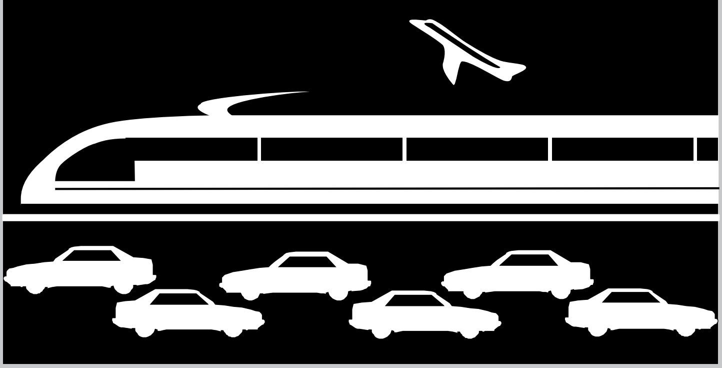
TRANSPORTATION



LAO

60 YEARS OF SERVICE

2003-04 Analysis

MAJOR ISSUES

Transportation

☑ **General Fund Relief Means Traffic Congestion**

- The Governor's proposal to use $1.7 billion in transportation funds to aid the General Fund would significantly delay projects in the Traffic Congestion Relief Program (TCRP) and raises substantial uncertainties regarding the program's future funding. We recommend that the California Transportation Commission (CTC) provide an updated status on all TCRP projects. In addition, the Legislature should act soon and decisively to determine the state's funding commitment to the program, and we provide several options for legislative consideration (see pages A-14 through A-21).

☑ **Proposal to Increase Truck Weight Fees Needs More Information**

- The State Highway Account balance has decreased as a result of increased expenditures and other factors, including a decline in weight fee revenue. In order to avoid a shortfall, the budget proposes to reduce expenditures and increase truck weight fees. However, we find that the fee proposal is based on inconsistent revenue estimates and better information is needed for the Legislature to assess the proposal. We recommend that the Departments of Finance and Motor Vehicles reconcile the difference in the estimates prior to budget hearings. (see page A-24).

☑ **Proposals to Save Motor Vehicle Account May Not Be Enough**

- The Motor Vehicle Account (MVA) faces a significant deficit in the budget year without corrective actions. The budget proposes a number of solutions to address the shortfall, including increasing fees to raise revenue by $163 million in 2003-04. However, these solutions may not go far enough if things don't "break right" for the account. In order to ensure that the MVA remains in a healthy fiscal condition, the Legislature will have to either increase fees further or reduce expenditures for the departments it supports to below current-year levels (see page A-30).

☑ **Costs for CHP Staff Continue to Soar**

- Costs for California Highway Patrol (CHP) staff could be over $100 million more than budgeted in order to fund required benefits and scheduled salary increases. We recommend that the Department of Finance and CHP report on the magnitude of these unfunded costs and present the administration's plan to pay for them (see page A-76).

☑ **Telephone Surcharge Proposed for Protective Services**

- The budget proposes to pay for CHP's protective and security services with a new surcharge on intrastate telephone calls, even though there is not a sufficient linkage between the proposed surcharge and the activities it would fund. If the Legislature deems the surcharge an appropriate funding source, however, we recommend that CHP not be authorized to set the surcharge rate, and that the use of surcharge revenue be limited to specific, non-transportation-related activities (see page A-80).

☑ **Extensive Project Rescheduling Diminishes Value of STIP and Comprises Oversight**

- In recent years, Caltrans has consistently rescheduled the delivery of a significant amount of State Transportation Improvement Program (STIP) projects to later years. This reduces the value of the STIP as a scheduling tool, and renders Caltrans' annual capital outlay and capital outlay support budgets meaningless. Legislative oversight of Caltrans' performance is seriously compromised. We recommend that Caltrans and CTC report on the reasons for the high levels of project rescheduling. We further recommend budget bill language requiring CTC to identify in strategies to reduce the level of project rescheduling (see page A-65).

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OVERVIEW

Transportation

Total state-funded expenditures for transportation programs are proposed to be significantly lower, by 6.6 percent, in 2003-04 than estimated current-year expenditures. The decline is primarily from lower expenditures for transportation projects as the result of (1) no funding for the Traffic Congestion Relief Program proposed for 2003-04, and (2) a projected cash shortfall in the State Highway Account in the current and budget years.

For traffic enforcement, the budget proposes no growth in the expenditure level of the California Highway Patrol and the Department of Motor Vehicles. The budget also projects a significant shortfall in the Motor Vehicle Account in 2003-04 and proposes increasing various fees to generate about $163 million in 2003-04 to avert a deficit in the account.

EXPENDITURE PROPOSAL AND TRENDS

Budget Proposal. The budget proposes total state expenditures of about $6.4 billion for all transportation programs and departments under the Business, Transportation and Housing Agency in 2003-04. This is a reduction of $454 million, or 6.6 percent, below estimated expenditures in the current year.

Historical Trend. Figure 1 (see next page) shows total state-funded transportation expenditures from 1996-97 through 2003-04. As the figure shows, these expenditures are projected to increase by about $1.6 billion, or 33 percent, from 1996-97 through 2003-04. This represents an average annual increase of 4.2 percent. Figure 1 also displays the spending for transportation programs adjusted for inflation (constant dollars). On this basis, expenditures are estimated to increase by 12 percent from 1996-97 through 2003-04, at an average annual rate of 1.7 percent.

As Figure 1 shows, state-funded transportation expenditures increased each year from 1996-97 through 2000-01, after which expenditures have declined. This expenditure trend reflects a combination of factors. First, state-funded expenditures by the Department of Transportation (Caltrans) increased steadily from 1996-97 through 2000-01 due to increasing expenditures (both support and capital outlay) for highway improvements, including the seismic retrofit of state highways and bridges. Second, in 2000-01, under the Traffic Congestion Relief Program (TCRP), the state allocated $400 million in General Fund money for local streets and road improvements. The drop in budget-year expenditures reflects mainly the budget proposal to suspend funding for TCRP projects in 2003-04. Third, from 1996-97 through 2002-03, state funding for both the California Highway Patrol (CHP) and the Department of Motor Vehicles (DMV) grew steadily. Over the period, expenditures for the CHP grew by 43 percent and those for DMV grew by 32 percent, or at an average annual rate of 6.2 percent and 4.7 percent, respectively.

Figure 1

Transportation Expenditures Current and Constant Dollars

1996-97 Through 2003-04
All State Funds (In Billions)

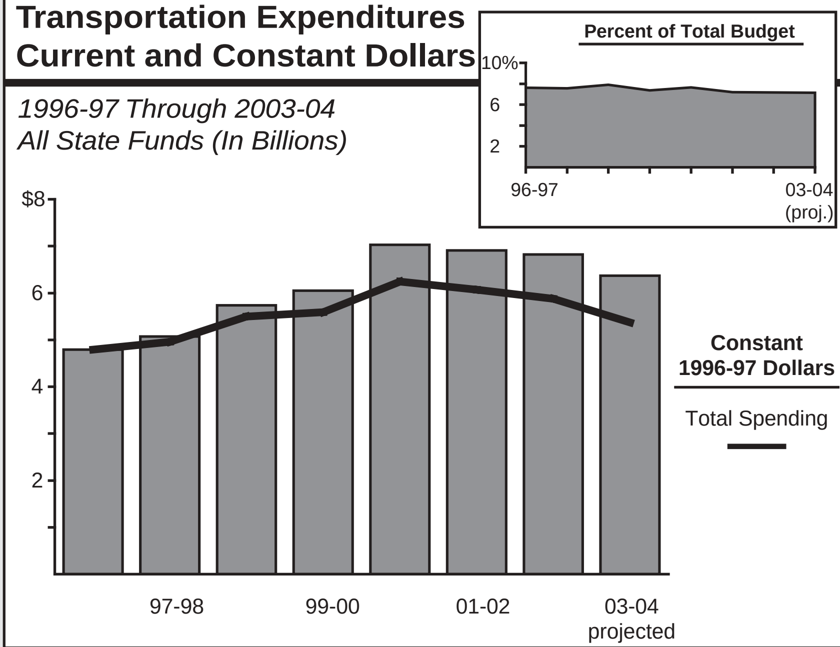


Figure 1 also shows that transportation expenditures as a share of state expenditures have remained relatively stable since 1996-97. In 2003-04, proposed transportation expenditures will constitute about 7.1 percent of all state expenditures.

Of the 2003-04 state transportation expenditures, about $5.1 billion is proposed for programs administered by the state and $1.1 billion is for subventions to local governments for streets and roads. Another $200 million will be for debt-service payments on rail bonds issued under Propositions 108 and 116 of 1990 and seismic retrofit bonds issued under Proposition 192 of 1996.

SPENDING BY MAJOR PROGRAM

Figure 2 (see next page) shows spending for the major transportation programs in detail. Specifically, the budget proposes expenditures of about $6.4 billion (from all fund sources including federal and bond funds and reimbursements) for Caltrans in 2003-04—a reduction of $673.6 million, 9.5 percent, below estimated current-year expenditures. The lower expenditure level reflects primarily reductions in two areas. First, expenditures on the TCRP would decrease by about $375 million due to the proposed suspension of the program in 2003-04. Second, expenditures from the State Highway Account (SHA) would be lower than the current-year level by about $265 million due to a projected cash shortfall in the account.

Spending for the CHP is proposed at $1.2 billion—$4.6 million, 0.4 percent, lower than the current-year level. Most of the expenditures, about 84 percent, would come from the Motor Vehicle Account (MVA). This is a significant drop from past years, when typically about 90 percent of CHP expenditures came from the MVA. The budget proposes to reduce CHP's support from the MVA in order to address a projected shortfall in the account. Instead, the budget proposes to fund from surcharges on intrastate telephone calls about $72 million in CHP activities related to responding to 9-1-1 emergency calls and to public safety activities. The budget also anticipates that about $75 million of the MVA expenditures in 2003-04 would subsequently be reimbursed by federal funds available for homeland security enhancements.

For DMV, the budget proposes expenditures of about $682 million—$4.3 million, 0.6 percent, less than in the current year. These expenditures would be mainly from the MVA and vehicle license fees (VLFs). Total departmental expenditures in 2003-04 would remain relatively the same as the current year, with funding coming more from the MVA and less from VLFs, compared to the current year.

Additionally, the budget proposes to fund the State Transit Assistance (STA) program in 2003-04 at $100.4 million, which is $4.5 million, or 4.7 percent, more than the current-year level. Annual STA funding is determined based on a statutory formula, and the level varies depending on anticipated revenues into the Public Transportation Account (PTA). The slightly higher 2003-04 funding level reflects the projected increase in diesel and gasoline sales tax revenues into the PTA. The amount, however, does not include about $42 million that otherwise would be made available to the program under Proposition 42. This is because the budget proposes to suspend in 2003-04 the transfer of gasoline sales tax revenue to transportation purposes required by Proposition 42.

Figure 2

Transportation Budget Summary Selected Funding Sources

2001-02 Through 2003-04 (Dollars in Millions)

	Actual 2001-02	Estimated 2002-03	Proposed 2003-04	Change From 2002-03	
				Amount	Percent
Department of Transportation					
State funds	$3,823.7	$3,982.3	$3,374.0	-$608.3	-15.3%
Federal funds	2,702.9	2,888.0	2,740.0	-148.0	-5.1
Reimbursements	812.7	192.0	274.7	82.7	43.1
Totals	**$7,339.3**	**$7,062.3**	**$6,388.7**	**-$673.6**	**-9.5%**
California Highway Patrol					
Motor Vehicle Account	$949.5	$1,126.0	$1,039.7	-$86.3	-7.7%
Other	102.8	110.5	192.2	81.7	73.9
Totals	**$1,052.3**	**$1,236.5**	**$1,231.9**	**-$4.6**	**-0.4%**
Department of Motor Vehicles					
Motor Vehicle Account	$351.3	$355.3	$389.3	$34.0	9.6%
Vehicle License Fee Account	277.4	269.6	213.1	-56.5	-21.0
Other	66.1	61.3	79.5	18.2	29.7
Totals	**$694.8**	**$686.2**	**$681.9**	**-$4.3**	**-0.6%**
State Transit Assistance					
Public Transportation Account	$171.0	$95.9	$100.4	$4.5	4.7%

MAJOR BUDGET CHANGES

Figure 3 highlights the major changes proposed for 2003-04 in various transportation programs.

Figure 3

Transportation Programs
Proposed Major Changes for 2003-04

Department of Transportation	**Requested:**	**$6.4 billion**	
	Decrease:	**$673.6 million**	**(-9.5%)**

+ $1.8 million for high speed rail environmental review

– $1 billion in General Fund transfer to the Transportation Investment Fund

– $500 million in loan repayment from the General Fund

– $208.9 million in staff and operating expenses

– $126.8 million in Traffic Congestion Relief Program support

– $109 million in local assistance expenditures

California Highway Patrol	**Requested:**	**$1.2 billion**	
	Decrease:	**$4.6 million**	**(-0.4%)**

+ $411,000 for the Motorcycle Safety Training program

– $20 million in one-time equipment cost for security enhancement

Department of Motor Vehicles	**Requested:**	**$681.9 million**	
	Decrease:	**$4.3 million**	**(-0.6%)**

+ $322,000 for office renovation

Caltrans. As the figure shows, the budget proposes to suspend the transfer of about $1 billion from the General Fund to the Transportation Investment Fund as required by Proposition 42, passed by the voters in March 2002. The budget also proposes to forgive $500 million in loan repayment from the General Fund to the Traffic Congestion Relief Fund

(TCRF) planned for 2003-04. These proposals would leave no funding for the TCRP in the budget year. Correspondingly, the budget proposes to reduce staff support for the program by 1,214 personnel years and $128.6 million in 2003-04.

In addition, the budget proposes to reduce various Caltrans expenditures in order to address a projected SHA cash shortfall. Specifically, the budget proposes to reduce staff support and noncritical operating expenses by about $209 million and local assistance expenditures by $109 million in 2003-04. These reductions are in addition to current-year actions that include a reduction of $307 million in the loan to the TCRF and a reduction of about $90 million in SHA funding for local streets and roads.

The budget also proposes to consolidate staff support for the High Speed Rail Authority into Caltrans. For the budget year, Caltrans would continue to oversee the environmental clearance work for a high-speed rail system at a cost of about $1.8 million.

The CHP and DMV. For both CHP and DMV, the budget proposes to maintain expenditures at essentially the current-year level. As Figure 3 shows, both departments would have very slight reductions in expenditures with no major program changes in the budget year. However, even with these levels of expenditures, the MVA is projected to face a significant shortfall in 2003-04 if corrective actions are not taken. The budget proposes to increase vehicle registration fees, fees for driver licenses and identification cards, as well as fees charged for various types of transactions in order to raise an additional $163 million in 2003-04. In addition, the budget proposes to shift about $72 million in CHP support from the MVA to revenues from surcharges on intrastate telephone calls. Specifically, $41 million would come from an increase in the State Emergency Telephone Number rate to cover CHP's costs to handle cellular 9-1-1 phone calls. Another $31 million would be generated from a new surcharge to cover CHP's costs to provide protective services and conduct search and rescue activities.

CROSSCUTTING ISSUES

Transportation

FUNDING FOR TRANSPORTATION PROGRAMS

California's state transportation programs are funded by a variety of sources, including special funds, federal funds, and general obligation bonds for transportation. Two special funds—the State Highway Account (SHA) and the Public Transportation Account—have traditionally provided the majority of ongoing state revenues for transportation. Additionally, in 2000, the Legislature enacted the Traffic Congestion Relief Program (TCRP), which created a six-year funding plan for state and local transportation needs, later extended to eight years—through 2007-08—by Chapter 113, Statutes of 2001 (AB 438, Committee on Budget). The program is funded by two fund sources—the Traffic Congestion Relief Fund (TCRF) and the Transportation Investment Fund (TIF)—from a combination of General Fund revenues (one-time) and ongoing revenues from the sales tax on gasoline that are to be transferred from the General Fund to the TIF annually beginning in 2003-04. In March 2002 voters passed Proposition 42, which permanently extended the transfer of gasoline sales tax revenues into the TIF and dedicated the funds to various transportation programs. These programs include local street and road improvement, the State Transportation Improvement Program (STIP), State Transit Assistance, and other mass transportation activities funded by the Department of Transportation (Caltrans).

The STIP. The state's primary program for the construction of new transportation projects is the STIP. Funding comes primarily from the SHA and federal funds. In addition, under Proposition 42, a portion of TIF money will annually be made available for the STIP. Each even-numbered year, the California Transportation Commission (CTC) programs new projects to receive STIP funding based on an estimate of the funds available over the next five years. Statute allows Caltrans to spend 25 percent of the available STIP funds on interregional transportation improvements, with the remaining 75 percent going to designated regional transportation planning agencies for regional transportation improvements. The regional funding is further allocated to counties based on statutory formula.

The TCRP. The TCRP is the second major project construction program. It consists of 141 statutorily-defined projects located throughout the state, with each project receiving a specified amount of money. Collectively, TCRP projects are to receive about $4.9 billion through 2007-08, with the General Fund providing $1.6 billion in 2000-01 and the sales tax on gasoline providing $678 million each year from 2003-04 through 2006-07 and $602 million in 2007-08. Because TCRP does not provide full funding for all of the projects, many of them are funded from multiple sources, including STIP money.

In this section, we review the Governor's proposal related to TCRP funding and discuss actions that the Legislature should take and options it can consider. We also review the condition of SHA and how it affects the funding of TCRP and STIP projects.

FUNDING FOR TCRP

TCRP Funds to Provide Substantial General Fund Relief

The administration proposes to use about $1.7 billion in transportation funds to aid the General Fund in the current and budget years, primarily from the Transportation Investment Fund and the Transportation Congestion Relief Fund. The proposal would significantly delay projects in the Traffic Congestion Relief Program and raise substantial uncertainties regarding the program's future funding.

Actions Taken in Prior- and Current-Year Budgets. To help balance the General Fund budget in 2001-02 and the current year, a total of about $1.3 billion from the TCRF has been loaned to the General Fund. This money is currently scheduled to be repaid over a multiyear period to the TCRF beginning in 2003-04. Under current law, all TCRF loans must be repaid by June 30, 2006.

Budget Proposes Further Redirection of TCRF Money and Suspension of TIF Transfer. The Governor proposes to address part of the projected General Fund shortfall by shifting about $1.7 billion from the TCRF and the TIF to the General Fund. Specifically, the budget proposes the following actions:

- Transfer $100 million from the TCRF to the General Fund in the current year.
- Forgive a $500 million loan repayment from the General Fund to the TCRF scheduled for the budget year.
- Suspend the transfer of about $1.1 billion in sales tax revenue from the General Fund to the TIF in the budget year. If the transfer were to occur as scheduled, $678 million of this money would fund TCRP projects, and the remainder would be split among STIP projects, local street and road improvements, and mass transportation.

In addition, the budget proposes to reduce SHA funding of local streets and road improvements in the current year by about $90 million to address a projected cash shortfall in the account.

