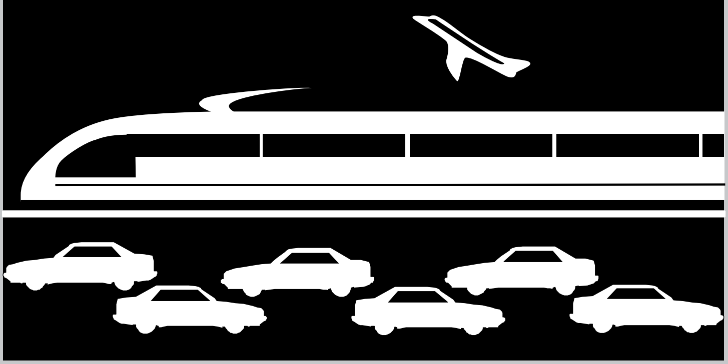
TRANSPORTATION



LAO

65 YEARS OF SERVICE

2007-08 Analysis

Major Issues

Transportation

☑ Eliminate Arcane Spillover to Simplify Transportation Funding Structure

- The "spillover" mechanism is arcane and outdated with the passage of Proposition 42, which results in all state gasoline sales tax revenues being used for transportation. We recommend that the mechanism be eliminated effective 2008-09. This would simplify the transportation funding structure and increase the predictability and stability of the Public Transportation Account (see page A-25).

☑ Governor's Proposition 1B Proposals Circumvent Accountability

- The budget requests (1) three-year appropriations of Proposition 1B bond funds and (2) authority for the administration to transfer these funds among programs. These proposals run counter to the bond measure's intent that the Legislature appropriate specific amounts for various programs. The "power of the purse"—appropriation authority—is one of the Legislature's most powerful tools to ensure accountability. We recommend rejecting the Governor's proposals as they would circumvent accountability in how funds are used (see page A-52).

☑ Highway Maintenance and Rehabilitation Needs Outpacing Available Funds

- The state faces increasing costs to maintain and rehabilitate its highways as the system ages. While the budget proposes more funding for these activities, it does not address the long-term issue that maintenance and rehabilitation requirements are growing faster than the revenues which pay for them.

As a consequence, there is an estimated $2 billion annual shortfall in funding for highway maintenance and rehabilitation. We offer options for the Legislature's consideration in addressing this shortfall, including increasing and indexing the gasoline tax (see page A-30).

☑ **Slow Progress in Traffic Congestion Relief**

- Delayed state funding and cost increases have impeded delivery of projects in the Traffic Congestion Relief Program. Seven years into the program, only 26 of 141 projects have been completed. Looking forward, the availability of state funding and cost increases will continue to threaten project delivery. We recommend steps that the Legislature can take so that projects are completed, including setting project deadlines and reverting funds where projects are no longer viable (see pages A-63 through A-69).

☑ **Time to Bite the Bullet for the Bullet Train**

- The Governor proposes to indefinitely postpone submitting a high-speed rail bond measure to the voters. The budget provides $1.2 million to support the High-Speed Rail Authority, but provides no money for contract services to develop the rail system. This would essentially end the project unless another source of funding is provided. We recommend that the Legislature decide whether to continue the project or disband the authority (see page A-77).

☑ **Real ID Regulations and Funding a Big Question**

- It is virtually impossible for California—or any other state—to implement Real ID by the federal deadline of May 2008, especially in light of the delayed federal regulations. Given the lack of federal direction to date, the absence of any federal plan to fund the law's costly implementation, and growing opposition to the program in a number of other states, we recommend the Legislature and administration go slowly, and limit any state funding to planning activities (see page A-88).

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OVERVIEW

Transportation

The Governor's budget shows total state-funded expenditures for transportation programs to be significantly higher, by $1.8 billion, or 17 percent, in 2007-08 than estimated current-year expenditures. The increase is primarily due to Proposition 1B bond-funded expenditures for state and local transportation capital improvements.

EXPENDITURE PROPOSAL AND TRENDS

Budget Proposal. The budget shows total expenditures of $12.6 billion from all state funds, including special funds and bond funds, for transportation programs and departments under the Business, Transportation and Housing Agency in 2007-08. This is a net increase of $1.8 billion, or 17 percent, over estimated expenditures in the current year. The major components of the net increase include:

- $2 billion in additional transportation capital expenditures for highways, roads, and transit improvements.
- $145 million in additional support for the California Highway Patrol (CHP).
- $18 million in additional support for the Department of Motor Vehicles (DMV).
- $439 million less funding for the operations of transit agencies under the State Transit Assistance (STA) program.

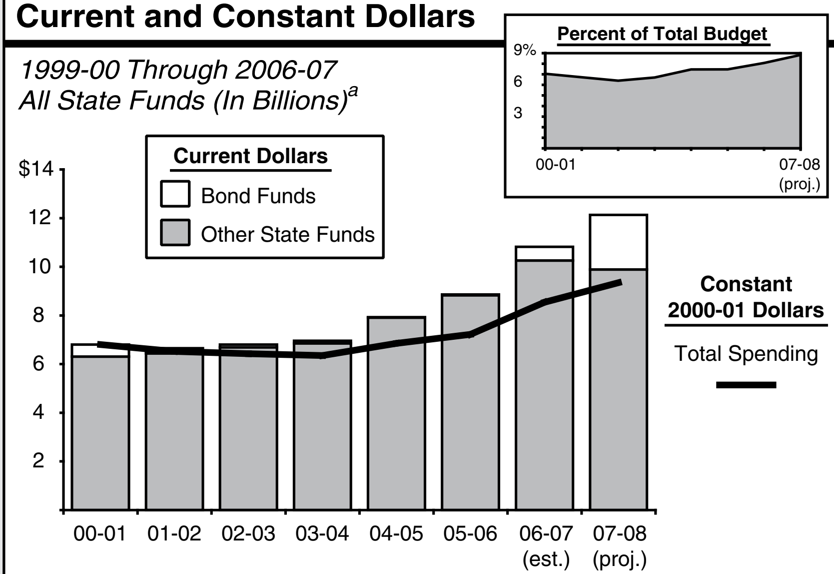
The increase in transportation capital expenditures proposed for the budget year is almost exclusively due to the availability of bond funds as a result of the passage of Proposition 1B in November 2006. Specifically, Proposition 1B authorizes the issuance of about $20 billion in general obligation (GO) bonds for various transportation improvements.

Historical Trends. Figure 1 shows total state-funded transportation expenditures from 2000-01 through 2007-08. As the figure shows, over the period, these expenditures are projected to increase by $5.8 billion, or 86 percent. This represents an average annual increase of 9.2 percent. Figure 1 also displays the spending for transportation programs adjusted for inflation (constant dollars). On this basis, expenditures are estimated to increase by 43 percent from 2000-01 through 2007-08, at an average annual rate of 5.2 percent.

Figure 1

Transportation Expenditures Current and Constant Dollars

1999-00 Through 2006-07
All State Funds (In Billions)[a]



[a]Including bond funds.

