion Relief Program (TCRP) to try and direct major capital investments in transportation in California, setting aside a portion of General Fund revenues to cover typically 10 to 20 percent of new capital projects deemed a priority by the administration and selected local interests.

Predating this view, the mid 90's was consumed with devolution of transportation system improvements that shared some of the conclusions espoused by the Davis Administration. The devolution perspective resulted in 1997 with the adoption of the current state transportation allocation formula with 75% of the STIP funds earmarked for regions and the remaining 25% retained by the state to address state priorities. <Question: How does this square with the Davis administration's desire to direct where the money went, and with Finance's continued attempts to control the program?>

Discussion

- The budget crises of this decade have essentially redirected funding that would otherwise be available for congestion relief, new capacity and interconnectivity projects. The forecast for the next couple years remains much the same.
- As discussed under the local option sales taxes, since the 1980s these local programs have provided about half of STIP capacity project funding.
- These factors together have *de facto* served to redefine the role of Caltrans along the lines of the devolution models reviewed nearly a decade ago. The 2004 STIP Fund Estimate protects Caltrans maintenance and rehabilitation programs at the expense of capacity and interconnectivity projects. Locals are the principal source in the next five years for funding these types of projects.
- There is a fundamental and overriding interest in continued investment in the State Highway system in order to adequately maintain it, and improve it for safety, connectivity, operational benefits, and to expand capacity.

Recommendation

Direct BT&H to examine the mission of Caltrans in implementation of new capacity and interconnectivity projects. The review should analyze and make recommendations with respect to the appropriate balance between further devolution of state resources to regional entities and sustaining an appropriate share to be retained by the state for maintenance, safety, connectivity, operational improvements, capacity enhancement and interregional mainline improvements. A final factor to be examined would be how to shape a program focused on business and job retention and other economic factors.

(6) Commercial vehicle cost recovery

Background

Caltrans scientific research has shown that a single commercial vehicle operating at maximum axle weights permitted under the law can have an impact on roadways equivalent to the impact of 10, 0000 passenger vehicles. Although the tax system on commercial vehicles has been adjusted from time to time, these efforts have been political in nature rather than based on projected costs to the statewide system.

Discussion

- The California Trucking Association (CTA) has taken the position that truck fees represent more than a "fair share" approach. They believe that California Air Resources Board adoption of a California-only fuel standard has disrupted the registration of commercial vehicles and therefore suppressed California's collection of truck based revenues.

- The CTA advocates development of a national fuel standard as a means to incentivize relocation of commercial vehicle registration and associated tax collections. They believe such corrective action would bring significant new funding to California.
- Operations in the states ports are heavily reliant on commercial vehicles. Major truck corridors from the ports are some of the most heavily congested highway segments, resulting in delayed movement of goods out of California.
- The ports have been receptive to major capital projects that speed the distribution of goods out of their system. One case in point is the Alameda Corridor Project that was largely revenue bond financed based on a fee per container carried by the railroads. SCAG and other southern California goods movement advocates, have had promising conversation with the ports and trucking interests on the concept of new dedicated truck fees earmarked for specific truck lane improvements

Recommendation

Direct BT&H to undertake a comprehensive cost allocation study focusing on the issue of whether Californians are receiving their fair share of revenues from commercial vehicles and secondarily, whether commercial vehicles are financing their approximate cost impacts to the state system.