Immediate Impact of the Governor's Proposal. Figure 1 (see next page) summarizes the programmatic impact of the Governor's proposal. At the time this analysis was prepared, the Legislature had rejected the Governor's proposal to reduce SHA funding for local street and road improvements in the current year. Accordingly, Figure 1 reflects this legislative action. As the figure shows, the largest effect of the remainder of the Governor's proposal would be on TCRP projects—about $1.3 billion. This amount includes $100 million transferred in the current year, the $500 million loan forgiveness, and $678 million (out of the $1.1 billion) that otherwise would be available from TIF in 2003-04. According to the administration's May 2002 projections of TCRP expenditures, almost all of the $1.3 billion would be needed through the budget year if TCRP projects were to proceed without delay. The Governor's proposal would provide no funding in the budget year for TCRP projects and would leave only about $300 million in TCRF to cover remaining current-year costs. The administration estimates that this amount is needed to reimburse Caltrans and local agencies for expenditures they have already incurred, and to close out or terminate existing contracts for TCRP projects in the current year. The administration's estimate assumes that TCRF would have to make payments to 114 projects, 36 of which would include contract termination expenditures.

At a minimum, the Governor's proposal would delay many TCRP projects until 2004-05, when under Proposition 42 another $678 million would become available for these projects. In the interim, only projects that have access to other funding sources may be able to continue. In response to the Governor's proposal and a projected low balance in the SHA, the CTC suspended making any new allocations for TCRP projects from December 2002 until at least February 2003 in order to avoid increasing the amount it has committed to pay on these projects. It is uncertain at this point whether any project would be permanently cancelled, although the Governor's proposal calls for statutory authority for CTC to de-allocate prior project allocations.

Figure 1

Programmatic Impact of the Governor's Transportation Proposals[a]

(In Millions)

Program	Impact
Traffic Congestion Relief Program	-$1,278
Local street and road improvements	-168
State Transportation Improvement Program (STIP)	—[b]
State Transit Assistance	-42
Other mass transit programs	-42

a Assumes that the transfer of gasoline sales tax revenues to the Transportation Investment Fund in 2003-03 would equal $1.1 billion in the absence of the Governor's proposal.

b Due to a difference between the Assembly and the Senate actions on the Governor's proposal, the impact on STIP ranges from a loss of $78 million to a loss of $168 million.

As Figure 1 also indicates, several other programs would lose funding under the Governor's proposal. Specifically, as the result of the proposed suspension of the transfer of gasoline sales tax revenue into the TIF, counties and cities would receive about $168 million less in 2003-04 for road improvements. The STIP would receive up to $168 million less, while funding for mass transportation programs would be lower by a total of about $84 million.

Governor's Proposal Creates Uncertainty for TCRP. The Governor's proposal raises a number of uncertainties related to funding of TCRP. In the near term, with no new funding for TCRP projects in the budget year, the projects will have to be funded from other sources if they are to continue. The administration indicates that project sponsors should look to the STIP process for replacement funding, and proposes that Caltrans and local agencies work with the CTC to reprioritize their STIP and TCRP projects in order to direct available STIP dollars to the highest-priority projects.

The CTC initiated discussions with local agencies and Caltrans in January with the goal of coming up with more precise estimates by March on the amount of funding available for projects and the demand for those funds. However, it is unclear at this point how priorities will be set, and the administration has not provided any guidance. It is also unclear what the level of available funds will be for TCRP projects in the budget year, as legislative deliberations have just begun on the Governor's proposal. These uncertainties make it difficult for the CTC and project sponsors to set priorities among projects, because how projects are reprioritized would depend in large part on how much and when funding is available.

The Governor's proposal also raises substantial uncertainty regarding long-term funding for TCRP. While the Governor's proposal clearly signals an intention to stop all TCRP funding through the budget year, the administration's intention for future years is unknown. The Mid-Year Budget Revision in December 2002 suggested that the administration was considering suspending the Proposition 42 transfer for several years, and possibly stopping funding for TCRP projects entirely. The Governor's January budget, however, only proposes stopping the TIF transfer in 2003-04, without reference to the administration's intent for future funding of the program.

Uncertainty about the status of TCRP funding in future years creates doubt about how to deal with the proposed cuts now. If funding for the program will be made whole after 2003-04, project sponsors need only find temporary funding solutions to keep projects going in the budget year. If funding of the program is to be terminated, then project sponsors will have to decide whether their TCRP projects should continue and how to fund them.

Funding TCRP: Issues and Options for Legislative Consideration

To assist the Legislature in determining whether to provide any funding for projects in the Traffic Congestion Relief Program (TCRP) in 2003-04, we recommend that the California Transportation Commission provide by mid-March an updated status on all TCRP projects. We also think that the Legislature should determine the state's long-term funding commitment for the program. We provide several options for the Legislature's consideration.

In considering the Governor's proposal to use funds dedicated for TCRP to address the state's General Fund condition, the Legislature should also address two issues related to the funding of the TCRP. Addressing these issues in a timely manner would significantly reduce the uncertainties discussed above.

- First, if the Governor's proposal is adopted, should any "bridge" funding for TCRP projects be provided for 2003-04?
- Second, what is the state's commitment to funding the TCRP program?

Should "Bridge" Funding Be Provided? As noted above, the Governor's proposal to redirect $1.3 billion from TCRP would leave about $300 million to cover estimated expenditures in the rest of the current year, but no funding at all in 2003-04. However, some projects will continue to incur expenditures in the budget year unless outstanding contracts are terminated. For instance, some projects are under construction. Cutting funding for these projects could leave partially constructed projects unfinished. Other projects may have just entered into contracts for work to be done in the budget year. Terminating these contracts could entail costs that might exceed the cost of completing the contract. In deciding whether to provide bridge funding in the budget year, the Legislature needs accurate information on the current status of TCRP projects and their funding requirements in 2003-04, absent the Governor's proposal.

Figure 2 shows the administration's rough estimates of the amounts that would be needed in 2003-04 if funding is provided to move projects through different stages. For instance, if all existing contracts are closed out in the current year, the state could suspend all additional funding of TCRP projects in 2003-04, as the Governor proposes. In that case, the Legislature may not need to provide any bridge funding. If, on the other hand, the Legislature wishes to see existing *construction* contracts completed, then funding of about $200 million would be needed in 2003-04. Similarly, funding *all* outstanding contracts to completion would cost about $310 million in the budget year. These amounts are the estimates the administration used in preparing the Governor's budget, but they were calculated without input from the local agencies responsible for TCRP projects and are therefore subject to change.

As noted earlier, the CTC has started discussions with Caltrans and local agencies that sponsor TCRP projects, and plans to have more up-to-date information on project status by March. We think this information is essential in order for the Legislature to determine the amount of money that would be needed to fund TCRP projects in 2003-04. Accordingly, we recommend that the CTC provide to the Legislature by mid-March detailed information on the status of each TCRP project, including projected expenditures to close out all contracts, to continue only construction contracts through the budget year, and to continue *all* contracts through the budget year.

What Is the Ultimate Fate of the TCRP? A more fundamental issue that the Legislature should consider is the state's commitment to fund the TCRP program. Addressing this issue would reduce the uncertainties surrounding the program's status and provide a clear signal to project sponsors so they can plan accordingly. It would also provide a basis to determine whether any bridge funding in 2003-04 is warranted.

Figure 2

Budget Year Funding Required for TCRP Projects Varies With Project Status[a]

(In Millions)

TCRP Projects	Projected 2003-04 Expenditures
Close out all contracts	—
Fund only construction contracts through completion	$200
Fund all outstanding contracts through completion	310

[a] All figures are preliminary Caltrans estimates. Projected expenditures for each category will be revised by the California Transportation Commission in March. It is anticipated that costs will be incurred to close out contracts.

Transportation projects typically span multiple years from project initiation to completion because they are developed in various phases beginning with siting and environmental reviews through construction. From a financing perspective, it is important to identify funding availability over the life of a project to insure that once projects are initiated they can be completed. Predictable funding is essential in order for projects to progress efficiently and effectively. Even projects with multiple funding sources can experience major disruptions if one of those sources is jeopardized. For example, much of the transportation funding provided by the federal government comes with a requirement that the recipient agencies provide matching funds. If the matching funds are lost on a project, the federal funds are too. By contrast, if a project sponsor has stable future sources of funding committed to a project, it can obtain financing by bonding against those future sources in order to get a head start on the project. If the future source of that funding is uncertain, this type of project acceleration is impossible.

The Legislature has a number of options in considering the status of the TCRP program. One of the options is to adopt the Governor's proposal as a *one-time* action, making clear that total funding of the program is reduced by $1.3 billion. In adopting this option, the Legislature should also determine how to allocate the reduction among the TCRP projects.

Other options range from terminating any future funding for TCRP to making a full funding commitment for the program. We discuss these options below.

- ***Option: End the State's Commitment to the TCRP.*** This option would remove from statute the commitment of state funds to TCRP projects. The Legislature could then allocate any future funds from Proposition 42 that have been designated to TCRP project to various transportation uses, including the STIP, local street and road improvements, and public transportation. This option would allow the Legislature to adopt the Governor's proposal to aid the General Fund without having to repay the funds. It would also eliminate outstanding loans from the TCRF to the General Fund that are to be repaid in 2004-05 and later.

  Under this option, all TCRP projects would compete equally for transportation funding under the STIP process implemented by the CTC. However, some large TCRP projects might never be constructed. This is because currently some TCRP projects are designated to receive state funding far exceeding the share of STIP money allotted to the county in which the project is located. Funding such projects may mean that the county would not have any STIP funds for other transportation priorities for a number of years. To the extent these TCRP projects are still of high priority to the Legislature, it may have to separately provide funding for them.

- ***Option: Partial or Full Deferred Repayment of TCRP Dollars From the General Fund.*** This option would entail adopting the Governor's proposal, but with the clear commitment that in future years the General Fund would partially or fully repay the TCRF both the amount redirected by the Governor's proposal ($1.3 billion), as well as all prior year loans ($0.8 billion). Full repayment would allow the state to fulfill its commitment to TCRP projects, although projects would be significantly delayed by the lack of funding in the near term. Full repayment would also create General Fund expenditures of $2.1 billion in future years.

- ***Option: Provide Full Funding for TCRP From a Predictable Funding Source.*** The Legislature could consider imposing a gas tax to raise revenues to fully fund the TCRP. A 3-cent-per-gallon increase would provide about $2.1 billion over four years. This option would relieve the General Fund of any obligation to repay TCRP projects for the Governor's proposed actions in the current and budget years ($1.3 billion) and for the funds that have already been borrowed from TCRF ($0.8 billion), which together remove

$2.1 billion from TCRP projects. It would also provide a steady revenue stream, allowing projects to proceed without further delay. If the tax were to be continued on a permanent basis, the additional revenues could begin to address a ten-year transportation funding shortfall of over $100 billion that was identified by the CTC in 1999.

Legislature Should Act Soon to Minimize Uncertainty. As we discuss above, the Governor's proposal to remove $1.3 billion from TCRP projects in the current and budget years creates uncertainty regarding the ultimate fate of these projects. This uncertainty affects the reprioritization decisions that CTC and project sponsors must make. In order to assist these parties in making informed decisions regarding the priorities of their TCRP and STIP projects and to avoid having to revisit TCRP funding on an annual basis, the Legislature should act as quickly as possible to determine its level of commitment to the TCRP and to ensure that funds are available to match this level of commitment.

FUNDING FOR STIP

The SHA and STIP Face New Pressures

In the late 1990s, the State Highway Account (SHA) accumulated a large cash balance due to increasing revenues and lower-than-projected expenditures. With increased State Transportation Improvement Program expenditures, the balance has declined. However, this decline has occurred concurrently with other factors that put pressure on the SHA's fund balance.

As noted earlier, the five-year STIP schedules transportation projects to be developed and constructed based on an estimate of state and federal funding available over the period. The SHA is the primary source of state funding for the STIP.

High SHA Balance Has Begun to Decline. As we discussed in the *Analysis of the 2002-03 Budget Bill*, the SHA's cash balance began to rise dramatically in 1994-95. It continued growing through 1998-99, when it reached a record high of $2.3 billion. Reasons for this growth included the unexpected availability of funds that were no longer needed for seismic retrofit work, increased federal funding for transportation, and lower-than-projected levels of capital outlay expenditures. As available transportation funds increased, CTC programmed additional STIP projects, and Caltrans and local transportation agencies began to increase their levels of expenditures. Partly due to these higher spending levels, the SHA balance began to decline after 1998-99, reaching $1.2 billion at the end of 2001-02. Caltrans projects that the SHA balance will continue to fall, and absent corrective actions, will face a shortfall of $173 million by the end of the current year. However, increased STIP-related expenditures are only one of several factors that have lowered the SHA balance. Additional factors contributing to this funding situation are discussed below.

The SHA Has Loaned Money to Other Funds. As the General Fund condition has deteriorated in the past few years, transportation funds—TCRF money in particular—have been used to aid it. In order to prevent TCRP project delay, SHA funds have been used to partially backfill the TCRF loans. Figure 3 shows for the period 2000-01 through 2002-03 loans of SHA money for TCRP and other non-STIP purposes. As the figure indicates, loans from SHA to TCRF will total about $232 million by the end of the current year. Current law requires that these loans be repaid by June 30, 2007. Also, the SHA made a $173 million loan directly to the General Fund in 2001-02. This loan must be repaid by June 30, 2005.

Figure 3

State Highway Account Loans Affecting Cash Balance

(In Millions)

	TCRF	General Fund	Local Streets And Roads	Total
2000-01	$2	—	—	$2
2001-02	41	$173	$143	357
2002-03	189	—	145	334
Totals	**$232**	**$173**	**$288**	**$693**

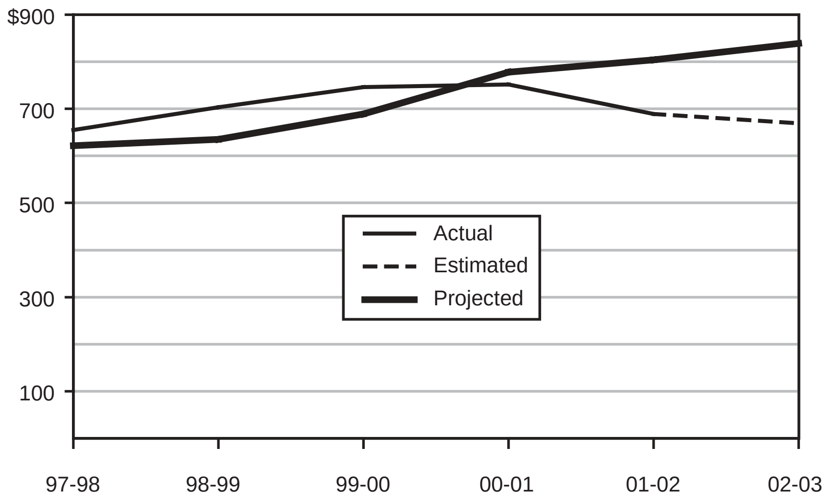
Additionally, under Chapter 113, which delayed the transfer of gasoline sales tax revenue into TIF for two years, SHA will pay about $288 million to local agencies for street and road improvements through 2002-03. Chapter 113 provided that the amount would be repaid to SHA from future TIF revenues. The budget proposes canceling the final three quarters of this payment—estimated at $90 million—in the current year. However, at the time this analysis was prepared, the Legislature had rejected this proposal to reduce SHA funding for local street and road improvement.

Weight Fee Revenues Have Declined. Truck weight fees are one of the primary sources of SHA funding. Chapter 861, Statutes of 2000 (SB 2084, Polanco), changed the way a portion of the weight fees is collected in order to be more consistent with the practices of other states. The change was intended to be “revenue neutral,” meaning that it would not affect the total amount of weight fees collected annually. However, actual weight fee revenue in 2001-02—the year the new fee schedule took effect—was only $689 million, 15 percent less than the amount estimated. The budget now anticipates revenue in the current year to be $669 million, 20 percent less than originally projected. Figure 4 shows the difference between actual and projected weight fee revenues. As the figure shows, weight fee revenues in the last two years will total about $300 million less than estimated. According to the Department of Motor Vehicles (DMV), the reason for the difference is that the number of trucks paying the new weight fees is much lower than it anticipated.

Figure 4

Actual Versus Projected Truck Weight Fee Revenues

1997-98 Through 2002-03
(In Millions)



Federal Funding Level Uncertain. Because the STIP funds projects based on an estimate of available SHA and federal funding, any reduction in federal funding below the estimated level increases the funding demands on SHA. This is because projects would look to SHA to make up any federal funding gap. Without SHA help, projects would be delayed due to insufficient funding. For the current federal fiscal year (extending through September 30, 2003), the President proposed a substantial decline in transportation funding. Congress has yet to approve a 2003 transportation funding level, but it is considering higher levels of funding than the President proposed. Until that level is decided, likely sometime this spring, the short-term federal funding picture remains uncertain.

A larger uncertainty is the upcoming reauthorization of the federal transportation legislation. The current federal act (TEA-21) expires on September 30, 2003. Because recent federal transportation acts have provided substantial funding increases, Caltrans assumed a similar increase in its federal fund projections to develop the 2002 STIP that extends from 2002-03 through 2006-07. If, however, the federal reauthorization provides a lower funding level, then the 2002 STIP will be short of sufficient funds to complete scheduled projects. In the worst-case scenario, if federal funding remained at the 2002 level for the six-year period from 2003-04 through 2008-09, the state could receive $4 billion less in federal money than anticipated over that period. Recognizing that large federal funding increases were increasingly unlikely, Caltrans built this worst-case assumption into its December 2002 projection of the SHA fund condition. Until the reauthorization is decided, however, this will remain a substantial unknown for the state's transportation funding outlook.

Recognizing the deterioration in SHA, the administration has made a number of proposals to address the fund balance, as discussed below.

Budget Proposes Weight Fee Increase and Lower Expenditures

The budget proposes trailer bill legislation to increase truck weight fees and to reduce State Highway Account (SHA) expenditures in order to ease demands on SHA. We recommend that prior to budget hearings, the Departments of Finance and Motor Vehicles provide the Legislature with consistent, updated estimates of current-year weight fee revenue, an explanation of the causes for the drop in these revenues, and an estimate of the additional revenue that would be generated under the administration's proposal.

Given the pressures on SHA discussed above, Caltrans projected in December 2002 that SHA would have a shortfall of $173 million in the current year and $634 million by the end of the budget year absent corrective actions. To address this projected shortfall, the administration proposes:

- Increases in truck weight fees through trailer bill legislation, to offset the unintended impact of Chapter 861.
- Reductions in Caltrans local assistance and state operations expenditures totaling about $240 million in the current and budget

years. We discuss these expenditure proposals in our analysis of Caltrans' budget (Item 2660).

- Cancellation of the SHA payment for local street and road improvements, as discussed earlier.
- Redirection of $125 million in federal funds from local agencies to Caltrans in the current and budget years.
- Slowing allocations to new capital outlay projects, resulting in reduced expenditures of about $650 million in the current and budget years.