As Figure 1 shows, state-funded transportation expenditures stayed relatively constant from 2000-01 through 2003-04. Since 2003-04, these expenditures have increased significantly, at an average annual rate of about 16 percent. These expenditures are proposed to increase in 2007-08 by 17 percent over the current year.

Figure 1 also shows that a portion of the current-year increase (over 2005-06) in state-funded transportation expenditures, and all of the increase expected in the budget year (over current year) are due to bond-funded expenditures. These expenditures, to be funded by Proposition 1B bonds, will be for capital improvements on the state's highways, streets and roads, and transit systems.

The expenditure trend shown in Figure 1 is driven by a combination of factors. First, the overall trend parallels the trend in expenditures by the Department of Transportation (Caltrans) for the period. Expenditures by Caltrans, which make up about 60 percent of total state-funded transportation expenditures, stayed relatively constant from 2000-01 through 2003-04. This is mainly the result of transportation funds being loaned to the General Fund in order to help the state's fiscal condition. Since 2004-05, expenditures increased as a result of repayment from the General Fund of some of the loans made in prior years. Additionally, beginning in 2005-06, transportation received the full amount of gasoline sales tax revenues required under Proposition 42. With the passage of Proposition 1B, the Governor's budget proposes significantly higher transportation bond expenditures in both the current and budget years.

Another reason for the change in the expenditure trend is due to a change in the method by which Caltrans expenditures are accounted for in the *Governor's Budget*. Specifically, prior to 2004-05, Caltrans expenditures were shown on a cash basis (that is, when funds were actually paid out). As a result of a statutory change, data for 2004-05 and onward are shown on an accrual basis (when funds are encumbered, not when they are paid out). Because capital expenditures for transportation projects tend to be large, showing these expenditures on an accrual basis (when they are encumbered) results in a generally higher level of expenditures than showing them when they are actually paid out over a number of years. (The accounting change was adopted in order to improve accountability of the department's expenditures. The change created a one-time anomoly in the overall expenditure trend.)

A second program driving expenditure growth is CHP. Specifically, the CHP's expenditures grew by about 91 percent from 2000-01 through 2007-08, or at an average annual rate of 9.7 percent. The growth is driven mainly by increases in the cost of employee (primarily uniformed staff) salaries and benefits. Additionally, after September 11, 2001, the department increased its staff and overtime expenditures in order to enhance its statewide security activities. The budget proposes a 9.3 percent increase in CHP expenditures in 2007-08 over the current year, mainly for additional patrol officers, increased staff to inspect truck terminals, and funding to continue replacement of the department's radio equipment.

Compared to the CHP and Caltrans, growth in state-funded expenditures for DMV has been modest. From 2000-01 through 2006-07, expenditures grew by 34 percent, or at an average annual rate of 4.3 percent. The growth was mainly to accommodate higher employee compensation costs and to implement various statutes. The budget proposes a 2.2 percent increase in 2007-08 over the current-year level to continue modernization of DMV's information technology (IT) systems, and to pay processing fees for customers who pay for various fees with credit or debit cards.

As a share of total state expenditures, transportation expenditures have stayed slightly below 7 percent through 2003-04, and increased thereafter, as shown in Figure 1. In 2006-07, transportation expenditures are estimated to account for a larger proportion—about 8 percent—of all state-funded expenditures, and are proposed to increase to 9 percent in 2007-08.

Spending by Major Program

Figure 2 shows spending for the major transportation programs and departments from all fund sources, including state, federal, and bond funds, as well as reimbursements.

Caltrans. The Governor's budget proposes total expenditures of $12.8 billion in 2007-08—an increase of $1.5 billion, or 14 percent, over estimated current-year expenditures. The increase is primarily due to expenditures of Proposition 1B bond funds. Specifically, the Governor's budget proposes to spend about $1.5 billion in bond funds in the budget year. Additionally, the budget proposes to transfer $1.5 billion in gasoline sales tax revenue from the General Fund to transportation, as required by Proposition 42. When compared to the current year, however, the total amount transferred is $1.2 billion less. This is because in 2006-07, the General Fund paid back to transportation a substantial amount ($1.2 billion) of past loans in addition to transferring Proposition 42 funds for transportation. The budget also proposes substantially higher transportation expenditures coming from federal funds in 2007-08, compared to the current year.

CHP and DMV. Spending for CHP is proposed at $1.8 billion—$150 million, or close to 9 percent, higher than the estimated current-year level. About 90 percent of all CHP expenditures would come from the Motor Vehicle Account (MVA). The increase in expenditures is mainly due to the full-year cost of patrol officers added in the current year as well as the second-year cost of upgrading and replacing the department's radio system. In addition, the department proposes to add another 120 patrol officers in 2007-08, and to increase staff by 71 positions in order to inspect truck terminals in a timelier manner than it current does.

For DMV, the budget proposes expenditures of $903 million—$19 million, or 2.2 percent, more than the current year. These expenditures would be funded primarily from the MVA and the Motor Vehicle License Fee Account. The increase in expenditures is due to a number of cost increases in the budget year, including higher processing fees for credit or debit card transactions, continued modernization of the department's IT systems, and additional facilities to provide various types of customer services.

Figure 2

Transportation Budget Summary Selected Funding Sources

2005-06 Through 2007-08 (Dollars in Millions)

	Actual 2005-06	Estimated 2006-07	Proposed 2007-08	Change From 2006-07	
				Amount	Percent
Department of Transportation					
General Fund	$1,358.5	$2,642.7	$1,558.4	-$1,084.3	-41.0%
Other state funds	4,317.8	3,470.8	4,457.3	986.5	28.4
Federal funds	3,274.0	3,484.5	4,054.5	570.0	16.4
Bond funds	—	523.0	1,491.7	968.7	185.2
Other	3,061.7	1,097.8	1,197.9	100.1	9.1
Totals	**$12,012.0**	**$11,218.8**	**$12,759.8**	**$1,541.0**	**13.7%**
California Highway Patrol					
Motor Vehicle Account	$1,265.9	$1,502.9	$1,646.0	$143.1	9.5%
State Highway Account	51.6	56.5	57.5	1.0	1.8
Other	99.9	121.9	127.9	6.0	4.9
Totals	**$1,417.4**	**$1,681.3**	**$1,831.4**	**$150.1**	**8.9%**
Department of Motor Vehicles					
Motor Vehicle Account	$413.1	$483.2	$482.9	-$0.3	-0.1%
Vehicle License Fee Account	297.5	334.0	349.2	15.2	4.6
State Highway Account	39.9	45.3	48.4	3.1	6.8
Other	21.2	21.1	22.3	1.2	5.7
Totals	**$771.7**	**$883.6**	**$902.8**	**$19.2**	**2.2%**
State Transit Assistance					
Public Transportation Account	$200.8	$623.7	$184.6	-$439.1	-70.4%
Bond funds	—	—	600.0	600.0	—[a]
Totals	**$200.8**	**$623.7**	**$784.6**	**$160.9**	**25.8%**

[a] Not a meaningful figure.