With these actions, the budget projects an SHA balance of about $116 million at the end of the budget year.

Weight Fee Estimates Inconsistent. To boost truck weight fee revenues, the administration proposes to increase enforcement of the weight fees under Chapter 861. In addition, it is proposing trailer bill legislation to increase the fees. It believes that these actions will bring weight fee revenue in 2003-04 back to it historic, higher levels. However, DMV indicates that the proposal is based on a current-year estimate of weight fee revenue that is $53 million lower than the estimate used in the Governor's budget. If this lower current-year estimate is correct, then the SHA condition will be worse than the Governor's budget projects and the actions proposed in the budget will not be adequate to address the SHA problem. If, on the other hand, the Governor's budget estimate is correct, then the proposed fee increases will generate more revenue than is needed to maintain revenue neutrality.

Furthermore, our review shows that the drop in weight fee revenue may not be due exclusively to a decrease in the number of trucks paying the new fee, as DMV indicated. There is anecdotal evidence that DMV may have delayed collection and enforcement of the new weight fees after they became effective December 31, 2001. If true, this would have decreased the amount of revenue collected regardless of the fee schedule contained in the law.

In order to assess the weight fee increase proposal, the Legislature should have better information. Accordingly, we recommend that prior to budget hearings, the Department of Finance and DMV provide the Legislature with consistent, updated estimates of the current-year weight fee revenue, an explanation of the causes for the drop in revenue, and an estimate of the additional amount of revenue that would be generated under the administration's proposal.

MOTOR VEHICLE ACCOUNT CONDITION

The Motor Vehicle Account (MVA) derives most of its revenues from vehicle registration and driver license fees. In 2002-03, those fees account for 89 percent of the estimated $1.4 billion in MVA revenues. The majority of MVA expenditures support the activities of the California Highway Patrol (CHP) (70 percent), the Department of Motor Vehicles (DMV) (22 percent), and the Air Resources Board (5 percent).

MVA Faces Deficit in Budget Year Without Corrective Actions

In the last few years, modest growth in revenues to the Motor Vehicle Account (MVA) has not kept pace with rising expenses such as employee benefits and new antiterror programs. If no corrective actions are taken and federal funds for homeland security are not received, the MVA will face a substantial shortfall by the end of 2003-04 that will worsen in future budget years. The budget proposes to bolster MVA's condition largely through a combination of fee and penalty enhancements and a reduction in the California Highway Patrol's reliance on MVA by providing the department with funding from other sources.

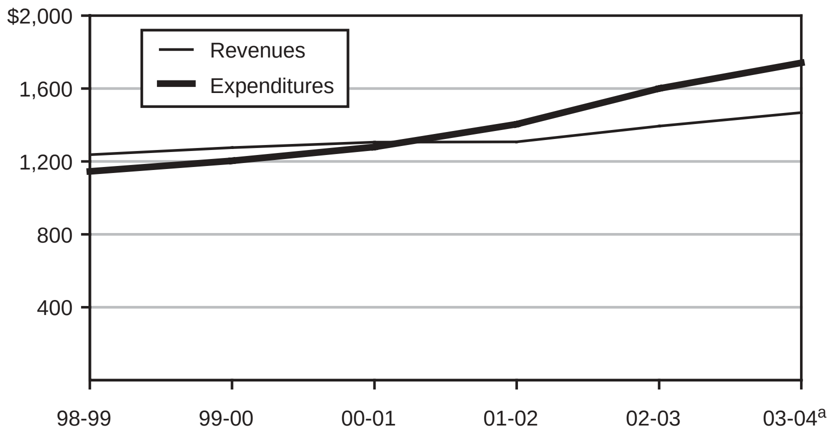
In the last five years, MVA expenditures have increased by 40 percent, while revenues have grown just 13 percent. Figure 1 (see next page) shows MVA revenues and expenditures from 1998-99 through the current year, and projections for 2003-04 based on existing trends. As Figure 1 shows, in 1998-99 MVA revenues exceeded expenditures by $92 million. The difference has dwindled every year since then, however, and in the current year expenditures are expected to exceed revenues by over $200 million. Figure 1 further shows that without corrective actions to raise revenues or to curb expenditures, that gap could grow to over $270 million by the end of 2003-04, resulting in a year-end deficit of approximately $200 million. This means that even if $170 million in federal funds are received in the current and budget years combined as the budget assumes, the account would end the budget year in a deficit.

A combination of factors has contributed to the deterioration of the MVA's condition. The CHP's costs have escalated due to heightened security activities since September 11, 2001. The MVA has paid for almost all of these added expenses, and has yet to receive any federal reimbursements. In addition, costs for staff benefits such as retirement, health insurance, and workers' compensation have risen dramatically in the last couple of years for DMV and CHP employees. Meanwhile, revenues have grown only modestly, and the current-year plan to raise an additional $40 million in fees from the sale of information was never implemented. As a result, current-year revenues are now estimated to be $20 million less than projected, while expenditures will be $69 million more than originally planned.

Figure 1

Motor Vehicle Account Revenues Versus Expenditures

1998-99 Through 2003-04 (In Millions)



a Projected based on current expenditure and revenue trends.

Fee and Penalty Increases Aimed at Boosting MVA Revenues. As part of its solution to this problem, the administration proposes to generate additional revenues by increasing fees and penalties collected by the DMV. As shown in Figure 2, these measures are projected to boost MVA revenues by $163 million in 2003-04 and $333 million annually thereafter. All of the fee increases would go into effect mid-year, and fees would be adjusted annually for inflation. Specifically, the budget proposes to:

- Increase vehicle registration fees from the current $30 to $37. Of the increase, $4 would be dedicated to the support of CHP officers.

- Increase noncommercial driver license fees by $9—from $15 for a five-year license to $24.
- Increase identification card fees for nonseniors from $6 to $20. Seniors, who currently pay $3, would receive their cards free of charge.
- Increase various DMV transaction fees to a standard $15.
- Impose a Business Partner Automation fee, which would charge private firms for the convenience of registering vehicles and performing other transactions on-site.
- Enact new penalties for failure to pay the current fee assessed upon transferring ownership of a vehicle.

Figure 2

Motor Vehicle Account Fee Proposals

(In Millions)

Proposal	2003-04	Annual Ongoing
Increase vehicle registration fees	$95	$190
Increase driver license fees	30	67
Increase identification card fees for nonseniors	9	19
Standardize transaction fees	15	31
Impose Business Partner Automation fee	2	2
Enact new penalties for failure to file transfer of title documents	12	24
Totals	**$163**	**$333**

The Department of Finance indicates that legislation is needed to implement each of these changes.

Budget Proposes New Funding Sources for CHP to Supplement MVA. From 2001-02 to 2002-03, MVA support for CHP increased by 19 percent, from $949 million to $1.1 billion. For 2003-04, the budget proposes to keep CHP funding at about the same level as the current year, but to reduce MVA's share of the department's budget by $86 million. The budget proposes to shift this amount of support to three other funds: the State Highway Account (SHA) ($15.7 million), the State Emergency Telephone Number Account ($41 million), and a proposed new Public Safety Surcharge Fund ($31 million).

In all, the fee / penalty and funding shift proposals total $260 million in the budget year and $427 million thereafter. According to the administration, with these actions, MVA would have a balance of $284 million at the end of 2003-04.

Budget Proposals May Not Go Far Enough In Addressing the Problem

The budget does not reflect a number of cost increases that are scheduled for 2003-04, relies heavily on the uncertain prospect of receiving $170 million in federal homeland security funds, and proposes some solutions that are problematic. In order to ensure that the Motor Vehicle Account remains in a healthy fiscal condition in the foreseeable future, the Legislature will either have to increase further some of the fees proposed in the budget, or reduce expenditures for the California Highway Patrol and the Department of Motor Vehicles below current-year levels.

Salary and Benefit Costs Could Be Significantly Higher Than Budget Reflects. Our review shows that the budget does not include a substantial amount of added costs that will likely require MVA funds. Specifically, the existing memoranda of understanding with state employees call for salary increases to go into effect in July 2003, including a 5 percent salary hike for DMV and nonuniformed CHP staff, and a 6.01 percent increase for uniformed CHP employees. As part of the solution to deal with the General Fund condition, the administration is in discussions with state employee groups to defer or modify these scheduled increases. If these renegotiations are unsuccessful, the increases would result in an extra $44 million in costs to the MVA in the budget year.

In addition, if the retirement rates for 2002-03 increase in the budget year as CalPERS anticipates, expenditures on retirement costs could be $62 million higher than budgeted. Moreover, health care and workers' compensation costs could go up several millions of dollars over the budgeted amount. All together, added costs to the MVA for salaries and benefits in 2003-04 could be well over $100 million higher than the budget reflects. These costs are detailed in Figure 3.

Thus, even if MVA revenues come in on target in the budget year, the 2003-04 projected year-end balance could be less than $10 million if salaries and benefits rise to their anticipated higher levels, and if anti-terror federal funds do not materialize. Figure 4 shows the account's year-end balances as projected by the budget and if MVA expenditures are higher as a result of other factors.

Proposal to Enforce Payment of Title Transfer Fee May Not Be Feasible. A further potential problem lies with the administration's proposal to enforce payment of a $15 fee by new vehicle owners. Currently, when-

Figure 3

Potential Additional MVA Costs Not Reflected in the Budget

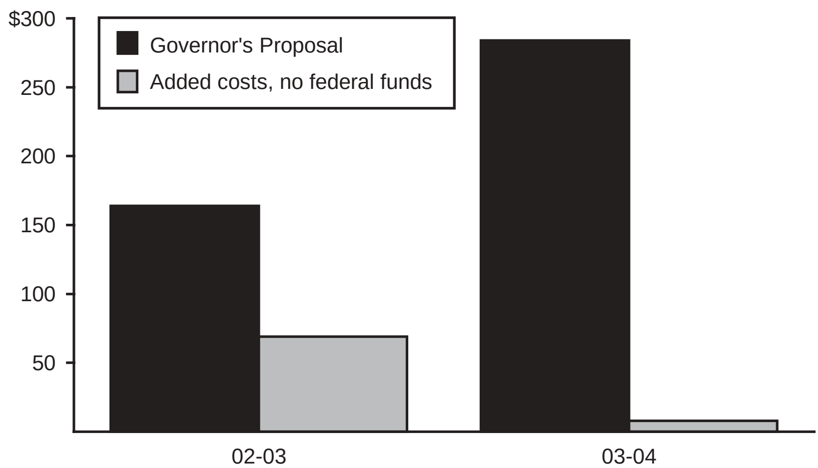
(In Millions)

	Salaries	Retirement
DMV	$10	$11
CHP nonuniformed	7	7
CHP uniformed	27	44
Totals	**$44**	**$62**

Figure 4

Projected MVA Balances With and Without Federal Funds and Additional Costs

(In Millions)



ever ownership of a vehicle changes hands (for example, when one buys a car, or pays off a car loan), the new owner is required to notify DMV and pay a $15 "transfer fee" within 30 days. The DMV estimates that only about one-quarter of these fees are collected. This is because new owners either do not know about the fee requirement, or choose not to report their transaction to the department. To address this situation, the administration proposes to assess a $15 penalty on those owners who fail to pay the fee on time. Based on our review of the proposal, it is not clear how effectively DMV will be able to track ownership changes and identify those new owners that are not in compliance. Thus we question the likelihood of DMV collecting $24 million per year (about $12 million in 2003-04) as proposed in the budget. While these amounts are relatively small in the context of total MVA revenues, their failure to materialize could be the difference between a positive and a negative year-end balance.

Funding Shift Proposals Are Problematic. We also have concerns with the administration's proposals to shift about $57 million in CHP's support costs to the State Emergency Telephone Number Account (911) and SHA. As regards the 911 Account, the budget proposes to increase the current 911 surcharge on intrastate phone calls, with a portion of the new revenues going to CHP activities related to responding to 911 calls. Based on our review, we conclude that the proposal is not justified because the proposed activities for funding (responding to 911 calls) do not relate directly to the purposes of the surcharge, which is to provide funds to maintain and operate the 911 telephone system. (Please see the "Crosscutting Issues" section of the "General Government" chapter for a discussion of this issue.) With regard to the proposed shift to the SHA, we find the proposal is not justified because the shift is based on an arbitrary allocation of costs, and would result in a cumbersome and inefficient system of timekeeping by CHP staff. (Please see our discussion of the SHA fund shift proposal in Item 2720, CHP.) Consequently, we are recommending against the shift of these expenditures to other funding sources.

Additional Revenue-Raising and/or Expenditure-Reducing Actions Needed to Avoid a Deficit. Given that expenditures will likely be higher than the budget projects, federal reimbursements are uncertain, and certain revenue and fund shift proposals are problematic, the Legislature will need to consider additional steps to take to prevent the MVA from slipping into a deficit in the budget year. For example, it could raise fees above the levels proposed by the administration. Approximately $27 million in additional revenue would be generated per year for every $1 increase in vehicle registration fees. For every $1 increase in driver license fees, $7.5 million would be raised. For every $1 increase above the proposed $15 standard fee on various transactions, the MVA would receive an additional $8.5 million in revenue. Alternatively, the Legislature could reduce CHP and DMV expenditures to below current-year levels, thereby avoiding a shortfall in the MVA. In order to do so, cuts in the departments' budgets would need to total several tens of millions of dollars.

DEPARTMENTAL ISSUES

Transportation

SPECIAL TRANSPORTATION PROGRAMS (2640)

STATE TRANSIT ASSISTANCE

The State Transit Assistance (STA) program is one of the state's primary sources of financial support for public transportation. The program will provide about $96 million in the current year to over 100 transit operators statewide, largely to support public transportation operating costs. For 2003-04, the budget proposes $100.4 million for STA, an increase of 4.6 percent over the current-year level.

The STA program is funded from the Public Transportation Account (PTA). Currently, revenues from the sales tax of diesel fuel as well as a portion of gasoline sales tax revenues are deposited in the PTA. Under current law, 50 percent of PTA revenues are allocated to the STA program to provide financial assistance for public transportation, including transit planning, operations, and capital acquisition. The remaining 50 percent of PTA funds are used to support intercity rail services, the Mass Transportation program in the Department of Transportation, and transportation planning.

STA Funding Reflects Proposed Suspension of Proposition 42. Proposition 42, passed by the voters in March 2002, would require the transfer of about $1.1 billion in gasoline sales tax revenue from the General Fund to the Transportation Investment Fund in 2003-04. Of this amount, $84 million would be allocated to the PTA, with 50 percent ($42 million) allocated to STA. In order to save General Fund money, the budget proposes to suspend the Proposition 42 transfer in 2003-04. Correspondingly, the proposed STA funding of $100.4 million reflects no transfer pursuant to Proposition 42. (Please see the discussion under the "Funding for Transportation Programs" section of this chapter.)

REVIEW OF TRANSIT OPERATING COSTS

AB 381 Reporting Requirement

Chapter 745, Statutes of 2002 (AB 381, Salinas) requires the Legislative Analyst to conduct an analysis of the impact of extraordinary increases in operating costs experienced by transit operators and providers on their ability to meet the farebox ratio requirement of the Transportation Development Act (TDA) and the efficiency standards of the STA program. Specifically, we were required to look at the impact of those costs that are beyond the control of transit operators and providers. Additionally, the Analyst is to examine:

- The extent to which any such operating cost changes or conditions are likely to persist.
- Whether there is any basis to temporarily suspend or exclude particular costs relative to the farebox ratio and other efficiency requirements of the TDA.

Transit Operating Costs. Transit systems' operating costs include a number of cost elements, the largest of which is employee compensation. Other cost elements include fuel and material, liability and casualty insurance, lease rentals, utilities, tax and interest, and purchased services. A transit operator can control these costs to varying degrees. For instance, an operator has relatively more control over its employee costs that are often determined through collective bargaining. In contrast, the operator's control over fuel cost is much less because the operator cannot affect the price of fuel. As directed by Chapter 745, our review focuses only on increases in those costs that are beyond the control of transit operators. Our analysis is primarily based on a review of data on farebox ratios and operating costs that transit operators and providers, that claim funding under TDA, report annually to the State Controller's Office. These data include actual data from 1998-99 through 2000-01 and budgeted data for 2001-02. In addition, we reviewed data provided by 33 transit operators and providers in response to a survey regarding their recent operating cost experience for those same years.

Chapter 745 requires that the Analyst conduct the study in consultation with transit operators and providers of community transit services and report her findings in the *2003-04 Analysis*. The following section presents our analysis and findings.

Transportation Development Act

The TDA provides two major sources of funding for public transportation: the Local Transportation Fund (LTF) and the PTA. First, the LTF provides counties with revenues generated from a one-quarter percent sales tax on all goods for transportation purposes. These funds can be used for transit planning, construction and operations, capital (equipment) acquisition, as well as for local streets and roads after transit needs are met. Second, as indicated above, revenues from the sales tax of diesel fuel and gasoline, deposited in the PTA, are used mainly for bus and rail purposes. In particular, 50 percent of PTA revenues are allocated to the STA program. Figure 1 shows the amount of LTF and STA funding for the last five years.

Figure 1

Transportation Development Act Funding

1998-99 Through 2002-03
(In Millions)

	Local Transportation Fund	State Transit Assistance	Total
1998-99	$812.5	$100.3	$912.8
1999-00	914.6	100.3	1,014.9
2000-01	1,063.8	115.9	1,179.7
2001-02	1,058.3	171.0	1,229.3
2002-03 (est)	1,142.5	95.9	1,238.4

The TDA designates transportation planning agencies to be responsible for allocating LTF and STA funds to transit operators and service providers. The act also specifies numerous requirements transit operators and providers must meet to be eligible to receive funds, as well as a number of variances and exemptions from the requirements.

Eligibility Requirements. In general, the eligibility requirements are intended to promote cost efficiency in the operation of a transit system and to encourage local funding support for the provision of transit services. In particular:

- ***LTF Funding***. To be eligible for LTF funding, an operator must maintain a ratio of fare revenue to operating costs (referred to as the farebox ratio) of either (1) at least 20 percent if serving an urbanized area or 10 percent if serving a nonurbanized area, or (2) the ratio it had attained in 1978-79, whichever is greater. Local revenues generated from taxes imposed by the operator or by a county transportation commission can be counted as fare revenue for purposes of the farebox ratio calculations. In addition, if an operator had a ratio of fare revenue and local support to operating costs in 1978-79 that exceeded 20 percent in an urbanized area, or 10 percent in a nonurbanized area, the operator must maintain at least that higher ratio to be eligible for LTF funding.

- ***STA Funding.*** To be eligible for STA funding, an operator must be eligible for LTF funds. In addition, current law prohibits the allocation of STA funds for transit *operating* purposes unless the transit operator meets one of two "efficiency standards." These standards limit the increase in operating costs per revenue vehicle hour (that is, each hour a transit vehicle is in revenue-generating service) to the increase in the Consumer Price Index (CPI). An operator can either limit the increase from one year to the next, or average the increases over a three-year period. The transportation planning agency may adjust the calculation of the standard by excluding certain cost increases beyond the change in CPI. These increases include costs for fuel, insurance, or state or federal mandates.

Failure to Meet Eligibility. If a transit operator fails to meet the farebox ratio requirement for a year in which it receives LTF funding, its LTF funding in a subsequent "penalty year" would be reduced by a specified amount. The operator must also demonstrate to the transportation planning agency how it would achieve the required ratio in the penalty year. Regarding STA funding, if an operator fails to limit its unit operating cost (per revenue-vehicle hour) as required, its STA allocation would be withheld for two years following the year of ineligibility until it meets the eligibility requirement again. If it continues to not meet the requirement, then withheld funds would be reallocated to other high priority regional transit activities.

Farebox Ratios Have Declined; But Meeting Requirement Generally Not a Problem

Overall, farebox ratios of transit operators have deteriorated in recent years. Nonetheless, our review shows that most transit systems receive local tax revenue support and therefore are able to meet the farebox ratio required by the Transportation Development Act.

The farebox ratio measures the portion of a transit system's operating costs that is covered by fare revenue. To meet the farebox ratio requirement, operators must control their operating costs, while ensuring their service generates a certain amount of fare revenue. Because TDA allows local tax revenue support to supplement fare revenue for purposes of calculating the farebox ratio, the amount of local funding is also a critical factor in meeting the farebox ratio requirement.

Farebox Ratios Have Deteriorated. Our review of data reported by operators to the State Controller's Office, as well as data from operators that responded to our survey, shows that for most transit operators, operating costs as well as passenger fare revenue have increased in the past few years. However, increases in fare revenue have not kept pace with the increases in operating costs. Figure 2 shows the percentage of transit agencies that reported increases in operating costs compared to the percentage of agencies that reported increases in fare revenues. As the figure shows, a smaller proportion of agencies reported increases in fare revenue in each of the years from 1999-00 through 2001-02 than the proportion of agencies reporting increases in their operating costs. For instance, in 2000-01 (the last year of actual data reported to the State Controller's Office), 47 percent of transit agencies had more than a 10 percent increase in operating costs. However, only a third of these agencies reported fare revenue increases of over 10 percent.

Figure 2

Percent of Transit Operators Reporting Increases in Operating Costs and Fare Revenues

1999-00 Through 2001-02

	1999-00	2000-01	2001-02 Estimated
Operating Costs			
0 - 10 percent increase	38.5%	35.0%	29.3%
Over 10 percent increase	40.2	47.1	56.3
Fare Revenue			
0 - 10 percent increase	34.5%	40.5%	30.3%
Over 10 percent increase	37.5	33.3	24.4

Source: State Controller's Office.

As a result, from 1999-00 through 2001-02, the portion of operating costs covered by fare revenue has declined for a majority of transit operators. Figure 3 shows that of 167 agencies that received TDA funds in 1999-00, 57 percent experienced a decline in their farebox ratio as compared to 1998-99. The percentage increased to about 62 percent in 2000-01, and 71 percent of these agencies expected to see their ratio decline in 2001-02.

Figure 3

Decline in Farebox Ratio

1999-00 Through 2001-02

		Agencies With Farebox Ratio Decline		
Agencies	**Number Reporting**	**1999-00**	**2000-01**	**2001-02 Estimated**
Transit	50	27	40	33
Cities	90	55	49	63
Counties	27	14	15	22
Totals	**167**	**96**	**104**	**118**
Percent of agencies with decline		57.5%	62.3%	70.7%

But Most Systems Meet Requirement. Despite the general decline in farebox ratios, our review shows that the large majority of transit operators continue to meet the TDA farebox ratio requirement. Our review also shows that most operators, in particular operators serving urbanized areas, receive local tax revenue funding such that meeting the farebox ratio requirement in general does not pose a problem. For instance, of the transit systems responding to our survey, each year about 16 percent do not generate sufficient fare revenue to meet the farebox ratio requirement. But most of these agencies receive sufficient local funding to make up that gap. However, annually there is a small number of transit operators and providers that fail to meet the farebox ratio requirement. These systems are typically small in size, serving nonurbanized areas, and receiving no local funding support.

Significant Cost Increases Worsen Farebox Ratio; Increases Will Likely Continue

In the past couple of years, transit systems have experienced sizeable cost increases, particularly for fuel and insurance. These increases contributed to the worsening of farebox ratios. Our review shows that

transit systems will likely continue to face significant increases in the cost of liability insurance, workers' compensation insurance, as well as health insurance in the near future.

As with other business entities, transit systems plan for anticipated cost increases and adjust their operations correspondingly when costs exceed their projections. Adjustments may be in the form of service reduction, fare and other revenue (such as state and local funding) increases, cost control or reduction, or expenditure deferrals. These adjustments may result in a decline in ridership and therefore a transit system's farebox ratio.

Any significant unanticipated cost increases would worsen the ratio further. To the extent a system's farebox ratio exceeds the minimum required, a decline in the ratio due to such cost increases may have no impact on the system's eligibility for TDA funds. But for systems that are barely meeting the required ratio, large unanticipated cost increases could result in their not being able to comply with the eligibility requirement.

Our review shows that transit systems have experienced in recent years significant cost increases for fuel and liability insurance. Additionally, transit systems will likely continue to face cost increases, particularly in various insurance costs, in the near future.

Significant Increases in Fuel Costs. Transit and paratransit fleets use a combination of gasoline, diesel fuel, and natural gas. Currently, diesel fuel accounts for the larger portion of fuel used by operators, although many fleets are converting to cleaner fuel such as natural gas. Our review shows that in general, fuel costs account for a relatively small proportion—typically between 3 percent and 7 percent—of a transit system's total operating costs. However, given a set level of service and fleet size, operators often have little room to adjust their operations in the short run in response to any sizeable unanticipated increase in fuel prices that last for an extended period. An example was in 2000, when average diesel prices increased by about 50 percent over the 1999 prices while natural gas prices increased by about 42 percent.

Figure 4 (see next page) shows the cost of fuel as a portion of total operating costs for a selected sample of transit operators from 1998-99 through 2001-02. As the figure shows, the proportion of total operating costs accounted for by fuel increased during the years when diesel and natural gas prices increased sharply. Because fuel prices fluctuate (both upward and downward) from month to month, transit systems would expect a certain amount of fuel cost fluctuations in their financial planning. It is when prices increase by unusually large amounts as in 2000, and remain higher than anticipated for an extended period of time, that transit operators' ability to meet the required farebox ratio can be negatively affected.

Figure 4

Fuel Costs as Percent of Operating Costs Selected Transit Operators

1998-99 Through 2001-02

	1998-99	1999-00	2000-01	2001-02
Amador Regional Transit	7.4%	7.9%	8.2%	7.4%
Golden Gate Bridge, Highway and Transportation District	2.7	4.2	4.9	3.6
Mendocino Transit Authority	5.5	7.9	8.4	6.3
Monterey-Salinas Transit	4.3	5.5	7.0	4.1
Orange County Transportation Authority	3.2	4.3	4.7	3.2
Sacramento Regional Transit	1.7	2.0	4.7	3.2
Yuba-Sutter Transit Authority	5.9	6.9	8.9	6.3

Data from State Controller's Office except for 2001-02, which are reported in LAO survey.

Fluctuations in Fuel Costs Will Continue. Projections by key suppliers of natural gas in the state show that prices are expected to be relatively stable over the next decade. However, these long-term projections do not attempt to anticipate any short-term fluctuations in prices. To the extent external factors, such as natural disasters or other catastrophic events, affect the supply or demand, prices would fluctuate. As for diesel fuel, based on past experience, these prices can be expected to fluctuate from month to month, although there is no indication that they will consistently increase over an extended period of time.

Liability Insurance Is Costing Significantly More; Cost Increase Will Continue. Transit systems purchase insurance to cover the risk of casualty damages and liability such as would be incurred in accidents involving transit vehicles or passengers. The cost of casualty and liability insurance depends mainly on the size of the fleet in service, the miles of service provided, and the level of ridership. Data reported to the State Controller's office show that liability insurance costs generally range from 2 percent to 5 percent of a transit operator's operating costs.

Our review shows that the cost to purchase liability insurance coverage has increased significantly in recent years, such that transit operators, in particular small operators, are finding it increasingly difficult to purchase coverage. To facilitate transit systems purchasing liability insurance, the California Transit Insurance Pool provides liability coverage currently to 32 public transit systems in the state. The program provides $500,000 of pooled coverage (essentially, self-insurance) for members in the pool and purchases excess coverage over that level. Our review shows that for $5 million in excess coverage (over the pooled $500,000 layer), the premium per transit vehicle increased from $433 in 2001-02 to $1,402 in 2002-03, an increase of 224 percent.

To reduce premium costs, a transit system may choose to reduce coverage purchased or shift to self-insurance. However, doing so would make the system more susceptible to significant unanticipated costs such as having to pay a sizeable settlement or judgment resulting from successful claims.

Discussions with the insurance industry indicate that while the cost of liability insurance has increased for all sectors, public transit is among the sectors that have been affected significantly due to a number of factors. These factors include:

- ***Potential Claims.*** Insurance premiums are determined based on risk and claim exposure. As public transit services expand, the frequency of claims has increased. Additionally, the severity of claims as reflected in the amount of damage sought per claim has also increased.
- ***Impact of September 11, 2001 Terrorist Attack.*** In general, the insurance industry buys reinsurance in order to spread its risk. According to industry sources, as a result of September 11, the reinsurance industry has sustained large losses and now charges significantly higher premiums for any reinsurance coverage sold. Additionally, the insurance industry may now view the risk exposure of public transit to be higher, being potential targets of terrorist acts.
- ***Stock Market Performance.*** The insurance industry invests premiums in the stock market to generate a rate of return. To recoup substantial losses experienced in the stock market in recent years, insurance carriers are charging higher premiums, according to industry sources.

As a result, the cost of liability insurance is expected to continue to increase in the near future. Discussions with the industry indicate that transit systems may be able to control their liability insurance costs to some extent via a number of measures, including training of personnel, proper maintenance of equipment, deployment of new buses which typically have more safety features, et cetera. Nonetheless, short of reducing coverage (including becoming self-insured), public transit systems will still face significant increases in premiums in the near future due to the other factors discussed above.

Transit Systems Also Face Increasing Workers' Compensation Insurance. Our survey also shows that the cost of workers' compensation insurance has increased in recent years and this trend will likely continue for the next few years. Specifically, beginning in 2003, the state's workers' compensation benefits are being increased as a result of Chapter 6, Statutes of 2002 (AB 749, T. Calderon). These increases will result in higher premium rates for workers' compensation insurance. For instance, in October 2002, the Commissioner of Insurance approved an average increase of 10.5 percent in premium rates for new and renewal policies that begin on or after January 1, 2003, and a 4.9 percent increase in premiums effective January 1, 2003 applicable to the portions of any 2002 policies that are still in effect. According to the Workers' Compensation Insurance Rating Bureau, the agency that sets rates for workers' compensation insurance, Chapter 6 will increase benefit costs by almost 18 percent when fully implemented in 2006. The higher benefit costs will be reflected in higher premiums.

As with liability insurance, transit systems have some control over their workers' compensation insurance costs, mainly by training of personnel and implementing worker and workplace safety procedures and measures. However, other cost drivers such as medical costs and other benefit costs are less within the control of transit operators.

Health Insurance Costs Expected to Increase by Double Digits. After a number of years of relatively modest increases, the cost of health coverage has increased in the current year, generally over 15 percent for all sectors. Projections by the healthcare industry show that the increase will likely continue at a double-digit rate annually for the foreseeable future. To the extent employee health benefits are set in labor contracts, operators have limited flexibility to control rising health insurance costs until a labor contract expires and is renegotiated. Transit providers that contract or purchase services (from a third party) may be able to avoid the cost increases under an existing service contract because the contractor must bear those increases. Nonetheless, the higher health insurance costs will likely be reflected in the cost of subsequent contracts to provide the same level of transit service. Because employers often provide health coverage as part of employee benefits, it is often subject to collective bargaining. The extent transit systems can control the increases in health insurance costs depends on their ability to negotiate with labor unions for a larger share of costs to be borne by employees (such as higher deductibles or copays), or reduced coverage provided to employees.

Cumulative Effect of Cost Increases on Meeting STA Efficiency Standards. Since 1995, the state has experienced low inflation, with the state CPI increasing between 1 percent and 3 percent annually. Because fuel and various insurance costs do not individually account for a significant portion of transit systems' operating costs, large increases in any one of these cost elements even if they are in excess of the CPI may not result in a transit operator's inability to meet the STA program's efficiency standard requirement. However, if there were large increases in a number of the cost elements concurrently, an operator's ability to limit its increase in operating cost per hour of service provided would be significantly lessened, making it more difficult to meet the efficiency standard. Current law recognizes the potential for significant increases in costs that are beyond the control of transit operators. As such, it allows transportation planning agencies to exclude increases in certain costs for the calculation of the STA efficiency standard.

Consistent Consideration of Operating Costs

We recommend the Legislature allow some modification in the calculation of farebox ratios in order to enable consistent application of the Transportation Development Act eligibility requirements for the Local Transportation Fund and the State Transit Assistance programs.

Currently, the TDA provides transportation planning agencies with the flexibility to take into consideration significant increases in certain costs that are beyond a transit operator's control when determining a transit operator's eligibility to receive STA funds. However, the act does not provide similar flexibility in the calculation of operating costs for the determination of a transit operator's farebox ratio.

We believe that the Legislature should allow some modification in the calculation of farebox ratio in order to provide similar flexibility in the determination of a transit operator's eligibility for LTF funding. Doing so would make the treatment of operating costs in the two programs' eligibility requirements consistent. The following two options would achieve that objective.

First, the Legislature could allow transportation planning agencies to adjust the calculation of operating expenses in determining a transit operator's actual farebox ratio in a way similar to current statutory flexibility provided under the STA program. For instance, significant increases in certain cost elements (such as fuel) may be excluded, in whole or in part, from operating costs for the calculation of farebox ratio.

Another option is to allow the averaging of farebox ratios over a period of time, for instance over three years. This would allow a transit system to adjust its fare, service level, and operations to accommodate any extraordinary increase in costs over a longer time period, thereby evening out some of the cost fluctuations. Doing so would be consistent with current statute that allows transit systems to average the increases in their operating costs per service hour under the STA program.

Our review shows that transit operators will be facing a number of cost pressures in future years. The magnitude of these cost increases and their impact on the supply of public transit services will vary among transit operators. While it is reasonable to require transit operators to meet certain farebox ratio requirements, there may be circumstances when transit operators are not able to comply due to conditions beyond their control. The options discussed above would allow transit operators, in meeting the eligibility requirements of both the LTF and STA programs, to mitigate those circumstances in which they experience significant increases in costs that are beyond their control.

DEPARTMENT OF TRANSPORTATION (2660)

The Department of Transportation (Caltrans) is responsible for planning, coordinating, and implementing the development and operation of the state's transportation systems. These responsibilities are carried out in five programs. Three programs—Highway Transportation, Mass Transportation, and Aeronautics—concentrate on specific transportation modes. Transportation Planning seeks to improve the planning for all travel modes and Administration encompasses management of the department.

The budget proposes total expenditures of $6.4 billion by Caltrans in 2003-04. This is about $670 million, or 9.5 percent, less than estimated current-year expenditures. This decrease is largely due to a significant projected drop in funding for capital improvements on state highways.

HIGHWAY TRANSPORTATION

Budget Proposes Decrease in Highway Program Expenditures

The budget proposes expenditures of $5.6 billion for the highway transportation program, about $350 million, or 6 percent, less than estimated current-year expenditures. This includes a 26 percent decrease in proposed capital outlay expenditures and a 20 percent **increase** ***in local assistance expenditures. To aid the General Fund and address projected State Highway Account shortfalls, the budget proposes several specific expenditure cuts.***

The major responsibilities of the highway program are to design, construct, maintain, and operate state highways. In addition, the highway program provides local assistance funds and technical support for local roads. For 2003-04, the budget proposes to spend $5.6 billion on the highway transportation program, approximately 87 percent of the department's proposed budget. This is a decrease of $350 million, or 6 percent, from estimated current-year expenditures. This is primarily due to a sizable decrease in projected expenditures for capital outlay, as discussed below.

Of the $5.6 billion, the budget proposes $1.5 billion in capital outlay expenditures, a decrease of 26 percent below estimated 2002-03 levels. This decrease is primarily due to lower estimated expenditures for new projects to be delivered in the five-year State Transportation Improvement Program (STIP). Conversely, the budget proposes an increase of 20 percent in the local assistance program, to $1.9 billion. This increase, however, mistakenly includes certain programs administered by the federal government. After adjusting for this factor, the local assistance program declines as well.

As shown in Figure 1, Caltrans expects that state funds would support about $2.8 billion (50 percent) of highway program expenditures in the budget year. Federal funds would fund about $2.6 billion (46 percent) of the program, while the remaining $236 million (4 percent) would be paid through reimbursements, primarily from local governments.

Figure 1

**Department of Transportation
Highway Transportation Budget Summary**

(Dollars in Millions)

Program Elements	Actual 2001-02	Estimated 2002-03	Proposed 2003-04	Percent Change From 2002-03
Capital outlay support	$1,194	$1,252	$1,107	-11.6%
Capital outlay projects	2,726	2,064	1,524	-26.2
Local assistance	1,091	1,568	1,874	19.5
Program development	70	73	76	5.1
Legal	84	63	63	-0.4
Operations	172	146	153	4.8
Maintenance	819	767	784	2.2
Totals	**$6,156**	**$5,932**	**$5,582**	**-5.9%**
State funds	*$2,821*	*$3,248*	*$2,769*	*-14.7%*
Federal funds	*2,583*	*2,534*	*2,577*	*1.7*
Reimbursements	*752*	*150*	*236*	*57.3*

Specific Expenditure Reductions Proposed. As discussed in our analysis of transportation funding (in the "Crosscutting Issues" section of this chapter), the Governor's budget proposes to use Traffic Congestion Relief Program (TCRP) funding to aid the General Fund in the budget year, and the State Highway Account (SHA) faces pressures that have begun to significantly lower its balance. To deal with these situations, the California Transportation Commission (CTC) stopped allocating money for new TCRP and STIP projects in December 2002. The Governor's budget has also proposed several actions to enhance SHA revenue, including increasing weight fees and redirecting federal funds from local agencies to Caltrans. In addition to these actions, the budget proposes the following specific actions to reduce Caltrans' expenditures:

- Reduce state staff for TCRP projects by 1,214 personnel in the budget year.
- Reduce state operations expenditures by a total of $177 million in the current and budget years, with related staff reductions of about 500 personnel.
- Reduce expenditures on local assistance programs totaling $60 million in the current and budget years.

We discuss some of these proposals in more detail below.