Transit Assistance. Current law requires that one-half of the annual revenues into the Public Transportation Account (PTA) be appropriated to the STA program, based on a statutory formula. Transit operators generally use these funds for operational expenses, such as staff support, fuel, and insurance costs. The total revenue into PTA can fluctuate greatly depending on gasoline prices and the economy. For the current year, the budget appropriated $624 million to STA, as a result of very high projected revenue into PTA as well as repayments from the General Fund of past transportation loans.

The Governor's budget proposes to fund STA in 2007-08 at $185 million—significantly less than what the program received in the current year. This funding level is the combined result of two proposed changes. First, on a permanent basis, the budget proposes that no "spillover" revenue into PTA be allocated to STA. (Spillover revenue is the amount that state gasoline sales tax at 4.75 percent exceeds the amount generated from sales tax on all other goods at the 0.25 percent rate.) Second, the budget proposes to reduce the 2007-08 STA level by the amount the program received in the current year that exceeds current law requirements.

The state also provides funding assistance to transit operators for capital improvements, such as construction of rail tracks and facilities, and acquisition of equipment. Proposition 1B includes $3.6 billion in GO bond funds for transit capital improvements. The Governor's budget proposes to spend $600 million of the amount in 2007-08.

MAJOR BUDGET CHANGES

Figure 3 highlights the major changes proposed for 2007-08 in various transportation programs.

Caltrans. The budget proposes significantly higher expenditures for various transportation capital improvements. In particular, the budget proposes an increase of about $1 billion in Proposition 1B bond-funded capital expenditures in 2007-08, and about $400 million more in capital outlay expenditures funded with federal money.

Regarding noncapital expenditures, the budget proposes an increase of $85 million to maintain and preserve highway pavements and $9.7 million to maintain intelligent transportation systems such as ramp meters, traffic signals, and changeable message signs. The budget also includes $13 million for equipment and strategies to monitor toxic air emissions.

CHP and DMV. The CHP proposes to add 120 traffic officers in 2007-08. This would be the second year of increases in patrol officers, with the department adding 240 in the current year. The department also proposes to increase its staff to inspect truck terminals by 71 positions. This would allow the department to double its annual inspections to more closely meet the statutory requirement of inspecting all terminals every 25 months.

The budget also includes an additional $51 million for CHP to continue to replace and enhance its radio system. This five-year effort started in the current year.

Figure 3

Transportation Programs
Proposed Major Changes for 2007-08

Department of Transportation	Requested:	$12.7 Billion	
	Increase:	$1.5 Billion	(+13.7%)

+ $969 million in bond-funded expenditures
+ $396 million in federally funded capital outlay expenditures
+ $85 million to preserve highway pavements
+ $13 million to acquire alternative fuel fleet equipment and to monitor air toxins from exhaust emissions
+ $9.7 million to maintain intelligent transportation systems

California Highway Patrol	Requested:	$1.8 Billion	
	Increase:	$150 Million	(+8.9%)

+ $51.4 million to continue to replace and enhance radio system
+ $17.5 million to add 120 officers and support staff
+ $7.7 million to add 71 staff to inspect truck terminals

Department of Motor Vehicles	Requested:	$902.8 Million	
	Increase:	$19.2 Million	(+2.2%)

+ $23.9 million to continue modernizing information technology systems
+ $11.4 million to pay credit and debit card processing fees
+ $9.6 million to lease space for new business service centers and consolidate other facilities

The DMV is requesting $24 million to continue to modernize its IT systems. Additionally, the budget requests $11.4 million to cover fees charged by financial institutions for processing payments to DMV that are made with credit or debit cards. The budget also proposes $9.6 million to lease and consolidate facilities in order to improve services to customers.

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 (GO) bonds. While state transportation programs have been traditionally funded on a pay-as-you-go basis from taxes and user fees, last year's passage of Proposition 1B provides almost $20 billion in bond funds, which will fund state and local transportation programs.

STATE FUNDING FOR TRANSPORTATION

Traditional State Fund Sources. Two special funds—the State Highway Account (SHA) and the Public Transportation Account (PTA)—have traditionally provided the majority of ongoing state revenues for transportation.

- ***The SHA.*** The SHA is funded mainly by revenues from an 18 cent per gallon excise tax on motor fuels (referred to as the gas tax) and truck weight fees. Generally, these funds have provided a predictable source of funding for transportation.
- ***The PTA.*** The PTA has been traditionally funded by sales tax on diesel fuel and a portion of the sales tax on gasoline. Some PTA revenues come from "spillover"—the amount that gasoline sales tax revenues at the 4.75 percent rate exceed the amount generated from sales tax on all other goods at the 0.25 percent rate. Most PTA revenues are fairly stable; however, spillover can vary greatly from year to year, as it corresponds with fluctuations in gasoline prices at the pump and the total economy.

More Recent State Fund Sources. Since 2000, state transportation programs have been supplemented by additional funding sources. In 2000, the Legislature enacted the Traffic Congestion Relief Program (TCRP), a six-year funding plan to address state and local transportation needs. The program created two new state transportation accounts—the Traffic Congestion Relief Fund (TCRF) and the Transportation Investment Fund (TIF). Both accounts have received funding from a combination of General Fund revenues (one-time) and gasoline sales taxes (ongoing) that did not previously go to transportation. In addition, the recent passage of Proposition 1B creates a number of new transportation accounts, which are to receive revenues through the issuance of GO bonds.

- ***The TCRF.*** The TCRF was created by Chapter 91, Statutes of 2000 (AB 2928, Torlakson), to allocate $4.9 billion to 141 specific transportation projects over a six-year period from a combination of General Fund and gasoline sales tax revenues. Originally, all of the $4.9 billion was to be transferred to the TCRF by 2005-06. However, due to the state's fiscal condition in the early 2000s, much of this funding was loaned to the General Fund. As a result, later statutes extended the annual transfer of revenues to the TCRF through 2007-08 and specified repayment of prior-year loans. The repayment is to include revenues from the General Fund and tribal bonds, which have yet to be issued. By the end of the current year, the TCRF will have received about $3.1 billion. (This amount assumes tribal bonds are not issued in the current year to repay General Fund debt to the TCRF.) In addition to the final annual transfer of $602 million scheduled for 2007-08, the fund will likely receive payments on prior-year loans into the next decade.
- ***The TIF.*** The TIF allocates revenues from gasoline sales taxes by formula to various transportation purposes, including local street and road improvements, the State Transportation Improvement Program (STIP), State Transit Assistance (STA), and other transit purposes. In 2002, voters passed Proposition 42, which made the transfer of gasoline sales tax revenues to the TIF permanent. The amount is estimated at $1.4 billion for the current year. These funds have been loaned to the General Fund when the state faced fiscal difficulties in previous years. However, the *2006-07 Budget Act* repaid most of this debt, and Proposition 1A (approved by voters in 2006) restricts the state's ability to borrow these funds.
- ***Proposition 1B Bond Program.*** Proposition 1B authorizes the state to sell $20 billion in GO bonds. The bond act creates several new transportation programs and will fund a variety of purposes including highway and transit capital, facilities for goods movement, local road improvements, as well as safety and security enhancements. All funds in the Proposition 1B bond program are subject to appropriation by the Legislature. (For more detailed

information about Proposition 1B, please see "Implementation of the Transportation Bond" following this write-up.)

FUNDING CONDITION IMPROVES IN 2006-07

2006-07 Budget Fully Funded Transportation, Repaid Debt. Generally speaking, 2006-07 has been a good year for transportation programs. The budget provided for the full transfer of Proposition 42 revenues ($1.4 billion) and prepaid $1.4 billion in debt to transportation programs. Additionally, as a result of projected high gasoline prices, the budget appropriated $668 million in spillover revenues to support public transit and various other transportation-related purposes.

Voter-Approved Ballot Measures Improve Funding Reliability, Increase Investment. The passage of Propositions 1A and 1B also improve the state's transportation funding picture. Proposition 1A enhances the reliability of transportation funding, as it limits the conditions under which Proposition 42 gasoline sales tax revenues may be loaned to the General Fund. The measure also requires that about $750 million in outstanding loans be repaid to transportation within nine years. Proposition 1B increases the state's investment in transportation by authorizing $20 billion in bonds, which will be spent on state and local transportation programs over multiple years. Together, these measures will help advance a number of projects that have been stalled in past years due to lack of funds, as well as deliver new projects.

2007-08 BUDGET PROPOSALS

The *2007-08 Governor's Budget* includes a number of proposals related to transportation funding. These proposals are summarized in Figure 1 (see next page) and described below.

Aggregate Funding for Major Transportation Programs to Increase. As shown in Figure 2 (see page 19), the Governor's proposals would, in aggregate, increase funding for major transportation programs in 2007-08 relative to estimated funding in the current year. Increased spending is due mainly to budget-year expenditure of nearly $2.8 billion in Proposition 1B bond funds. However, due to the large prepayment of Proposition 42 loans in 2006-07, a few programs, including STIP and TCRP, would receive less funding in the budget year. Two transit programs, STA and High-Speed Rail, are to receive considerably less in 2007-08, due to policy proposals in the Governor's budget.

Figure 1

Governor's Major 2007-08 Proposals for Transportation

- Transfer to transportation the full amount required by Proposition 42, amounting to about $1.5 billion.
- Repay $83 million in past-year debt to transportation, as required by Proposition 1A.
- Begin using Proposition 1B funds to deliver projects. Proposes $523 million in expenditures in 2006-07, as well as $2.8 billion in 2007-08.
- Use existing tribal compact revenues to repay a portion of transportation loans in 2006-07 and 2007-08, rather than wait for bond issuance.
- Use $1.1 billion in transportation funds for General Fund expenditures including:
  —Use first $340 million to offset transportation bond debt service.
  —Use $771 million in Public Transportation Account revenues to fund Home-to-School transportation and regional center transportation.
- Permanently discontinue allocation of spillover revenues to State Transit Assistance (STA).
- Reduce 2007-08 STA funding to compensate for overappropriation in 2006-07.
- Fund only staff support of the High-Speed Rail Authority.

Proposition 42 to Be Fully Funded in 2007-08. The budget proposes to transfer $1.5 billion of gasoline sales tax revenues to the TIF, the full amount required under Proposition 42. Of these funds, $602 million will be available to fund construction of TCRP projects, $698 million will be used for STIP projects, and $175 million will be allocated to PTA for public transit. Consistent with current law for the budget year, none of the revenues will be allocated for local streets and road purposes.

Partial Repayment of Proposition 42 Loan. Due to the state's fiscal condition, the Proposition 42 transfer was suspended partially in 2003-04 and fully in 2004-05. By the end of 2006-07, there will be about $750 million in outstanding Proposition 42 loans that must be repaid by the General Fund. Proposition 1A requires that the amount be repaid, with interest, no later than June 30, 2016, with the minimum annual repayment of one-tenth the amount owed. The budget proposes to repay from the General Fund $83 million, about one-ninth of the outstanding amount in 2007-08.

Begin Using Proposition 1B Bond Funds. The Governor's budget proposes to appropriate $7.7 billion in Proposition 1B bond money in

2007-08. Of the amount, about $2.8 billion would be expended in 2007-08. The budget also proposes that the Department of Transportation (Caltrans) expend $523 million in bond funds in the current year, mainly on projects in existing state programs and one new program created under Proposition 1B. Because all Proposition 1B bond funds are subject to legislative appropriation, any expenditure in the current year would require separate legislative action. (For a more detailed discussion of the Governor's proposals for Proposition 1B funds, please see our write-up on "Appropriating Proposition 1B Funds.")

Figure 2

Funding for Major Transportation Programs

(In Millions)

Programs	Estimated 2006-07	Proposed 2007-08	Change
STIP	$1,464	$1,142	-$322
SHOPP	2,268	2,563	295
TCRP	1,001	684	-317
Proposition 1B total	523	2,788	2,265
Corridor Mobility	(100)	(317)	(217)
Trade Corridors	(15)	(170)	(155)
State-Local Partnership	(—)	(170)	(170)
STIP	(262)	(340)	(78)
SHOPP	(141)	(403)	(262)
Transit Capital	(—)	(600)	(600)
Local Roads	(—)	(600)	(600)
Other	(5)	(188)	(183)
Local Roads	1,590	1,173	-417
STA	624	185	-439
High-Speed Rail	14	1	-13
Totals	**$7,484**	**$8,536**	**$1,052**

STIP= State Transportation Improvement Program; SHOPP= State Highway Operation and Protection Program; TCRP= Traffic Congestion Relief Program; STA=State Transit Assistance

Use Tribal Compact Revenues to Repay Debt, Instead of Bond Funds. Chapter 91, Statutes of 2004 (AB 687, Nuñez), provided that $100 million in annual tribal compact revenues would back the issuance of $1.2 billion in bond funds to repay certain transportation loans made to the General Fund. Due to pending lawsuits, the bonds will not be issued in the current year, and most likely not in 2007-08. Absent the bonds, the budget proposes to use $100 million of tribal compact revenue in each of the current year and the budget year to repay a portion of the loan.

Use Transportation Funds to Offset General Fund Expenditures. The budget proposes to use $1.1 billion in PTA funds to offset a number of General Fund expenditures, including:

- Use the first $340 million in spillover in 2007-08 to pay debt service on outstanding transportation bonds, including bonds issued under Propositions 108 and 116 (1990) for transit and Proposition 192 (1996) to retrofit highways and bridges for seismic safety. Debt service for these bonds has traditionally been paid from the General Fund.
- Use $771 million in PTA money to fund Home-to-School transportation ($627 million) and regional center transportation ($144 million) in 2007-08. Currently, Home-to-School transportation is paid from Proposition 98 school funding. The budget proposes the funding shift to PTA on a permanent basis and to "rebench" the Proposition 98 funding requirement downward by a like amount. (This has the effect of lowering the school funding guarantee beginning in the budget year.) The proposal to fund regional center transportation from PTA instead of the General Fund, however, would be a one-time shift in the budget year only.