Capital Outlay Support Request Will Be Revised

The budget proposes $1.1 billion to fund capital outlay support (COS), a 12 percent decrease from current-year estimated expenditures. Most of the proposed decrease is due to a reduction in Traffic Congestion Relief Program (TCRP)-related staff, but the administration will revise its proposal in the spring based on new information. We withhold recommendation on the COS budget pending the administration's revised proposal. However, we also note that the Legislature could take separate action to provide budget-year funding for TCRP projects. Any such action would directly affect the administration's proposed staff reduction.

Budget Proposes COS Reduction. The budget proposes $1.1 billion to fund COS in the budget year. This represents a 12 percent decrease from estimated current-year funding. The budget's proposed COS level includes funding for 9,160 personnel-years, a net decrease of 906 personnel-years from the estimated 2002-03 level. The bulk of this drop is due to a proposed reduction of 1,110 TCRP-related COS personnel-years. This reduction conforms to the administration's proposal to suspend all TCRP funding in the budget year.

Proposal Is Not Finalized. The administration typically revises its proposed COS budget in the spring based on its most recent available workload projections, as we describe in our analysis of COS budgeting later in this write up. However, for the budget year, the administration must take into account not only its estimated workload, but its available funding as well. This is particularly true for the level of TCRP staff, since the budget proposes no funding for TCRP projects in 2003-04. The administration states that it intends to reassess in the spring the mix of STIP and TCRP projects that Caltrans will work on in the budget year and revise the COS budget accordingly. Because of these factors, Caltrans' COS request is likely to change substantially. Therefore, we withhold recommendation on Caltrans' COS budget pending finalization of the proposal.

Other Legislative Actions May Affect COS Staffing. Even though we do not recommend that the Legislature take action on this proposal at this time, other actions the Legislature may take would directly affect Caltrans' COS staffing level. In our analysis of transportation funding, we list several options for the Legislature to consider regarding the level of funding to provide TCRP projects. We also recommend that the Legislature act quickly to reduce the uncertainty created by the Governor's proposals. Any action the Legislature takes regarding its commitment to TCRP projects will affect the level of TCRP-related staff Caltrans needs. For example, if the Legislature commits to funding TCRP projects with a new, predictable funding source, Caltrans may need many of the TCRP-related positions in the budget year to continue developing these projects.

State Operations Reduction Proposals Need Development

The Governor's budget proposes several actions that would reduce Caltrans' state operations expenditures by $177 million in the current and budget years. However, the administration indicates that it has not yet determined exactly where many of these cuts would be taken. Therefore, we withhold recommendation on these proposals pending the administration's revisions in the spring.

Budget Proposes State Operations Reductions. As indicated in our analysis of the condition of the state's transportation funds, Caltrans projects that the SHA will experience a shortfall of about $630 million by the end of the budget year, absent corrective actions. One of the corrective actions proposed in the Governor's budget is to reduce Caltrans' state operations expenditures by $177 million. The specific reductions proposed include:

- Reduce operating expenses by $40 million in the current year and $88 million in the budget year.
- Reduce staff department-wide by 471 personnel-years through attrition in the budget year, for a savings of $36 million.
- Reduce overtime expenditures in the budget year by $10 million.
- Remove funding for 31 state personnel-years, equating to $2.8 million, from the Local Assistance Enhanced Level of Service Program in the budget year.

The budget also proposes to redirect $72 million in operating expense funding to pay staff salaries in the budget year.

Proposal Details Remain Unknown. While the administration has proposed specific dollar amounts to be saved by each of the reductions listed above, it has not determined exactly where many of the cuts would be made. This is particularly true for $18 million of the $88 million budget-year operating expense reductions and the entire $72 million operating expense redirections to personnel costs. The Governor's budget indicates that the administration will submit a finance letter in the spring to allocate these cuts.

The Governor's budget did allocate the rest of the proposed cuts listed above to general program areas. However, discussions with administration staff indicate that they are in the process of reviewing these proposals and will revise them in the spring as well. These revisions will likely change the allocation of some of the cuts from the current proposals. Therefore, we withhold recommendation on these proposed cuts pending new administration proposals in the spring.

Caltrans Ignores State Policy; Has Not Addressed Problems On Information Technology Project

The budget includes $1 million to develop and implement the Transportation Permits Management System (TPMS) in order to automate Caltrans' manual permit writing process. Caltrans was directed by the Department of Finance (DOF) to amend its contract for TPMS in order to improve its efficiency, but to date Caltrans has not complied with this directive. In addition, the TPMS project has experienced several schedule delays and is expected to have additional costs. We recommend that Caltrans and DOF report at budget hearings on steps they will to take to address problems with the contractor, increased costs, and schedule delays.

Caltrans issues permits to oversize vehicles—those that exceed statutory limits on vehicle size, weight, or loading—to allow them to travel on the state's highways. These permits specify the routes oversize vehicles are allowed to take in order to ensure the safety of the highway system. Currently, Caltrans issues these permits manually.

The budget includes $1 million to develop and implement the TPMS. The purpose of this system is to replace Caltrans' manual permit writing process with an automated system that is used in other states. The new system will (1) verify eligibility of permit applicants, (2) determine safe truck routes, (3) track applications through the permitting process, (4) issue and automatically deliver permits, (5) assess fees, and (6) maintain financial accounting records. The cost to develop the system is estimated at $7 million, with an annual ongoing cost of $1 million. Upon full implementation, TPMS is estimated to save $2.7 million and 54 positions annually.

TPMS Is Vital for Public Safety. Caltrans received funding for TPMS to address a poor safety record related to its oversize vehicle permits. From 1996 through early 2000, there were 31 accidents in California involving oversize vehicles that struck and damaged bridges, one of which resulted in a fatality. As an interim measure to reduce errors in its permitting process, Caltrans requested and received funding for personnel to manually double-check each permit before it was issued. Caltrans still uses this process. While this is a good interim step, it is not an acceptable permanent solution. The Bureau of State Audits found in May 2000 that Caltrans' permitting system, including the manual double-checkers, was an inefficient use of resources and did not adequately protect public safety. The audit cited the proposed TPMS system as a way to reduce the potential for human error and improve the efficiency of the process.

TPMS Contract Has Not Been Amended. During our review, we found several problems with the TPMS project. First, in December 2001, DOF notified the Legislature that Caltrans would amend its primary TPMS contract in order to comply with the administration's policy of locating servers at state data centers. This policy is appropriate since state data centers are able to support servers more efficiently and provide technical services that may not be provided by departments. Our review shows that to date, Caltrans has not yet amended the contract. Moreover, it is unclear to us why Caltrans has not complied with DOF's direction.

Caltrans Expects Amendment to Increase Contract Costs. Caltrans has received preliminary information from the contractor on the proposed amendment suggesting that contract costs will increase to meet the state's policy on the location of servers. Based on our review, we conclude that TPMS hardware's location should not affect the contractor's workload and therefore should not require increased contract costs.

Caltrans Reports Hardware Will Cost More at Data Center. According to Caltrans, the Stephen P. Teale Data Center (TDC) estimates that it will cost $1 million to locate hardware at TDC's site, whereas there would be no cost to house the hardware at Caltrans. It is typically more cost effective to locate hardware at state data centers since they are able to support more equipment with less staff at a lower cost. It is unclear to us then, why the costs to locate the hardware at TDC will *increase* and not decrease the project's costs.

Caltrans Continues to Spend, But Contractor Has Not Delivered Products. The Feasibility Study Report that supports this project estimated that Caltrans would spend $6.6 million and use nine positions in developing the system from December 2001 through June 2003. According to Caltrans, the primary contractor has been unable to deliver a satisfactory product since the contract was signed in 2001 and failed to meet the project's first due date in October 2002. Caltrans, however, has continued to use staff resources in developing the project. Based on this information and Caltrans' current projection of additional contract and TDC costs, the current project budget ($7 million) will be insufficient to develop and implement the system authorized by the Legislature.

Unclear If Administration Is Addressing Problems. According to the Governor's executive order on oversight for state information technology (IT) projects, department directors and agency secretaries are responsible for overseeing IT projects. In addition, the Legislature provided current-year funding to DOF to oversee and direct corrective actions for state IT projects. The DOF is aware of the problems on the TPMS project. However, it has not taken formal action to correct the problems. In addition, it is unclear what actions, if any, DOF or Caltrans has taken regarding the contractor, who has neither delivered the first product nor met the first due date.

Administration Should Report on Actions Taken to Address Problems. The administration has not adequately addressed the problems on the TPMS project. Caltrans has ignored state policy and has not addressed problems with its contractor. In addition, DOF has not directed corrective actions to a project that is delayed by at least one year and will be unable to meet budget estimates. For these reasons, we recommend Caltrans and DOF report at budget hearings on (1) steps the administration has taken or will take to address problems with the contractor and Caltrans' compliance with state policy, (2) an explanation of TDC costs, (3) estimated costs and timeframes to complete the project, and (4) revised program savings based on the new project costs. This would provide information the Legislature needs for oversight of the project.

COS: Budgeting and Performance Measurement

Simply put, COS is the work required to produce capital outlay projects. Before a capital outlay project can be constructed, Caltrans must assess environmental impacts, acquire rights-of-way, and design and engineer the project. Caltrans is also responsible for overseeing the progress of project construction. Caltrans' COS budget consists primarily of the salaries, wages, benefits, and operating expenses of the more than 10,000 state staff who perform these functions. It also includes the costs of consultants who perform a portion of this work. The COS budget does not, however, include the salaries and benefits of the contractors who construct the actual projects; these costs are part of the capital outlay budget.

In 2001-02, COS expenditures totaled almost $1.2 billion. This was about 19 percent of Caltrans' expenditures on the Highway Transportation program. Relative to expenditures on highway capital outlay, Caltrans spent 44 cents on COS for every dollar it spent on capital outlay in 2001-02. For 2003-04, the budget includes $1.1 billion for COS. This level will likely be amended in the spring after Caltrans has a better estimate of the total project workload.

Realistic COS Budget Requires an Accurate Budget Model. In any one year, Caltrans works on various phases of hundreds of STIP and State Highway Operation and Protection Program (SHOPP) projects. As Caltrans is responsible for the delivery of these projects, it is essential that the department has the necessary support resources to produce them in a timely and cost-efficient manner. Accordingly, a budget model that provides a reasonable and accurate estimate of staffing and resource needs is critical. If the budget model underestimated COS needs, Caltrans would not have enough resources to complete the work it committed to do. If the model overestimated COS needs, on the other hand, then resources would be spent on staff support inefficiently, leaving less funds for capital outlay expenditures.

In this section, we review Caltrans' COS budgeting process and the department's ability to measure the performance of the COS program. We also make recommendations to improve the budget process and provide for more thorough reporting to the Legislature.

Budgeting for COS: Inconsistent Process

Each of Caltrans' district offices estimates the resource needs to deliver and construct capital outlay projects in a different way. This can lead to inconsistencies among their estimates, which could in turn make Caltrans' capital outlay support (COS) budget request inaccurate. We recommend budget bill language directing Caltrans to develop a standard workload estimation methodology for districts to use in estimating COS needs.

Since 1998, Caltrans has developed its annual COS budget using primarily a bottom-up process, by aggregating the estimated staffing needs for each of the capital outlay projects that it plans to work on in a given year. This methodology appears to improve on the previous model by tying support resources directly to capital project workload. By contrast, the previous budget model was based on a statistical formula that tended to overestimate staffing needs.

Districts Estimate COS Resource Needs. The COS budget process begins at the district level, where the project team for each capital outlay project estimates its project workload requirements. The workload requirements are the expected number of person-hours needed to perform each phase of the work. Major phases of highway capital outlay projects include environmental studies and mitigation, project design, right-of-way acquisition, and construction oversight. These estimates form the core of the COS budget. They are also used by project teams to manage project progress. Each of Caltrans' 12 district offices submits its project workload to Caltrans headquarters, where the estimates are aggregated.

Headquarters Reviews District Estimates for Reasonableness. Headquarters staff perform several checks of the aggregated data to ensure that the district estimates of workload and resource requests are reasonable in terms of both cost and timing. For example, staff compare the ratio of projected COS costs to projected capital outlay costs for each project to statewide average ratios from 1992 through 1997. If the ratio of COS to capital outlay for a given project falls outside the ranges of the statewide average ratios, headquarters staff will review the project with the district to determine whether the district's estimate is justified or should be modified. Once headquarters is satisfied with the districts' project workload estimates, they are accepted as the basis for the COS budget request.

Headquarters Adjusts COS Estimates to Include Other Workload. Headquarters staff make additional adjustments to the COS request. First, the districts' staffing requests are adjusted to reflect the assumption that 5 percent of the work done by state staff will be overtime work. Second, headquarters determines for each district the amount of work to be accomplished through contracts. These two adjustments determine how the COS workload will be accomplished, but do not alter the total amount requested by the districts. Third, the resources Caltrans estimates that it needs to use to oversee work done by local governments on the state highway system, overhead costs such as headquarters COS staff, and other activities that do not directly relate to capital outlay on new Caltrans projects, such as storm water cleanup, are added to the final COS budget request. According to Caltrans, these costs make up about 15 percent of its total COS costs on an annual basis.

Districts Have Inconsistent COS Estimation Processes. Our primary concern with the current COS budgeting process is that each district uses a different method for estimating workload. This is problematic because the difference in approaches can result in very different estimates of time and resources needed to produce the same type of projects. For example, in one district, each member of a project team develops three estimates of the workload for each phase of a project—high, low, and most likely. The project manager then compares these estimates to the statewide average project workload requirements in order to determine which estimates to submit to headquarters. In a second district, the project team first makes a rough guess of the order of magnitude of the total resource costs for a project, based on the team members' experiences with similar projects. It then uses a computer program maintained only in that district to estimate the amount of time and staff resources each activity should take on average. Project team members then further refine the estimates based on unique features of the project. Other districts use similar but varying methods to estimate their COS workload requirements.

The districts use different estimation methods because Caltrans headquarters does not require a consistent method to be used, although it does provide the districts with an example of a process to estimate workload. Although headquarters reviews all district project workload estimates, the potential inconsistencies in project cost and schedule estimates resulting from the use of different estimation approaches may not be totally addressed. In part, this is because for certain types of capital outlay projects, the database used by headquarters contains only a small sample of these projects, with wide ranges of costs and schedule estimates. For these types of projects, headquarters' review would likely not be able to identify any inconsistencies in estimation among districts. Indeed, Caltrans concurs that a consistent department wide estimation process would provide a more sound basis for its COS budget.

Department Should Adopt Consistent Workload Estimation Methods. Caltrans indicated that it is in the process of updating its average COS to capital outlay ratios with information from projects completed within the past five years (1998 through 2002). Caltrans also indicated that it intends to impose a consistent COS estimation process when it implements a new central workload database and new project management software.

However, our review shows that the software project is several years behind schedule, and its implementation is in doubt. While it may be preferable to implement the two new systems at the same time, the implementation of one is not dependent on the other. We believe that given the status of the new database implementation, Caltrans should proceed to create a workload estimation process that is consistent across all districts. In fact, absent a new database that provides better information for estimation, it is even more important that districts use a consistent methodology to determine their project workload.

Using a consistent methodology does not mean that support resources for each project should align exactly with the average resources budgeted for that type of project. In fact, the districts should be able to take into account factors that are unique to each project and each region while using the same process statewide. A standard process would ensure that unique features of transportation projects are considered and weighted in a consistent manner, no matter their location in the state. Therefore, we recommend the following budget bill language in Item 2660-001-0042:

> The Department of Transportation shall create a standard process for the estimation of capital outlay support workload, to be implemented by all of the department's district offices. The department shall create this process in conjunction with the districts and begin implementing it in all district offices no later than July 1, 2004.

Actual Project Support Expenditures Higher Than Budgeted

Even though the capital outlay support (COS) budget is directly based on the workload needs of individual projects in the budget year, our review finds that actual COS costs per project exceeded budgeted costs for the period reviewed. There are plausible explanations for this cost increase, but little data are available to validate these explanations. We recommend the Legislature request an audit by the Bureau of State Audits to determine the primary causes for the growth in support costs for capital outlay projects.

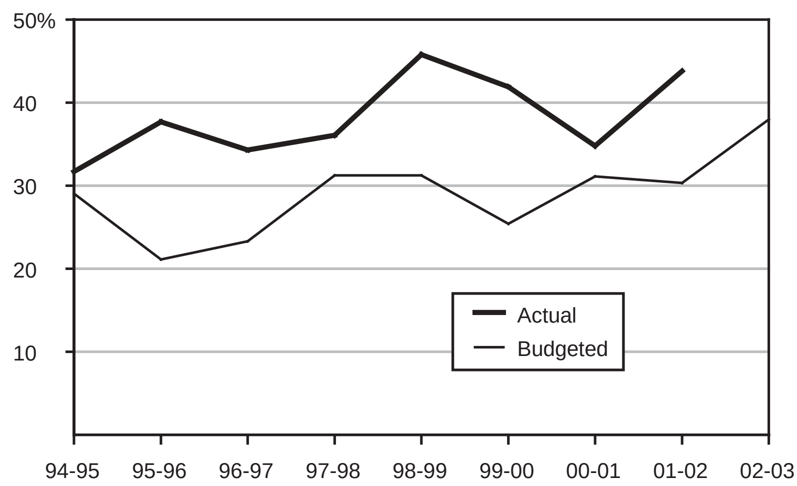
Actual COS Expenditures Per Project Are Higher Than Originally Estimated. Our review of the COS budget process also shows that the estimated support workload per project, on average, is understated when compared to actual expenditures. An examination of the budgeted and actual expenditures for COS over the past decade provides one measure of this cost increase. Figure 2 (see next page) shows *budgeted* COS costs as a percentage of *budgeted* capital outlay costs in each year, compared to *actual* COS costs as a percentage of *actual* capital outlay costs. The figure shows that the actual ratio of COS to capital outlay is consistently higher than the budgeted ratio.

The reason for the difference between the budgeted and actual COS-to-capital outlay ratios is not that Caltrans spent more on COS than it was budgeted in any given year. In fact, actual COS expenditures have consistently been very close to the budgeted amounts. The difference lies in the fact that capital outlay expenditures are consistently lower than budgeted. In part, this is because large capital projects inevitably encounter delays. The fact that Caltrans spends its entire COS budget every year while capital outlay expenditures are consistently lower than budgeted implies that the actual support costs to produce a project are higher than budgeted.

A more direct measure of how COS costs increase over time is to examine the changes in support cost estimates for a sample of capital outlay projects as they are developed. The DOF did this in a December 2000 report entitled, *How the California Department of Transportation Budgets Capital Outlay Projects.* It examined the support costs of 76 capital outlay projects in four Caltrans districts and compared the latest cost es-

Figure 2

Actual Versus Budgeted Capital Outlay Staff Costs As a Percentage of Capital Outlay



timates (at the time of the study) to the original estimates made one or two years earlier. The study found that, on average, estimates of project support costs grew. For instance, in one district, the support hours for the 15 projects sampled increased over initial estimates by an average of 71 percent in two years. In another two districts, support cost estimates were revised upward by 10 percent and 22 percent, respectively.