Reduce STA Funding Level. The budget proposes to permanently discontinue the allocation of spillover revenue to STA. For 2007-08, the proposal would free up $309 million in PTA revenue for other proposed uses, including Home-to-School transportation, regional center transportation, and debt service on transportation bonds.

Additionally, the budget proposes to reduce 2007-08 STA by the "extra" amount appropriated in 2006-07. Specifically, the current-year budget appropriated $624 million in spillover funds and other PTA revenues to STA. The budget now indicates that because overly high gasoline prices were used to project spillover revenue, the amount provided in the 2006 budget is about $102 million more than current law requires. The Governor's budget proposes to offset this extra allocation by reducing the 2007-08 funding level by a corresponding amount.

Fund Only Staff Support for High-Speed Rail Authority (HSRA). The budget proposes to indefinitely postpone the bond measure for the development of a statewide high-speed rail system (which is scheduled for the November 2008 ballot) in order to free up bonding capacity for other capital improvements proposed by the Governor. At the same time, the budget proposes $1.2 million from the PTA for staff support of HSRA, but no funding for any contracted services to develop a high-speed rail system.

Slim PTA Balance Could Evaporate; Expenditure Priorities Should Be Established

The budget curtails certain transit expenditures in 2007-08 in order to use $1.1 billion in Public Transportation Account (PTA) funds to offset General Fund expenditures, and leaves a small balance of $69 million at the end of the budget year. Because of the volatility of certain revenues, total available PTA funds could be significantly lower than projected, resulting in an account shortfall in 2007-08. Higher than assumed expenditures for transit projects could also bring about a shortfall in PTA.

We recommend that the Legislature establish priorities for PTA expenditures in 2007-08 to clarify what expenditures would not be made in the event of insufficient PTA funds. We further recommend the California Transportation Commission and the California Department of Transportation advise the Legislature at budget hearings on the transit capital projects that would be delayed or not funded as a result of the budget proposals.

Traditional Uses of PTA Funds. Under current law, PTA funds can only be used for transit and transportation planning purposes. Current law allocates one-half of all PTA revenues to STA to assist the operations of local and regional transit systems, mainly bus and rail. The remaining one-half of PTA revenues is used to support the state-funded intercity rail service contracted through Amtrak, fund Caltrans' mass transportation program to oversee federal transit funding to local entities, support the development of high-speed rail, as well as provide funds for transit capital improvements in the STIP.

Budget Proposes to Use PTA Funds to Offset General Fund Expenditures. Instead of using PTA for purposes established in current law, the Governor's budget proposes to use the bulk of the money in the account—$1.1 billion—to offset a number of General Fund expenditures, as discussed earlier. Figure 3 (see next page) compares how PTA funds are used in the current and budget years, as proposed in the Governor's budget. The proposals are intended to help the state's fiscal condition by using the PTA funds in lieu of General Fund monies.

Budget Curtails Other Transportation Expenditures to Free Up PTA Funds. In order to fund the Governor's expenditure proposals, and leave a PTA balance of $69 million at the end of 2007-08, the budget proposes to curtail other transportation expenditures funded by PTA. Specifically, the budget proposes to:

Figure 3

Public Transportation Account Expenditures 2006-07 Versus 2007-08 Budget Proposal

(In Millions)

	2006-07	2007-08	Change
State Transit Assistance	$623.7	$184.6	-$439.1
Department of Transportation			
Support/intercity rail	133.3	142.5	9.2
Transit capital improvements	571.0	69.3	-501.7
High-Speed Rail Authority	14.3	1.2	-13.1
Other agency support	5.4	5.5	0.1
Debt service	—	340.0[a]	340.0
Home-to-School transportation	—	626.8	626.8
Regional center transportation	—	144.0	144.0
Totals	**$1,347.7**	**$1,173.9**	**$166.2**

[a] Amount to be paid with spillover revenue before it is deposited into the Public Transportation Account.

- ***Reduce STA Funding.*** The budget proposes to fund this program at $185 million in 2007-08. This is $410 million less than the level called for under current law (assuming the administration's projections for spillover revenue). This reduced funding level results from the budget's proposal to (1) permanently discontinue allocating one-half of spillover revenue to STA, and (2) reduce 2007-08 STA funding by $102 million to offset the amount the program received beyond the statutory requirement in the current year.
- ***Provide No Contract Funding for HSRA.*** The budget provides $1.2 million to support existing staff of HSRA, but includes no funding for contract services to develop the rail system.
- ***Defer PTA Allocations for Transit Projects.*** The 2006 budget appropriated $571 million in PTA money for local transit capital projects. These projects have been scheduled for funding in the 2006 STIP (covering the period from 2006-07 through 2010-11). The budget estimates that the California Transportation Commission (CTC) would allocate $362 million for various projects in the current year, with the remaining amount (about $210 million) to be

allocated to projects in later years. The Governor's budget assumes that no new allocations would be made in 2007-08 to these projects. This means that any transit projects requesting allocations in 2007-08, when they are ready to spend the funds (such as for construction) would not receive any PTA funding. Thus, absent other funds, these projects would be delayed.

Spillover Revenue Volatile—Lower Gasoline Prices Could Erase Account Balance. Spillover revenue is very volatile and can fluctuate greatly depending on gasoline prices and the economy. If everything else stays constant, higher-than-expected gasoline prices would generate additional spillover. Conversely, lower-than-projected gasoline prices would result in lower spillover than projected in the budget. This has occurred in the current year. Specifically, the budget now estimates that STA funding for 2006-07 is too high—$102 million more than current law requires because overly high projected gasoline prices were used in the spillover projection when the 2006 budget was adopted last June.

The Governor's budget assumes gasoline prices to average $2.87 per gallon (at the pump) for purposes of projecting PTA revenues for 2007-08. This would generate $617 million in spillover revenue. Since the budget was proposed in January, however, gasoline prices have been dropping. If the current trend continues, spillover revenue for 2007-08 would be substantially lower than the budget projects. We estimate that if gasoline prices were 5 percent lower than projected in the Governor's budget (at $2.73 per gallon), everything else staying the same, spillover revenue into PTA would be about $100 million less than the budget projects for 2007-08. In that case, funding all of the Governor's proposals would create a shortfall instead of leaving the account with a $69 million balance at the end of 2007-08.

Expenditures Could Be Higher; Adding to the Shortfall. Expenditures also could be higher than the budget projects due to higher-than-assumed expenditure of funds that have been allocated to transit capital projects. When CTC allocates funding to a transit capital project (such as to construct stations or rail tracks), the allocated amount is often expended (or liquidated) over several years. The rate of liquidation is mostly beyond the state's control. Rather, it depends largely on how quickly a project is constructed. About $280 million in PTA funds allocated for transit capital projects in the current and prior years have not been liquidated. The budget anticipates that $100 million or so would be liquidated in 2007-08, leaving $180 million to be liquidated in subsequent years. However, if projects are constructed sooner than the budget assumes, the amount of expenditure (liquidation) would be higher. For example, if expenditures are $70 million higher than assumed in the budget, a shortfall would result in the account in 2007-08.

Establish Priorities for PTA Expenditures. The Governor's budget does not indicate the priorities of its proposed PTA expenditures. If a shortfall occurs, it is not known what expenditures should have funding priority, and what projects or programs should be left unfunded. Accordingly, we recommend that the Legislature establish clear expenditure priorities for PTA funds in the budget to guide the use of these monies in the event that revenues fall below projections or expenditures exceed the forecast.

Administration Should Report on How Projects Would Otherwise Be Funded. As noted earlier, the budget assumes that $210 million of transit capital projects scheduled for funding in the 2006 STIP would not receive PTA allocations in 2007-08. At the same time, the Governor's budget is proposing to expend $600 million in Proposition 1B funding for transit capital. It is not clear whether the administration proposes to substitute bond funds for PTA funding for these projects. So that the Legislature is informed on the impact of the Governor's budget proposals on these transit capital improvements, we recommend that CTC and Caltrans advise the Legislature during budget hearings on (1) the projects that would not be allocated PTA funds in 2007-08, and (2) the impact, including the extent of delay, on these projects. The administration should also advise the Legislature on whether it intends to substitute Proposition 1B bond funds for PTA funds for the $210 million of transit capital projects scheduled for funding in the 2006 STIP.

Home-to-School Transportation Proposal Requires Substantial Spillover

The administration's proposal to fund Home-to-School transportation from the Public Transportation Account, rather than the General Fund, raises significant issues for the Legislature regarding the impact on transit capital projects and the financing of K-12 education.

Shift Proposal Raises Significant Issues. The administration's proposal to fund Home-to-School transportation using PTA funds on an ongoing basis raises significant issues for the transportation program. Specifically, the proposal would divert $627 million annually to support Home-to-School transportation, leaving little, if any, funding for transit capital improvements.

Funding Home-to-School Transportation Requires Substantial Spillover. Meeting the PTA spending priorities proposed in the Governor's budget beyond the budget year would require substantial spillover revenue into the PTA annually, in addition to the account's other revenue sources. Specifically, to keep the PTA in balance, the account would require about $320 million in spillover revenue each year, over and above revenue from other sources. This amount would be needed to fund on an ongoing basis $627 million in Home-to-School transportation, provide support for STA (at the level proposed by the Governor's budget, which is allocating no spillover to the program), and sustain the current level of intercity rail service. With this level of spillover revenue, there would be no PTA funds available for transit capital projects. Furthermore, after 2007-08, any liquidation of outstanding allocations (funding commitments) that have previously been made to transit capital projects would have to be paid from non-PTA funds. Given the historical volatility of spillover, it is highly unlikely that the necessary amount of funds would be generated on an annual basis.

Proposal Raises Other K-12 Education Issues. Moreover, while the Home-to-School transportation program appears to meet the eligibility requirements for PTA funding, the administration's proposal raises legal and programmatic issues in K-12 education. (Please see the "Home-to-School Transportation" section of the "K-12 Education" chapter for our discussion and recommendations concerning these issues.)

Reduce PTA Volatility; Increase STA Funding Predictability

In order to simplify the state's transportation funding structure, we recommend the enactment of legislation to eliminate the "spillover" mechanism for generating revenue into the Public Transportation Account (PTA) beginning in 2008-09. This would also reduce the volatility in the PTA. While eliminating the spillover would result in less funding for STA in some years, it would increase the predictability and stability of annual program funding. Moreover, additional funds could become available for broader transportation uses.

Spillover: Anachronistic and Arcane Formula. The spillover funding formula was created as part of the Transportation Development Act (TDA) in 1971. The TDA reduced the state sales tax rate at the time by one-quarter percent, and reimposed that one-quarter percent as local sales tax, with revenues dedicated to local transit purposes. To offset the loss of state General Fund revenue resulting from the tax rate reduction, the state sales tax was extended to include gasoline. The law also provided that after offsetting the General Fund loss, any additional revenue—the spillover—would be deposited in what is now PTA, to be used for transit purposes. At that time, the spillover was the only source of state assistance to transit operators.

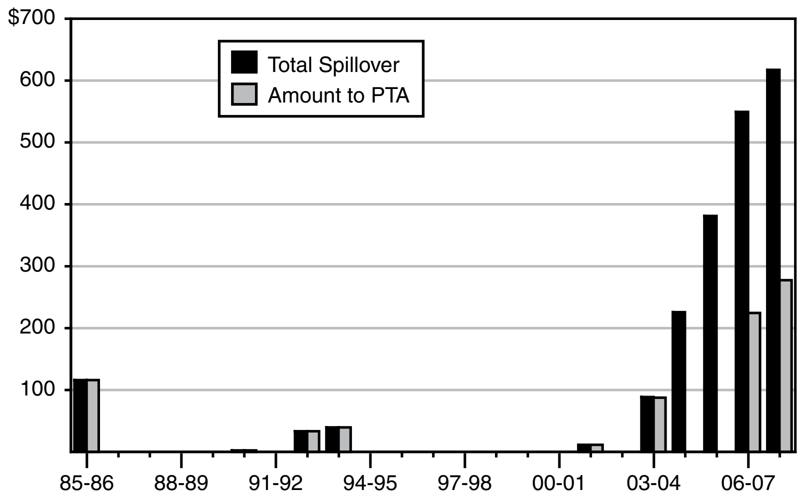
Between 1971 and 2000, the PTA funding base has been expanded to include sales tax on diesel fuel. Additionally, statute specifically designates revenues generated by the sales tax on 9 cents of the per gallon gasoline excise tax (as a result of the passage of Proposition 111 in 1990) to PTA.

Under the spillover formula, if there is no excess gasoline sales tax revenue after offsetting the General Fund loss, there would be no spillover for transportation. Generally, this occurs when gasoline prices are relatively low and the economy is robust and sales of all other goods are high. Conversely, when gasoline prices are high in a weak economy, spillover revenue is significant. Thus, spillover revenue is very volatile and can fluctuate greatly from year to year. For instance, between 1973-74 and 1985-86, annual spillover fluctuated from less than $2 million to $159 million. As Figure 4 shows, for 12 of the 15 years after that (through 2000-01) no spillover revenue was generated. Figure 4 also shows that spillover revenue has not always been deposited into the PTA. For instance, in 2003-04 through 2005-06, spillover revenue was retained in the General Fund as well as used to pay prior transportation loans. In the current year, a portion of spillover revenue was used for the seismic retrofit of the Bay Bridge and to help repay Proposition 42 loans. However, because of the expanded fund sources, PTA received steady revenues each year from diesel sales tax and the Proposition 111 portion of gasoline sales tax for transit.