Reasons for Cost Increases Should Be Identified to Improve Cost and Project Management. Caltrans argues that an optimistic—that is, low—projection of workload needs provides a target against which to measure the department's performance in producing projects. However, the approach could result in the setting of unrealistic targets and the adoption of a budget that overstates the department's cost-efficiency in project delivery. Because there are many possible reasons why COS costs could grow as projects progress, it is important that the causes of the cost increases be identified. Absent this information, it is difficult to determine what are the necessary corrective actions to better manage projects and their costs and to improve the estimation of workload needs. For example, if the bulk of the COS cost growth is due to prolonged environmental review processes, then efforts should focus on environmental review streamlining. If the cost increase is mainly due to public opposition to projects, then more effort should be directed toward public outreach. If, however, the bulk of the growth is due to inefficiencies in Caltrans' engineering processes, then reforms of departmental policies and processes may be warranted.

To determine the primary causes of COS cost growth would require an in-depth, statistically valid study to examine COS expenditures associated with a sample number of projects. To do so, we recommend that the Legislature request the Bureau of State Audits to perform an audit of Caltrans' COS expenditures to determine both the extent of COS cost growth and its primary causes.

Evaluating COS Performance: Imperfect Information

While Caltrans has established a number of performance measures for its capital outlay support (COS) program, it has not set targets for those that measure COS expenditures. Additionally, the current performance measures are not sufficient to allow the Legislature to evaluate whether Caltrans' COS budget requests are warranted because they do not tie COS costs to specific capital outlay projects. We recommend the adoption of budget bill language to require that Caltrans set targets for each of its COS program performance measures. We further recommend the enactment of legislation to require Caltrans to establish new performance measures beginning with the **2004-05 Governor's Budget.**

Current COS Performance Measures Have No Targets. In response to a 1994 consultant report on Caltrans' organizational structure and management practices and a requirement in the *Supplemental Report of the 1995-96 Budget Act*, Caltrans developed performance measures for its COS program. These measures were intended to (1) provide an accurate measure of annual efficiency, (2) provide a consistent basis for year-to-year comparisons, and (3) evaluate both the department's cost and its timeliness in the delivery of capital projects. Caltrans subsequently adopted a number of performance measures for the COS program. Of these, we have identified three that most closely relate to COS expenditures. These measures are detailed in Figure 3 (see next page).

However, as Figure 3 shows, Caltrans has not set target values for any of the three performance measures even though data are available for the department to do so. Specifically, data are available for the project development and construction support cost change measures for three years, and data exist for the COS versus capital outlay expenditure measure back to at least 1988-89. In fact, Caltrans at one time had set a target of 33 percent for the COS versus capital outlay measure. That is, COS costs in a given year should not be more than 33 percent of capital outlay expenditures. However, Caltrans has only met this target once since 1988-89, and it abandoned the target in 2000-01.

Figure 3

Performance Measures Related to Capital Outlay Support (COS) Costs

Measure	Caltrans Target
COS Versus Capital Outlay. Measures the relationship of COS expenditures to capital outlay expenditures in a given year, in percentage terms. Until 2000-01, Caltrans recommended a target of 33 percent.	None
Project Development Support Cost Change. Measures the relationship of actual cost of project development (including environmental review, right-of-way acquisition, and design and engineering) to projected costs.	None
Construction Support Cost Change. Measures the relationship of actual construction oversight costs to projected costs.	None

Performance Should Be Measured Against Targets. We believe that to fully evaluate the performance of a program, the program's accomplishments must be assessed against defined targets for performance measures. This is consistent with the recommendations of the Government Accounting Standards Board (GASB), a standard-setting body for state and local government organizations. A GASB principle is that, to facilitate the budgetary decision-making process, each government entity should "establish and communicate clear, relevant goals and objectives; set measurable targets for accomplishment; and develop and report indicators that measure its progress in achieving those goals and objectives." Caltrans' COS performance measures do not currently meet these standards. Without defined targets, it is difficult for the Legislature to evaluate the department's efficiency and effectiveness in completing projects in terms of cost and timeliness.

We recommend the adoption of budget bill language requiring Caltrans to set targets for each of its performance measures. However, as we discuss in greater detail below, there are shortcomings with some of the measures that Caltrans currently uses. Caltrans has indicated that several of its COS performance measures should be revised. Therefore, we recommend that the budget bill language exclude existing performance measures from the target-setting requirement if they will be replaced by the beginning of 2004-05.

> Item 2660-001-0042: The Department of Transportation shall develop measurable targets for each of the performance measures reported in its Capital Support Performance Measures Report for 2001-02, excluding those performance measures that will be replaced by July 1, 2004. These targets shall be included in the department's Capital Support Performance Measures Report for 2002-03.

Existing Performance Measures Inadequate. More important than the lack of targets, our review shows that existing COS performance measures are inadequate and do not allow for a full evaluation of the COS program's performance. One measure—the COS versus capital outlay expenditure measure—is of particular concern.

Specifically, this measure compares COS and capital outlay expenditures in the same year, but most of the COS expenditures in a given year do not relate to the capital outlay expenditures in that year. This is because capital outlay projects often take several years to develop and construct. For instance, expenditures for environmental review and design of a project—which occur before any capital outlay dollars are spent—may take multiple years. Thus, part of the COS costs in any year would not have any capital outlay expenditures associated with them. Likewise, projects that are at the height of construction in any year would incur large capital outlay expenditures but relatively low COS expenditures. Therefore, comparing the capital outlay expenditures in any one year with the COS costs incurred in the same year does not provide an accurate measure of the cost efficiency in producing capital outlay projects. If, for example, Caltrans is in the process of expanding its workload in a given year, the COS expenditures in that year may be a much larger percentage of capital outlay than is desirable for a single project, because COS expenditures are weighted toward the beginning of a project. Conversely, as workload declines, COS costs should shrink before capital outlay does. A comparison of COS to capital outlay expenditures in one year cannot adequately recognize these situations.

Better Measures Needed to Properly Evaluate COS Budget Request and Performance. In order to allow the Legislature to more effectively evaluate Caltrans' performance, better performance measures are needed. Our review shows that the following three measures would, in combination, provide a more accurate picture of the COS program's performance. In particular, the third measure also provides better information for the Legislature to assess the COS budget request. These measures are summarized in Figure 4 (see next page).

One measure should show aggregate COS and capital outlay expenditures over time for all the projects that *complete* construction in a given year. This measure—past efficiency—would allow a comparison of the ratio of COS to capital outlay expenditures over the life of a single set of

Figure 4

LAO Recommended Performance Measures for Caltrans Capital Outlay Support (COS)

Recommended Efficiency Measure	Included Projects
Past Efficiency. Comparison of actual COS to actual capital outlay costs over the life of the projects.	STIP[a] and SHOPP[a] projects that completed construction in the prior year.
Estimated Current Efficiency. Comparison of actual project development COS to projected capital outlay costs over the life of the projects.	STIP and SHOPP projects that began construction in the prior year.
Detailed Budget Breakdown. Budgeted, estimated, and actual COS costs for the budget, current and prior years, respectively—grouped by year of project delivery.	All STIP and SHOPP projects worked on in a given year.

a State Transportation Improvement Program (STIP) and State Highway Operation and Protection Program (SHOPP).

projects. This would improve the existing COS versus capital outlay measure by avoiding a comparison of two numbers that do not directly relate to each other. In fact, we believe this should be the primary measure of the efficiency of the COS program. It would provide a consistent basis for evaluating Caltrans' COS expenditures over time, regardless of fluctuations in the amount of COS workload.

While a measure of COS efficiency for completed projects would be valuable, it would primarily measure Caltrans' *past* efficiency, rather than its current performance. This is because most of the work Caltrans performs on a project occurs in years prior to the date the measure would be produced. To provide some indication of Caltrans' expenditures on *ongoing* projects, we believe a second measure—estimated current efficiency—is needed. This measure should aggregate for all projects that *begin* construction in a given year their project development COS costs over time as well as their projected total capital outlay costs.

In fact, current law requires Caltrans to calculate a version of this measure for STIP projects. Current law also requires that the ratio of project development COS costs to capital outlay costs calculated by this measure average 20 percent or lower over any given three-year period. Caltrans indicates that this ratio averaged just over 16 percent for the three-year period from 1999-00 through 2001-02.

However, the above two measures would not account for all of Caltrans' annual COS expenditures. This is because Caltrans works on many projects in any given year that neither begin nor end construction in that year. To capture ongoing expenditures on these remaining projects, a third measure would be needed to track projected COS costs in the budget year for groups of projects grouped by the year the construction contract is to be awarded. Current- and prior-year figures should also be provided for comparison purposes. This measure—detailed budget breakdown—would allow the Legislature to better evaluate Caltrans' annual COS budget request by breaking the request down into its component parts. Thus, if Caltrans asked for a large COS budget increase without a similar capital outlay budget increase, for example, this measure would allow the Legislature to determine whether this increase was related to new projects to be delivered in the future or more support work needed for the set of current projects.

Measures Should Cover STIP and SHOPP Projects Separately. Caltrans works on many different types of projects at any given time. Some projects are generally large efforts to add capacity to the highway system—STIP projects—while others are usually smaller efforts to improve the condition of existing parts of the system—SHOPP projects. Caltrans works on other categories of projects as well, but STIP and SHOPP projects are the two primary types. These different types of projects have different timelines as well as different patterns of support and capital outlay expenditures. If the performance measures we propose above grouped all capital outlay projects together, they would intermingle projects with different expected ratios of COS to capital outlay expenditure, rendering any targets for the measures meaningless. Therefore, we believe Caltrans should calculate separate measures for STIP and SHOPP projects.

Recommend Legislation Requiring New Measures. We believe that the above measures would provide the information needed for the Legislature to evaluate Caltrans' annual COS budget request accurately. The measures would also allow a more complete assessment of Caltrans' efficiency and effectiveness in developing and overseeing the construction of capital outlay projects. Accordingly, we recommend the enactment of legislation to require Caltrans to begin tracking and reporting data for these performance measures in 2004-05.

PROJECT DELIVERY

Project delivery is arguably the most critical element in Caltrans' mission to improve mobility. Because of concerns over project delays, the Legislature requires our office to report on the department's progress in delivering projects that are scheduled for construction in the STIP and the SHOPP.

Our findings related to Caltrans' project delivery are summarized in Figure 5. First, we found that Caltrans delivered a lower percentage of its planned STIP and SHOPP projects in 2001-02 than in 2000-01, but the total number and value of projects delivered increased substantially. We also found that the reason for the large fluctuation in STIP projects delivered from year to year was due to a record amount of project rescheduling in the past three years, by which Caltrans and local agencies moved their scheduled project delivery dates to later years. Because of this, neither the adopted STIP nor the annual budget reflect Caltrans' actual project delivery schedule, and there is no baseline against which to measure delays in Caltrans' project delivery. Also, the number of STIP and SHOPP environmental documents Caltrans completed in 2001-02 and plans to complete in 2002-03 are significantly lower than in the previous two years. This suggests that fewer projects will be delivered in the future, contrary to the administration's stated intent to accelerate the delivery of transportation projects.

In the following section, we discuss these project delivery issues, as well as project delivery for local agencies and the seismic retrofit program.

Figure 5

LAO's Project Delivery Findings

- ✓ ***Mixed Project Performance in 2001-02.*** Caltrans delivered a lower percentage of its planned State Transportation Improvement Program (STIP) and State Highway Operation and Protection Program projects in 2001-02 than in 2000-01. However, the number and dollar value of projects delivered increased from the previous year.
- ✓ ***Significant Project Rescheduling Decreases Value of STIP and Annual Budget.*** Caltrans and local agencies moved back the scheduled delivery dates for a record amount of STIP projects in the past three years. Because of this, Caltrans' "planned" delivery in those years matches neither the adopted STIP nor the annual budget.
- ✓ ***Future Project Delivery Likely to Drop***. The number of environmental documents Caltrans completed in 2001-02 and planned for 2002-03 dropped significantly from the previous two years. This suggests that future project delivery will drop as well, contrary to the administration's stated intent to accelerate the delivery of transportation projects.

Caltrans Project Delivery Mixed

In 2001-02, Caltrans delivered 86 percent of programmed State Transportation Improvement Program (STIP) projects and 89 percent of programmed expenditures. These percentages represent decreases from 2000-01, but the total number and value of projects delivered increased substantially. Delivery of State Highway Operation and Protection Program projects remained high.

In the *Analysis of the 2001-02 Budget Bill*, we adopted the CTC's definition of project delivery. This definition compares the number of projects that were allocated funding by CTC to the number of projects programmed in the STIP or SHOPP for delivery in that year. (Please see page A-37 of the *2001-02 Analysis*.)

Figure 6 summarizes the number of projects Caltrans delivered ("allocated funding") compared to the number programmed in the STIP and SHOPP. Figure 7 (see next page) shows delivery in terms of dollar volume.

Figure 6

Caltrans Project Delivery by Number of Projects

2001-02

Program	Projects		Percent Delivered[a]
	Programmed	Delivered	
STIP[b]	49	42	86%
SHOPP[c]	180	175	97
Totals	**229**	**217**	**95%**

[a] Excludes expenditures for advanced projects.
[b] State Transportation Improvement Program.
[c] State Highway Operation and Protection Program.

STIP Delivery Percentage Decreased From Previous Year, But Amount of Delivery Was Significantly Larger. According to information provided by CTC, in 2001-02 Caltrans delivered 86 percent of STIP projects that were programmed for delivery in that year, as shown in Figure 6. These are projects that primarily expand highway capacity. In terms of expenditures (Figure 7), the department delivered $675 million, 89 percent, of the programmed level for 2001-02.

Figure 7

Caltrans Project Delivery by Expenditure

2001-02
(Dollars in Millions)

Program	Expenditures: Programmed	Expenditures: Delivered	Percent Delivered[a]
STIP[b]	$759	$675	89%
SHOPP[c]	843	825	98
Totals	**$1,602**	**$1,500**	**94%**

[a] Excludes expenditures for advanced projects.
[b] State Transportation Improvement Program.
[c] State Highway Operation and Protection Program.

The percentage of programmed STIP projects delivered in 2001-02 was lower than in the previous year. However, Caltrans delivered more projects for a higher total dollar value of work in 2001-02. Specifically, Caltrans delivered $675 million worth of projects—214 percent more than the value of projects delivered in 2000-01.

Delivery of SHOPP Projects Remains Strong. With respect to SHOPP projects, the department delivered 175 projects, or 97 percent of the projects that were programmed for delivery. The SHOPP projects provide safety, operation, or rehabilitation improvements to the state highway system. In terms of funding allocations, the department delivered $825 million, or 98 percent, of the amount in programmed funds. In general, SHOPP projects are less complicated from a design standpoint and require less extensive environmental review. This makes them, in general, easier to deliver on schedule than STIP projects.

Department Delivered Some Projects Programmed for Different Years. Figures 6 and 7 only show delivery of projects programmed for 2001-02. They do not include the delivery of projects scheduled for delivery in other years. In 2001-02, the department delivered ten STIP projects ahead of schedule and seven projects that had originally been programmed for delivery in 2000-01. With these projects, STIP delivery in 2001-02 totaled $813 million. With respect to SHOPP projects, the department delivered 16 projects that were advanced from future years and no projects from prior years.

We support the department's practice of advancing projects ahead of schedule when possible. However, we do not include these projects in our main calculations because the Legislature's primary concern has been how well Caltrans meets its *intended* delivery schedule, which more closely reflects its original priority of projects. Likewise, including delivery of delayed projects would not provide a true representation of Caltrans' project delivery.

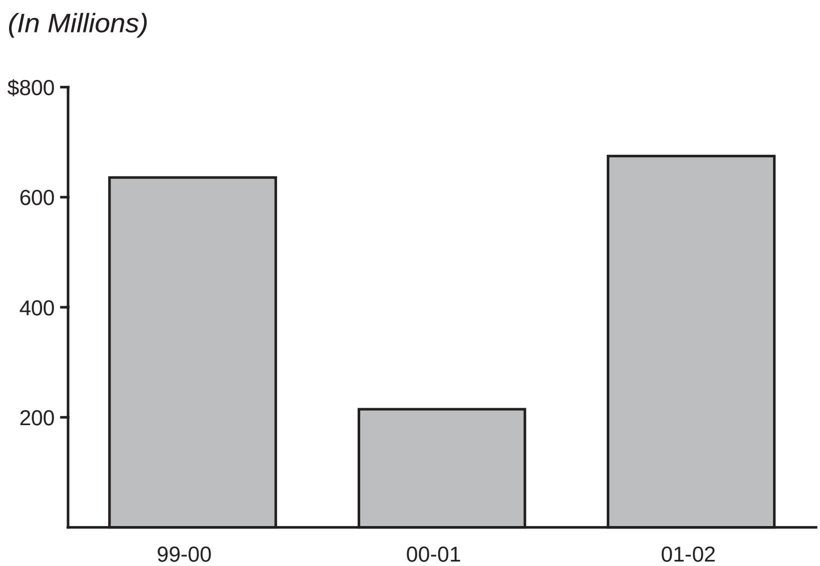
Extensive Project Rescheduling Decreases Value Of Adopted STIP and Annual Budget

Caltrans has experienced large fluctuations in State Transportation Improvement Program (STIP) delivery over the past three years due to record levels of project rescheduling. This level of rescheduling of STIP projects calls into question the value of the STIP as a scheduling tool because it allows Caltrans to annually move the baseline against which its performance is measured. Furthermore, rescheduling project delivery after Caltrans' annual budget renders its capital outlay and capital outlay support budget meaningless. We recommend that Caltrans and the California Transportation Commission (CTC) report at budget hearings on the reasons for the high levels of project rescheduling in recent years. We further recommend adoption of budget bill language requiring CTC to include strategies for reducing this level of rescheduling in its next annual report.

Large STIP Fluctuation Due to Project Rescheduling. As we indicated in the prior section, Caltrans delivered $675 million worth of projects in 2001-02—214 percent more than the dollar value of projects delivered in 2000-01. Our review shows that the reason for the large increase in STIP delivery in 2001-02 was not that Caltrans' STIP project delivery was abnormally high in that year. Rather, its delivery was abnormally low in the previous year. Figure 8 (see next page) shows the value of Caltrans' STIP project delivery over the past three years. The reason for the dip in 2000-01 was the rescheduling of an unprecedented level of projects to later years. Specifically, $788 million in projects were rescheduled, including $646 million that was originally programmed to be delivered in 2000-01. As a result, the delivery goal for 2000-01 shrank significantly. Many of these projects were rescheduled to be delivered in 2001-02, which would have caused a spike in project delivery in that year given the number of projects already scheduled for delivery. However, Caltrans again rescheduled a large number of projects from 2001-02 to later years, so that the level of project delivery was not abnormally high. This practice has continued in the current year, with STIP projects worth about $870 million rescheduled from delivery in 2002-03 and 2003-04 to later years.