Figure 4

Spillover Revenue to PTA

1985-86 Through 2007-08
(In Millions)

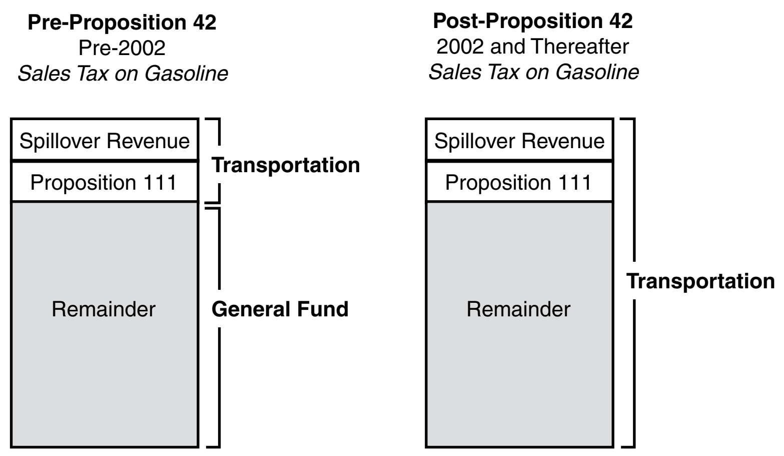


Proposition 42 Use of Gasoline Sales Tax Revenues Renders Spillover Mechanism Unnecessary. Figure 5 shows how revenues from the

state sales tax on gasoline were distributed before the passage of Proposition 42, and the current distribution under Proposition 42. As the figure shows, prior to the passage of Proposition 42, most of the state gasoline sales tax revenues accrued to the General Fund. Specifically, of the total state gasoline sales tax revenue, only the Proposition 111 portion and spillover revenue were used for transportation. The remainder was deposited in the General Fund for other purposes. Since 2002, this remainder amount has been dedicated to transportation as well, pursuant to Proposition 42. Thus, *all* state gasoline sales tax revenues are dedicated to transportation, as shown in Figure 5. As a result, for purposes of determining the state's *total* level of transportation funding from gasoline sales tax, it is no longer necessary to estimate the spillover revenue that would be available for transportation versus the amount of gasoline sales tax revenue that would be paid to the General Fund.

Figure 5

Distribution of State Sales Tax on Gasoline



Eliminate Spillover to Streamline Funding Structure; Reduce PTA Volatility. To streamline the state's transportation funding structure, we recommend the enactment of legislation to eliminate the spillover formula. This would not alter the amount of *total* state funding for transportation. Instead, the issue is how to allocate revenue among various transportation uses. In contrast, the Governor's proposal would retain the spillover formula, but change the allocation of spillover revenue to fund expenditures that currently are paid from the General Fund.

There are a number of advantages to eliminating the spillover formula. First, it increases the stability and predictability of PTA revenues, because they will be based on diesel sales tax and Proposition 111 gasoline sales tax only (in addition to the Proposition 42 transfer), which are relatively stable sources. In turn, the funding level for STA would also be more stable.

Second, most of the gasoline sales tax revenue would be available for broader transportation uses. Under the Proposition 42 allocation formula, beginning in 2008-09, 40 percent of gasoline sales tax revenues in the TIF would go to fund STIP projects including highways and transit projects, 40 percent would be allocated to local entities for local streets and road improvements, and 20 percent would accrue to PTA (with one-half of the revenue allocated to STA).

Third, and maybe most important, eliminating spillover would ensure that all gasoline sales tax revenue be used for transportation, in keeping with voters' intent in passing Proposition 42.

There are a couple of disadvantages to eliminating spillover, however. First, in years where spillover would otherwise be positive, PTA and STA would receive less revenue than under current law. However, as we discuss in the STA write-up (Item 2640), we forecast that beginning in 2008-09, STA would receive substantial amounts—more than twice the average in past years—even if the program receives no spillover revenue.

While eliminating spillover would reduce volatility in PTA and STA, it would take away a source of funding that the administration and Legislature may use, as they have in recent years, to aid the General Fund. If such need arises in the future, Proposition 1A, passed by voters in November 2006, allows the state to borrow Proposition 42 transportation funds to help the state's fiscal condition, as long as specified conditions are met.

On balance, we think eliminating the spillover mechanism is preferable in that it simplifies the state's transportation funding structure. Any future need to use gasoline sales tax revenues to help the state's fiscal condition could still be achieved under the provisions of Proposition 1A.

If Tribal Bonds Not Issued, Repayments to Transportation Would Span Far Into Future

Due to pending litigation, the Governor's budget proposes to use tribal compact revenues to repay transportation loans in 2006-07 and 2007-08, rather than bond funds. This would provide almost $200 million for highway rehabilitation over the two years. However, based on

current estimates, if bonds are not issued, it would take until 2016-17 to repay the loans with tribal compact revenues as they become available. The impact on transportation projects funded by these monies is unknown.

To aid the state's fiscal condition, a total of $1.4 billion was loaned from the TCRF to the General Fund in 2001-02 and 2002-03. Of that amount, $183 million was repaid in 2004-05. Under Chapter 91, Statutes of 2004 (AB 687, Nuñez), the remaining $1.2 billion would be repaid from bonds backed by certain tribal compact revenues. These compact revenues will be paid to the state over 18 years (through 2022-23), at about $100 million a year.

Pending Lawsuits Make Bonds Uncertain, Compact Revenues Used to Repay Debt. Due to pending lawsuits, the state has not yet issued tribal bonds and probably will not be able to do so in the near future. In 2005-06, because of uncertainty regarding the timing of bond issuance, the state used the first $151 million of tribal compact revenues to repay a portion of the transportation debt. The Governor's budget proposes to similarly use $200 million in compact revenues received in 2006-07 and 2007-08 to repay transportation loans. If these proposals are adopted, $871 million in transportation debt would remain.

If the state could issue tribal bonds in the near future, this would provide upfront capital to repay transportation loans and advance projects. However, beyond the uncertainty regarding the timing of bond issuance, there is also uncertainty over the amount that could be generated by tribal bonds. Specifically, the State Treasurer indicated in late 2004 that bond proceeds would total only about $800 million, far short of the $1.2 billion originally anticipated because of risks associated with the bonds. As the stream of income to back the bonds declines due to compact revenues being used to pay back loans on an ongoing basis, the amount of bonds that could be issued would be less. Thus, it is possible the tribal bonds could not generate sufficient capital to repay the entire transportation debt.