Figure 8

Value of STIP Project Delivery Over Time



Extensive Rescheduling Decreases Value of STIP and Budget. This magnitude of rescheduling calls into question the value of the biennial STIP as a project scheduling tool. *In effect, rescheduling allows Caltrans to annually move the baseline against which its performance is measured, thereby making it difficult to get a picture of Caltrans' "true" project delivery performance.*

Furthermore, rescheduling moves the project delivery baseline *after* Caltrans develops its annual budget request. As we describe in our analysis of COS budgeting earlier, Caltrans bases its annual COS budget request (submitted in the spring) on its workload projections as of the January prior to the budget year. Its capital outlay budget request is set even earlier. However, Caltrans adjusts its budget-year delivery schedule with CTC throughout the spring preceding the budget year. Therefore, the capital outlay and COS funding that Caltrans requests in the budget do not match the projects Caltrans actually plans to deliver that year. Because this funding is not tied to specific deliverables, the Legislature is unable to hold Caltrans accountable for its annual expenditure of billions of dollars in capital outlay and COS money.

While some project rescheduling will always occur, the amount of STIP rescheduling witnessed in the past few years should be reduced. To begin to address the discrepancies between Caltrans' project delivery schedule, the annual budget, and the adopted STIP, we recommend that Caltrans and CTC report at budget hearings on the reasons for the high level of STIP project rescheduling exhibited in the past three years. Furthermore, we recommend the adoption of the following budget bill language in Item 2600-001-0046:

> The California Transportation Commission shall include in its 2003 annual report to the Legislature pursuant to Government Code 14535 and 14536 an analysis of strategies to reduce the high level of rescheduling of State Transportation Improvement Program projects exhibited in 2000, 2001, and 2002.

Local Project Delivery Good, Largely Unchanged

In 2001-02, local agencies delivered 81 percent of programmed STIP projects and expenditures. They also obligated more than 100 percent of their annual allocation of federal funds, continuing to reduce their previously high balance of unobligated federal funds.

Local Agencies Delivered 81 Percent of Programmed Expenditures. Under Chapter 622, Statutes of 1997 (SB 45, Kopp), local agencies are responsible for determining how to spend 75 percent of STIP funds. To the extent that local agencies decide to spend their share of STIP funds on highway capacity improvements, they have traditionally depended on Caltrans to deliver the projects. However, to the extent that they choose to spend their share of funds on transit projects or local road improvements, *they* are responsible for that delivery.

In 2001-02, local agencies delivered 453, or 81 percent, of the local street and road or mass transit projects programmed in the STIP for delivery in that year. These projects totaled $400 million. Like Caltrans, however, local agencies also delivered a significant amount of projects that were scheduled for different years. Specifically, local agencies delivered 84 projects from future and prior years. These additional projects bring total delivery by local agencies to $491 million.

Local Agencies Continue Strong Use of Federal Funds. Over the past few years, local agencies' use of federal funds that they receive directly has improved significantly. In 1998 and 1999, the first two years of the current federal transportation act (TEA-21), local agencies underspent their allotment of federal funds by 41 percent and 57 percent, respectively. As a result, by October 1999, local agencies had accumulated $1.2 billion in unobligated federal allocations.

To remedy this situation, Chapter 783, Statutes of 1999 (AB 1012, Torlakson) was enacted to allow CTC to redirect most of a local agency's unused federal funds to another agency before the federal obligation authority expired. As a result, in 2000 and 2001, local agencies increased markedly their use of the major categories of federal funds, obligating 154 percent and 124 percent of their share of federal funds, respectively. Local agencies continued their strong delivery in 2002, obligating 101 percent of their federal funds. As a result, the amount of unobligated federal funds has been reduced to about $600 million. This is a big step toward lowering the backlog to a reasonable level of between $100 million and $200 million.

Number of Completed STIP and SHOPP Environmental Documents Falls

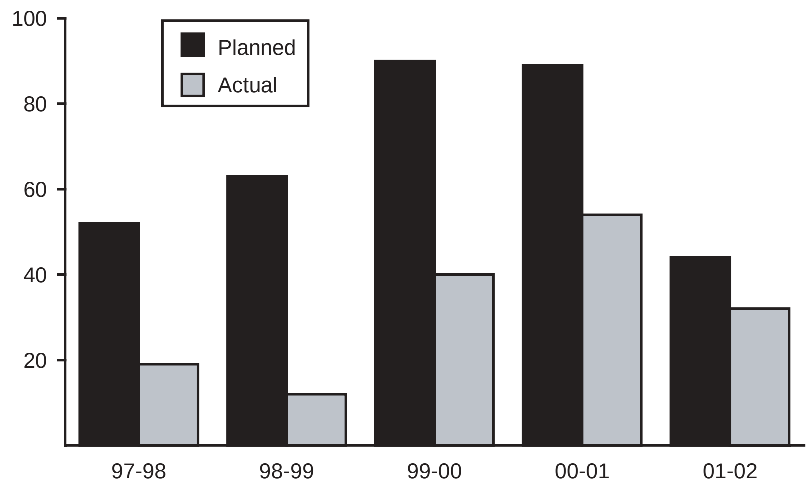
Caltrans completed 73 percent of the State Transportation Improvement Program (STIP) environmental documents it planned to complete in 2001-02, its highest percentage in five years. However, the total number of documents completed declined 41 percent from the previous year. Completion of State Highway Operation and Protection Program (SHOPP) environmental documents exhibited the same trend, with a higher percentage completed than in the previous year, but a drop of 42 percent in total number of documents delivered. These low levels of environmental document completion suggest that future STIP and SHOPP project delivery levels will be low.

Number of Completed STIP Environmental Documents Drops 41 Percent. Our review of planned environmental documents completed for STIP projects last year reveals that of the 44 environmental documents the department planned to complete during 2001-02, 32 were completed. The remaining 12 rolled forward to 2002-03 and beyond. This completion rate (73 percent) represents the highest percentage of STIP environmental document completion in the last five years. However, as Figure 9 shows, the total number of documents completed decreased by 41 percent from the number delivered in 2000-01. Unfortunately, this trend of decreased delivery appears to extend into the current year, when Caltrans plans to complete only 41 final environmental documents for STIP projects. Caltrans completed only three of these documents in the first quarter of the current year.

Environmental Document Completion for SHOPP Declines 42 Percent. Completion of environmental documents for SHOPP projects in 2001-02 exhibited the same trend as noted above for STIP environmental documents. Caltrans completed 59 of 78 planned SHOPP environmental documents, for a completion rate of 76 percent. This surpasses the previous year’s completion rate, but the total number of documents completed dropped 42 percent from the 101 documents delivered in 2000-01. Similar to the trend for STIP projects, Caltrans plans to complete even fewer SHOPP environmental documents in the current year. Only 62 final SHOPP environmental documents are planned for 2002-03, of which Caltrans completed eight in the first quarter.

Figure 9

STIP Environmental Documents Planned Versus Delivered



Decreased Environmental Document Completion Signals Lower Project Delivery in the Future. Since all transportation construction projects must receive environmental clearance, Caltrans' level of environmental document completion is a good indicator of future project delivery. The low levels of environmental documents planned and completed in 2001-02 and 2002-03 suggest that future levels of STIP and SHOPP project delivery will be low as well. For STIP projects, this is a reversal of a trend toward increased environmental document completion exhibited in the past few years, which was attributed to the department's efforts at streamlining its environmental process. This reversal is due in part to a decrease in the number of documents being rolled over from the previous year. However, our review shows that there is also a decrease in the number of new documents initiated. A decrease in environmental document completion suggests that fewer projects will be delivered in the future, contrary to the administration's declared intent to accelerate the delivery of transportation projects.

Delays Continue in Bridge Seismic Retrofit Work

Phase 1 of the highway bridge seismic retrofit program is complete. Phase 2 is 98 percent complete, but work will not be completed on some

bridges until 2010. Seismic retrofit of the state-owned toll bridges continues to be delayed.

Caltrans inspects all state and local bridges at least once every two years. Since 1971, when the Sylmar earthquake struck the Los Angeles area, Caltrans has had an ongoing bridge retrofit program. The retrofit program involves a variety of different improvements, depending on the needs of the particular structure. The improvements include strengthening the columns of existing bridges by encircling certain columns with a steel casing, adding pilings to better anchor the footings to the ground, and enlarging the size of the hinges that connect sections of bridge decks to prevent them from separating during an earthquake.

Following the 1994 Northridge earthquake, Caltrans expanded its seismic retrofit program for state highway bridges, creating a Phase 1 and a Phase 2 program. Phase 1 included 1,039 bridges identified for strengthening after the 1989 Loma Prieta earthquake at a total construction cost of $800 million, as shown in Figure 10. These projects were completed by May 2000. Phase 2 consists of an additional 1,155 bridges that were identified for strengthening following the Northridge earthquake. To date, Caltrans has completed the work on 1,135 (98 percent) of the Phase 2 bridges and estimates Phase 2 construction costs to be $1 billion. However, Caltrans estimates some Phase 2 projects will not be completed until 2010 due to more complex retrofit and replacement work on a number of these bridges.

Figure 10

Highway Seismic Retrofit Program Scope and Progress

As of September 2002
(Dollars in Millions)

	Number of Bridges	
	Phase 1	**Phase 2**
Retrofit construction complete	1,039	1,135
Under contract for construction	—	3
Design not complete	—	17
Totals	**1,039**	**1,155**
Estimated construction cost	$844	$1,000
Construction complete target	2000	2010

Phase 2 seismic retrofit work is funded primarily by bonds authorized by Proposition 192 in 1996. As of September 2002, only about $43 million of Proposition 192's authorized bonding authority remained unallocated. However, Caltrans has not yet allocated any funds for four of the remaining Phase 2 bridges, and their costs are unknown. If costs for the seismic retrofit of Phase 2 bridges exceed the amount of available funding, Caltrans plans to use federal highway bridge funds to complete the work. This, in turn, will place pressure on the SHA to fund projects that otherwise would have been funded by the federal funds.

Schedule Continues to Slip for Toll Bridge Retrofit. Caltrans is also retrofitting seven of the state's toll bridges for seismic safety. As Figure 11 indicates, Caltrans has completed work on five of the seven bridges, but the scheduled completion dates for the retrofit of the remaining bridges are now much later than Caltrans' original projections.

Figure 11

Toll Bridge Seismic Retrofit Schedule Delays

Bridge	Completion Date: Original	Completion Date: Revised	Approximate Delay in Years
San Francisco-Oakland Bay			
New east span	Winter 2004	Summer 2007	3.5
West span	Fall 2003	Summer 2009	6.0
Richmond-San Rafael	Fall 2000	Spring 2005	4.5
Benicia-Martinez	Summer 1999	Spring 2002	3.0
Carquinez—eastbound	Winter 1999	Winter 2002	3.0
San Diego-Coronado	Fall 1999	Spring 2002	2.5
San Mateo-Hayward	Fall 1999	Fall 2000	1.0
Vincent Thomas	Winter 1999	Spring 2000	1.0

Caltrans indicates that the delays in the retrofit work are due to numerous factors, and each bridge's delays are unique. For example, the east span of the Bay Bridge has been delayed more than three years from its original projected completion date. Caltrans indicates that this delay is due partly to the United States Navy's initial refusal to grant an encroachment permit to allow Caltrans to drill on Yerba Buena Island and partly to Caltrans' inability to release the bid for the first contract on the east span until a federal loan was approved.

The west span of the Bay Bridge, on the other hand, has been delayed almost six years from its original completion date, which Caltrans indicates is due in part to safety issues with the ongoing work on the bridge. As a further example, the Richmond-San Rafael Bridge was delayed four and a half years according to Caltrans because the department redesigned the retrofit schedule to reduce the scope of work in environmentally sensitive locations during certain seasons. Because many of the factors causing delays are unanticipated, it is likely that Caltrans could encounter more delays as projects progress.

MASS TRANSPORTATION

Heavy Maintenance of Rail Equipment Not Yet Justified

We withhold recommendation on $10.3 million requested for heavy maintenance of intercity rail equipment pending further information from the department.

Caltrans owns a fleet of passenger rail equipment, including passenger cars and locomotives for its Intercity Rail program. This program supports and funds intercity passenger rail service on three corridors—the Pacific Surfliner in Southern California, the San Joaquin in the Central Valley, and the Capitol in Northern California.

In 2000-01, the program's support level was increased by $5.8 million to provide ongoing funding for heavy maintenance and parts replacement of the equipment. For 2003-04, the budget requests $10.3 million for these activities. However, the department did not submit a budget change proposal for the increase, and at the time this analysis was prepared, had not provided sufficient information to justify the increase. Accordingly, pending further information from the department, we withhold recommendation on $10.3 million from the Public Transportation Account for heavy maintenance of rail equipment.

HIGH-SPEED RAIL AUTHORITY (2665)

The California High-Speed Rail Authority (HSRA) is responsible for planning and constructing an intercity high-speed rail service that is fully integrated with the state's existing mass transportation network. The California High-Speed Rail Act of 1996 (Chapter 796, Statutes of 1996 [SB 1420, Kopp]) established HSRA as an independent authority consisting of nine board members appointed by the Legislature and Governor. The HSRA has an executive director and three staff positions.

The HSRA was due to expire December 31, 2003. Chapter 696, Statutes of 2002 (SB 796, Costa) repealed the expiration date, making the HSRA permanent. Additionally, Chapter 697, Statutes of 2002 (SB 1856, Costa) enacted the Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century. The act, if approved by voters in the November 2004 election, would authorize the issuance of $9.95 billion in general obligation bonds for rail improvements, including $9 billion to fund the design and implementation of a high-speed train network.

Consolidating HSRA Into Caltrans Will Not Be More Effective or Efficient

The proposal to consolidate the High-Speed Rail Authority (HSRA) into Caltrans would result in some savings, but would not improve the effectiveness and efficiency of the state's efforts to develop and implement a high-speed rail system. We recommend that the proposal be rejected and HSRA funding be restored. We further recommend that Caltrans' budget be reduced by $2,242,000. (Augment Item 2665-001-0046 by $2,242,000 and reduce Item 2660-001-0046 by $2,242,000.)

The administration proposes to consolidate the staff and administrative responsibilities of the HSRA into Caltrans in 2003-04. The proposal entails transferring $1,992,000 in support from the HSRA to Caltrans to continue a consultant contract and to pay for other administrative expenses. The proposal would result in the abolishment of all HSRA staff, for a savings of about $400,000. The budget proposes to generate the savings by eliminating the executive director position and having Caltrans "absorb" the three staff positions that would transfer over to the department. In turn, Caltrans would establish a new high-speed rail unit and supplement any additional personnel needs with existing staff. Our review raises a number of concerns, as discussed below.

Proposal Reduces HSRA's Accountability; Complicates Lines of Authority and Responsibility. Our review finds that the proposal would reduce accountability within the high-speed rail program. This is because the administration's proposal would statutorily eliminate the HSRA board's power to appoint an executive director, thereby leaving the authority without a focal point to hold accountable for carrying out its mission.

In addition, the proposal would have the practical effect of limiting the board's ability to carry out its mission while still holding it responsible for doing so. This is because the board would continue to be responsible for implementing the high-speed rail system even though it would no longer have the authority to allocate staff resources (since such staff would be under the control of the Director of Caltrans). Beyond these fundamental issues of accountability, authority, and responsibility, the proposal raises a number of practical issues, including:

- How would policy and process differences be resolved if the board and Caltrans disagree on issues pertaining to the planning and construction of the rail system?
- How would the proposed organizational arrangement resolve communication and coordination issues with federal and local governments in the review and funding of a high-speed rail system?
- Who would have the authority to award and sign contracts and who would have fiduciary responsibility for monies earmarked for the high-speed rail project? Who would have the authority to hire and fire staff working on the project?

Consolidation Does Not Improve Program Effectiveness. The HSRA is scheduled to finish its current efforts of preparing an environmental impact report for the entire high-speed rail project at the end of 2003. After that, its next major step is to put into place an implementation plan that will lay out in detail, among other things, the various construction and funding stages of the project. Our review finds that currently, Caltrans does not possess any expertise in high-speed rail development or planning that it can bring to the project. Thus, the consolidation would not enhance the program's effectiveness by virtue of the department's expertise.

Savings Not From Reduced Workload; But Due to Excess Positions in Caltrans. Our review also shows that the consolidation will not result in increased workload efficiency in developing a high-speed rail system. In fact, the workload will remain the same in 2003-04 regardless of whether it is carried out by HSRA (as it is now) or by Caltrans. Most of the savings proposed in the budget are not the result of increased efficiency. Rather, they result from Caltrans having excess positions and funds that it can redirect to the program. Absent the proposed consolidation, these positions and associated funds ($250,000) should be deleted.

Conclusion. For the reasons stated above, we recommend that the consolidation proposal be rejected and funding for HSRA be restored at $2,242,000. This amount would provide support for the consulting contract and three staff positions. In addition, we recommend funding for Caltrans be reduced by $2,242,000, the amount proposed to be transferred to Caltrans ($1,992,000) plus $250,000 from the elimination of Caltrans' excess positions.

CALIFORNIA HIGHWAY PATROL
(2720)

The California Highway Patrol (CHP) is responsible for ensuring the safe, lawful, and efficient transportation of persons and goods on the state's highway system. In addition, CHP provides protective services and security for state employees and property, and carries out a variety of other mandated tasks related to law enforcement. Since the attacks of September 11, 2001, CHP has played a major role in the state's enhanced anti-terror programs.

The budget proposes $1.2 billion in support for CHP in 2003-04, slightly less (0.4 percent) than estimated current-year expenditures. Current-year expenditures, meanwhile, are expected to be higher than 2001-02 by $184 million (about 17 percent) due primarily to a substantial increase in support for enhanced anti-terror activities and higher costs for staff benefits.

Most of CHP's expenses are paid for by the Motor Vehicle Account (MVA), which derives its revenues primarily from vehicle registration and driver license fees. For 2003-04, the budget proposes to reduce MVA's funding for CHP from $1.1 billion in the current year to $1 billion. With this reduction, MVA will make up 84 percent of CHP's support.

Expenditures on Personal Services for CHP Continue to Soar

Although it is not reflected in the budget, additional monies potentially totaling over $100 million for benefits and salaries will likely be required for 2003-04. We recommend that the Department of Finance and the California Highway Patrol report on the magnitude of these unfunded costs at budget hearings, and present the administration's plan to pay for them.

The support for CHP's activities has increased significantly, by about 28 percent, from 2000-01 to the current year. The increase is in part due to service expansion, particularly for anti-terror security programs after 2001. However, our review shows that the increase is also the result of significantly higher expenditures for staff benefits and salaries.

Significant Increases in Expenditures for Employee Benefits. As Figure 1 shows, in just three years (2000-01 to the current year), expenditures on staff benefits for CHP grew from $110 million to an estimated $283 million. The administration expects to spend at least as much on benefits in the budget year.

Figure 1

Costs for CHP Staff Benefits

2000-01 Through 2003-04
(In Millions)

	2000-01	2001-02	Estimated 2002-03	Proposed 2003-04
Retirement	$3	$40	$142	$142
Health insurance	51	54	63	67
Workers' Compensation	41	41	61	59
Other	15	21	17	19
Totals	**$110**	**$156**	**$283**	**$287**

Retirement costs have grown the most dramatically. Under the current memorandum of understanding (MOU) with CHP uniformed staff, the state has to pay both employer's (state's) and employees' retirement contributions. In the last couple of years, the stock market's poor performance has erased the surplus in the CHP Public Employees' Retirement account that up until recently had defrayed a large portion of these expenses. As a result, the MVA has had to pay for these expenses in the current and budget years. As Figure 1 indicates, in 2000-01 the state's contribution to retirement totaled $3 million. In the current year, the state will pay an estimated $142 million. While the budget includes the same amount for retirement contributions for 2003-04, CalPERS expects retirement rates to increase in the budget year, potentially costing the state in excess of $60 million more.

Health insurance and workers' compensation costs have also contributed to increased costs for CHP. As Figure 1 shows, health insurance costs have increased by about 24 percent from 2000-01 to the current year, and expenditures on workers' compensation have grown by 49 percent. The administration proposes to hold these costs more or less steady in the budget year. However, recent legislation (Chapter 6, Statutes of 2002 [AB 749, T. Calderon]), which changes workers' compensation benefits statewide, could drive up CHP's workers' compensation costs by several more millions of dollars in the current and budget years combined.

Increases in Salaries Expected to Cost State Millions More in Budget Year. Under current MOUs with state employees, CHP's expenses on staff salaries and wages will also increase. As Figure 2 illustrates, the budget proposes a slight increase (about 1.4 percent) in expenditures on salaries over the current year. However, the budget does not reflect the pay raises for uniformed and nonuniformed staff of 6.01 percent and 5 percent, respectively, that are to take effect in July 2003. The administration is in discussions with state employee groups to defer or modify these scheduled increases. If these renegotiations are unsuccessful, the present contract would obligate the state to pay another $40 million in the budget year.

Figure 2

Salary Costs for CHP

2000-01 Through 2003-04
(In Millions)

	2000-01	2001-02	Estimated 2002-03	Proposed 2003-04
Uniformed	$488	$514	$518	$525
Nonuniformed	134	145	146	148
Totals	**$622**	**$659**	**$664**	**$673**

Support for CHP Could Cost Over $100 Million More. Thus, between scheduled salary raises ($40 million) and expected increases in expenditures on benefits ($60 million plus), CHP's staff support costs in 2003-04 could be higher than the budget indicates by more than $100 million. In order to provide the Legislature with better information regarding the cost of CHP support, we recommend that the Department of Finance (DOF) and the CHP report at budget hearings on the magnitude of these unfunded costs and the administration's plan to fund them.

Plans to Shift Funds in Support of CHP Raise Concerns

The budget proposes to shift $57 million in California Highway Patrol (CHP) support costs from the Motor Vehicle Account to the State Emergency Telephone Number Account (911) and State Highway Account (SHA). We do not think the shift to the 911 Account is justified, and recommend its disapproval. We also recommend that the Legislature reject the proposal to shift additional CHP support to the SHA because the shift is based on an arbitrary allocation of cost, and would result in a cumbersome and inefficient system of timekeeping by CHP staff.

In part because of growing CHP costs, the MVA is facing a substantial shortfall in the budget year absent corrective actions. Besides proposing to boost revenues through fee and penalty increases, the administration plans to bolster the MVA condition by shifting $88 million of expenses to three other funding sources: the 911 Account, the SHA, and a new Public Safety Surcharge Fund. Figure 3 details these proposed fund shifts. (Please see a discussion of the MVA condition in the "Crosscutting Issues" part of this chapter.)

Figure 3

CHP Fund Shift Proposals

(In Millions)

Proposal	2003-04	Ongoing
Increase funding from State Highway Account	$16	$19
Increase funding from State Emergency Telephone Number Account	41	51
Establish a new Public Safety Surcharge Fund	31	24
Totals	**$88**	**$94**

Proposal to Increase 911 Surcharge Is Not Justified. Current law allows government agencies and telephone companies to be reimbursed for costs related to the operation and maintenance of California's 911 phone system using revenue from a surcharge on intrastate phone calls. The administration proposes to increase the maximum surcharge rate from 0.75 percent to 1 percent in order to raise about $50 million in 2003-04 for various state activities. The budget proposes using about $41 million of this new revenue to cover CHP staff costs to answer and respond to 911 calls. In the "Crosscutting Issues" section of the "General Government" chapter, we discuss the administration's proposal in detail. We find that the proposal is not justified because, among other reasons, the proposed activities for funding (responding to 911 calls) do not relate directly to maintaining and operating the 911 telephone system—the intended use of the surcharge under current law. As such, we recommend that the proposal be rejected.

Proposal to Enhance SHA's Support of CHP Is Problematic. The CHP currently receives $28 million from the SHA to pay for CHP services at truck inspection facilities around the state. The budget proposes to increase the amount of SHA support by $15.7 million in the budget year. The administration's rationale is that the SHA should fund CHP for the work it does in facilitating the flow of highway traffic. For example, if a ladder or piece of furniture falls off a truck on a state highway, a passing CHP officer must stop and clear it from the highway. Since this action contributes to the efficient operation of state highways, the reasoning goes, these activities should be paid from the SHA instead of the MVA. In estimating the amount SHA should provide for these functions, the department assumes that on average CHP officers and supervisors spend 4.2 percent of their time performing such activities.

We have two main concerns with this proposal. Our primary concern is that accounting and paying for CHP officers' time in a manner proposed by the administration could lead to a fragmented funding structure for the department involving a number of fund sources. Charging CHP activities on state highways according to the amount of time spent on these services would require extensive time tracking efforts that would reduce the department's efficiency in carrying out its mission. In effect, under the administration's proposal, the MVA would pay for the time it takes for an officer to ticket a speeding motorist, but SHA would pay for time that the officer spends chasing a stray dog off the highway. The ongoing process of tracking the percentage of time that officers, sergeants and other personnel (including nonuniformed staff) spend performing specific duties, and then charging a proportional amount to the appropriate account would risk creating a complicated, cumbersome and unstable system of departmental budgeting.

The second concern relates to the method by which CHP would determine the percentage of its costs to charge to SHA. Our review shows that the department allocated 4.2 percent of CHP officers' and supervisors' time to traffic flow control, but it has no data to substantiate the percentage.

The MVA has traditionally paid for the support of CHP activities related to traffic enforcement and the promotion of safe traffic flow. This is consistent with Article XIX of the State Constitution, which restricts the use of state-imposed vehicle registration and driver license fee revenues to transportation and traffic enforcement. Because of the concerns discussed above, we believe that support of CHP activities that are related to traffic flow should continue to be funded from the MVA. Accordingly, we recommend that the proposal to shift $15.7 million of CHP support to the SHA be rejected.

Budget Proposes Public Safety Surcharge for Protective Services

In recent years, the California Highway Patrol's (CHP's) responsibilities for protective and security services have increased substantially. The budget proposes to pay for these and other programs

by establishing a new Public Safety Surcharge Fund. While an alternative funding source is warranted, there is not a sufficient linkage between the proposed new surcharge on intrastate phone calls and the protective services activities that it would fund. If a surcharge is deemed appropriate by the Legislature, we recommend that CHP not be granted authority to set the surcharge rate, and that the use of surcharge revenue be limited to specific, non-transportation-related activities.

State Law Restricts Activities MVA May Fund. The California State Police provided protective services for state property and employees until 1995, when it was consolidated into the CHP. Since that time, CHP has assumed those responsibilities. As a result of the events of September 11, CHP has expanded considerably its protective and securities activities around the state. Using monies that the Legislature allocated to the department earlier this year, CHP officers patrol nuclear power plants and health laboratories, and perform enhanced duties on bridges and at state office buildings and truck inspection facilities. In addition, CHP has other responsibilities unrelated to vehicles or traffic enforcement, such as aerial search and rescue missions. In all, CHP programs unrelated to traffic safety and enforcement total about $125 million.

To date, the MVA has provided most of the funds to pay for these programs from revenues that are not restricted by Article XIX of the State Constitution. As we discussed in the *Analysis of the 2002-03 Budget Bill*, only a limited amount of resources in MVA are not restricted by the State Constitution. In 2003-04, these funds are insufficient to support the range of CHP activities that are not vehicle and transportation related.

Budget Proposes New Phone Surcharge to Supplement CHP Funding. Recognizing the constitutional restriction on the use of MVA funds, the budget proposes to assess a new surcharge on intrastate telephone calls (separate from the "911" State Emergency Telephone Number surcharge discussed previously) to provide an ongoing source of funding for CHP's protective and security services. The administration indicates that the rate would initially be set at 0.25 percent, though CHP, with approval by DOF, would have the authority to raise the rate up to 2 percent. Assuming a new surcharge of 0.25 percent is implemented beginning in November 2003, the administration estimates that $32.5 million would be generated in the budget year, with CHP spending $31 million of it. Besides paying for activities such as security and protective services, CHP would be authorized to use the account to pay for any other programs.

Ongoing Funding Source for CHP's Non-Transportation Activities Is Needed; But Proposed Source Raises Issues. Given the MVA's spending restrictions, a revenue source that provides stable ongoing funding for CHP's non-transportation-related activities is warranted. This is particularly so in light of the recent expansion of CHP's anti-terror activities since September 11. In past *Analyses*, we recommended that protective services be funded from the General Fund because these activities protect the state's employees and facilities at large, and provide broad based, general benefits to the state.

However, given the General Fund condition, the administration's proposal provides an alternative funding source. We have one main concern with the proposal. Specifically, we do not think there is a sufficient linkage or nexus between a surcharge which is based on the use of a telephone with the activities that would be funded by the surcharge.

Additionally, we are concerned with the proposal's provisions that CHP be authorized to set the rate, and direct the revenue to whatever activities it deems appropriate. If the Legislature chooses to impose the proposed surcharge for CHP protective and security services, we recommend that it grant authority to raise the surcharge rate to a third party such as the Board of Equalization, which currently sets the rate for the 911 Account. Additionally, we would recommend that the use of surcharge revenue be limited to specific, non-transportation-related activities.

Additional Revenues Need to Be Raised, or Expenditures Reduced, If Legislature Rejects Fund Shift Proposals

If our recommendations to reject the fund shift proposals are adopted, the Legislature will have to decide what actions to take with regard to the California Highway Patrol's (CHP's) budget. One option is to boost revenue in the Motor Vehicle Account by raising fees and penalties beyond the proposed amounts. Alternatively, the Legislature could make cuts in CHP's budget.

As discussed above, we recommend that the budget's proposals to increase CHP's funding from the 911 Account and SHA be rejected. If the Legislature concurs, it will need to decide how to bring expenditures and revenues in line. It could make up the difference (about $57 million) by taking more funds out of the MVA. This would necessitate further increases in fees and penalties for the MVA. As we discussed in the "MVA Condition" write-up of this chapter, raising the vehicle registration fee by $1 would generate about $27 million a year. Alternatively, the Legislature could reduce CHP's budget by $57 million, or combine spending cuts with revenue enhancements.

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Crosscutting Issues

Funding for Transportation Programs

A-14 ■ **TCRP Funds to Provide Substantial General Fund Relief.** The administration's proposal to use about $1.7 billion in transportation funds to aid the General Fund would delay projects and raise uncertainties regarding future TCRP funding.

A-17 ■ **Funding TCRP: Issues and Options for Legislative Consideration.** Recommend that the California Transportation Commission provide by mid-March an updated status on all TCRP projects. The Legislature has several options to clarify the state's long-term funding commitment to TCRP.

A-21 ■ **The State Highway Account (SHA) and STIP Face New Pressures.** The high SHA balance has declined in recent years, partly due to increased expenditures and partly due to other factors.

A-24 ■ **Budget Proposes Weight Fee Increase and Lower Expenditures.** Recommend that prior to budget hearings, the Departments of Finance and Motor Vehicles provide the Legislature with consistent, updated estimates of current-year weight fee revenue, an explanation of the causes for the drop in revenue, and an estimate of the additional revenue that would be generated under the administration's proposal.

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Motor Vehicle Account (MVA) Condition

A-27 ■ **The MVA Faces Deficit in Budget Year Without Corrective Actions.** The MVA revenues have not kept pace with rising expenditures. If no corrective actions are taken and federal funds do not materialize, the account will face a substantial shortfall by the end of 2003-04. The budget proposes a combination of fee and penalty enhancements and a reduction in California Highway Patrol's (CHP's) reliance on MVA in order to bolster the account's condition.

A-30 ■ **Budget Proposals May Not Go Far Enough in Addressing the Problem.** The budget does not reflect a number of cost increases, relies on the assumption of federal funds becoming available, and proposes some solutions that are problematic. The Legislature will need to consider increasing fees further to raise MVA revenues, or consider reducing the support of the CHP and the Department of Motor Vehicles to below current-year levels.

Special Transportation Programs

Review of Transit Operating Costs

A-36 ■ **Farebox Ratios Have Declined, But Meeting Requirement Generally Not a Problem.** Overall, farebox ratios of transit operators have deteriorated in recent years. Nonetheless, most transit systems receive local tax revenue support and are able to meet the farebox ratio required by the Transportation Development Act.

A-38 ■ **Significant Cost Increases Worsen Farebox Ratio; Increases Will Likely Continue.** Transit systems have experienced sizeable cost increases, particularly in fuel costs and insurance costs. These increases contributed to the worsening of farebox ratios. Transit systems will likely continue to face significant increases in certain costs.

A-43 ■ **Consistent Consideration of Operating Costs.** Recommend the enactment of legislation to allow some modification in the calculation of farebox ratios in order to enable consistent

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application of the Transportation Development Act's eligibility requirements for the Local Transportation Fund and the State Transit Assistance programs.

Department of Transportation

Highway Transportation

A-45 ■ **Budget Proposes Decrease in Highway Program Expenditures.** The budget proposes expenditures of $5.6 billion for the highway transportation program, about 6 percent less than estimated current-year expenditures. To aid the General Fund and address projected State Highway Account shortfalls, the budget proposes several specific expenditure cuts.

A-47 ■ **Capital Outlay Support (COS) Request Will Be Revised.** Withhold recommendation on the COS budget pending the administration's revised proposal. However, we also note that the Legislature could take action that would directly affect the administration's proposal.

A-48 ■ **State Operations Reduction Proposals Need Development.** Withhold recommendation on proposed reductions of $177 million until the administration revises these proposals in the spring.

A-49 ■ **Caltrans Ignores State Policy and Has Not Addressed Problems on Information Technology Project.** Recommend Caltrans and the Department of Finance report at budget hearings on steps they will to take to address problems with the Transportation Permits Management System contractor, increased project costs, and schedule delays.

COS: Budgeting and Performance Measurement

A-52 ■ **Budgeting for COS: Inconsistent Process.** Recommend budget bill language directing Caltrans to develop a standard workload estimation methodology for districts to use in estimating COS needs.

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A-55 ■ **Actual Project Support Expenditures Higher Than Budgeted.** Recommend the Legislature request an audit by the Bureau of State Audits to determine the primary causes for the growth in support costs for capital outlay projects.

A-57 ■ **Evaluating COS Performance: Imperfect Information.** Recommend the adoption of budget bill language to require that Caltrans set targets for each of its COS program performance measures. Further recommend the enactment of legislation to require Caltrans to establish new performance measures beginning with the 2004-05 Governor's budget.

Project Delivery

A-63 ■ **Caltrans Project Delivery Mixed.** In 2001-02, Caltrans delivered 86 percent of programmed State Transportation Improvement Program (STIP) projects and 97 percent of programmed State Highway Operation and Protection Program (SHOPP) projects.

A-65 ■ **Extensive Project Rescheduling Decreases Value of Adopted STIP and Annual Budget.** Recommend that Caltrans and California Transportation Commission (CTC) report at budget hearings on the reasons for high levels of project rescheduling in recent years. Further recommend budget bill language requiring CTC to include in its next annual report strategies for reducing this level of rescheduling.

A-67 ■ **Local Project Delivery Good, Largely Unchanged.** In 2001-02, local agencies delivered 81 percent of programmed STIP projects and expenditures. They also obligated more than 100 percent of their annual allocation of federal funds, continuing to reduce their previously high balance of unobligated federal funds.

A-68 ■ **Number of Completed STIP and SHOPP Environmental Documents Falls.** Caltrans' STIP environmental document delivery in 2001-02 declined 41 percent from the previous year. SHOPP environmental document delivery declined 42 percent from the previous year.

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A-69 ■ **Delays Continue in Bridge Seismic Retrofit Work.** Phase 1 of the highway bridge seismic retrofit program is complete. Phase 2 is 98 percent complete, but work will not be completed on some bridges until 2010. Seismic retrofit of the state-owned toll bridges continues to be delayed.

Mass Transportation

A-72 ■ **Heavy Maintenance of Rail Equipment Not Yet Justified.** Withhold recommendation on $10.3 million for heavy maintenance of intercity rail equipment pending further information from the department.

High-Speed Rail Authority

A-73 ■ **Consolidating High-Speed Rail Authority (HSRA) Into Caltrans. Augment Item 2665-001-0046 by $2,242,000 and Reduce Item 2660-001-0046 by $2,242,000.** Recommend rejection of proposal to consolidate the HSRA into Caltrans because it reduces accountability and complicates authority and responsibility for the project. Also, recommend Caltrans position and funding reduction because consolidating the authority into Caltrans will not result in improved program effectiveness or workload efficiency.

California Highway Patrol (CHP)

A-76 ■ **Expenditures on Personal Services Continue to Soar.** Although it is not reflected in the budget, additional funds for staff benefits and salaries will likely be required for 2003-04. Recommend that the Department of Finance and the CHP report at budget hearings on the magnitude of these unfunded costs and their plan to pay for them.

A-78 ■ **Plans to Shift Funds in Support of CHP Raise Concerns.** Recommend disapproval of the proposal to shift a part of CHP's support to the State Emergency Telephone Number Account (911) and the State Highway Account (SHA) because the proposals are not justified on the basis of (1) the use of the phone surcharge to respond to 911 calls does not relate directly

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to the maintenance and operation of the 911 system, which is the purpose for the surcharge, and (2) the proposed shift to the SHA would result in an inefficient system of timekeeping by CHP staff.

A-80 ■ **Budget Proposes Public Safety Surcharge Fund for Protective Services.** An alternative funding source to pay for the cost of CHP protective service activities is warranted, but there is not a sufficient linkage between the proposed telephone surcharge and the protective service activities that the surcharge would fund. If a surcharge is deemed appropriate, recommend that CHP not be granted authority to set the surcharge rate, and that the use of surcharge revenue be limited to specific, non-transporation-related activities.

A-82 ■ **Additional Revenues Need to Be Raised, or Expenditures Reduced, if Fund Shift Proposals Are Rejected.** If the Legislature rejects the proposal to shift CHP funding to the 911 Account and the SHA, it will have to either raise Motor Vehicle Account revenues beyond the amounts proposed in the budget, or reduce CHP support to below current-year level, or some combination thereof.