Using Existing Revenues Provides Certainty, but Stretches Repayment Far Into Future. Using tribal compact revenues to repay transportation debt as these revenues become available each year provides certainty of a repayment schedule and amount. However, this stretches repayment far into the future, making some recipients wait another ten years to receive funding. The order in which accounts are to be repaid is directed by Chapter 56, Statutes of 2006 (SB 1132, Committee on Budget and Fiscal Review). Figure 6 shows the repayment schedule under Chapter 56, assuming that compact revenues, rather than bonds, are used to repay transportation loans.

Figure 6

Timing of Transportation Repayment Through Compact Revenues if No Bond Issued

(In Millions)

Year	State Highway Account	Traffic Congestion Relief Fund	Public Transportation Account
2005-06	$151	—	—
2006-07	100	—	—
2007-08	100	—	—
2008-09	100	—	—
2009-10	14	$86	—
2010-11	—	100	—
2011-12	—	100	—
2012-13	—	4	$96
2013-14	—	—	100
2014-15	—	21	79
2015-16	—	100	—
2016-17	—	71	—
Totals	**$465**	**$482**	**$275**

Effect of Delayed Repayment on Project Delivery Unknown. As Figure 6 shows, stretching repayment through 2016-17 would likely be most detrimental for TCRF, which will receive funds in the later years. It is uncertain precisely what effect this repayment schedule would have on TCRP projects. To the extent that some projects are behind schedule due to reasons other than the availability of state funds, the effect of this delayed repayment may be fairly minor. However, if projects are ready to go, this repayment schedule could be detrimental to project delivery. (Please see further discussion of this issue under "Department of Transportation, Item 2660," in this chapter.)

Maintenance and Rehabilitation Needs Outpacing Available Funds

As the state highway system ages, the costs to maintain and rehabilitate state highway miles are increasing. While the Governor's budget proposes more funding for highway maintenance and rehabilitation in 2007-08, it does not address the long-term issue that needs are growing faster than the revenues which pay for these activities. We recommend

actions to ensure sufficient revenues are available to address long-term maintenance and rehabilitation needs.

While travel on the state's highway network continues to increase, many of California's highways have surpassed their design life. As a result, maintenance and rehabilitation costs have grown considerably in recent years. The Governor's budget includes some proposals to address highway maintenance and rehabilitation needs. For example, the budget proposes to use $141 million in Proposition 1B funds on State Highway Operation and Protection Program (SHOPP) projects in the current year and $403 million on SHOPP projects in the budget year. It also proposes to permanently augment funding for pavement maintenance by $85 million and provide $9.3 million more for pavement maintenance materials costs.

While these proposals provide some additional funding for highway maintenance and rehabilitation, they do not address the long-term issue that maintenance and rehabilitation needs are growing faster than the revenues which pay for them. In its 2006 annual report, CTC projects that annual gas tax and weight fee revenues are insufficient to address all of the state's highway maintenance and rehabilitation needs. Over the next ten years, the state would have to spend about $2 billion more per year to address all of these needs.

Existing Gas Tax Inadequate to Cover Maintenance and Rehabilitation Costs. Growing maintenance and rehabilitation demands resulting from the state's aging highway system consume increasing portions of SHA revenues (primarily gas tax and weight fees), which traditionally have been the *state's primary source to fund capacity expansion on highways*. Gas tax revenues have not increased enough in recent years to keep pace with escalating maintenance and rehabilitation costs because:

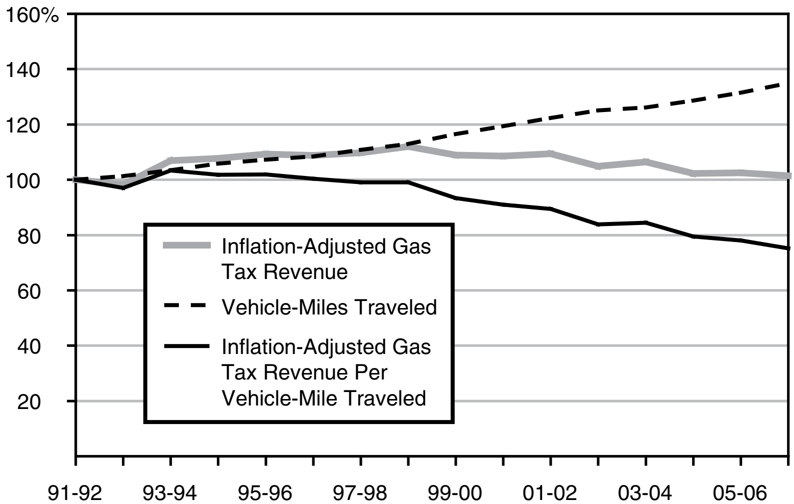
- ***Gas Tax Has Not Increased in Over a Decade.*** The current state gas tax rate (18 cents per gallon) has been in place since 1994. Since then, inflation has eroded the value of per gallon gas tax revenues by 29 percent.

- ***Eroding Revenues.*** As shown in Figure 7 (see next page), between 1991 and 2006, travel on California's roads increased by an estimated 35 percent. Meanwhile, gas tax revenues (adjusted for inflation) have not increased. As a result, the revenue generated per vehicle-mile traveled declined by more than 20 percent over the period.

The failure of gas tax revenues to keep pace with growth in maintenance and rehabilitation costs is particularly troubling since the SHA is the *sole source of funding for highway maintenance*. Federal dollars may be used to fund highway rehabilitation. However, even with the addition of federal monies, the state is only able to fund about one-half of its annual rehabilitation needs.

Figure 7

Real Gas Tax Revenues Have Not Kept Pace With Road Use



Funding Highway Maintenance and Rehabilitation Over the Long Haul. In deciding how to adequately fund highway maintenance and rehabilitation needs, we recommend that the Legislature take the following actions to ensure long-term funding:

- ***Raise the Gas Tax and Index for Inflation.*** Because the gas tax has not been increased in 13 years, the per gallon value of the tax has declined by 29 percent. This means that the purchasing power of the 18 cent per gallon rate established in 1994 has been reduced to 13 cents per gallon (adjusted for inflation). As previously mentioned, CTC estimates that current gas tax and weight fee revenues are no longer sufficient to address the state's maintenance and rehabilitation costs. In order to address this shortfall, we recommend that the Legislature raise the gas tax to a level that would adequately fund current maintenance and rehabilitation needs. We estimate that the current rate would need to be increased by about 10 cents per gallon. We further recommend that the gas tax be indexed to inflation to prevent further erosion of the revenue over time.

- ***Pave the Way for Mileage-Based Fees.*** Mileage-based fees offer an advantage over gas taxes in that these revenues are not eroded by increasing fuel economy or use of alternative fuels. Rather, the fees would closely match the extent motorists use highways and roads. There are privacy and technical obstacles to overcome in implementing a mileage-based approach to fund transportation. However, the State of Oregon is currently undertaking a pilot to implement mileage-based fees in Portland. Similarly, we recommend that the Legislature examine the policy and implementation issues that must be addressed if mileage-based fees were to be implemented in California.

Taking these actions would better match state revenues with long-term highway maintenance and rehabilitation needs.

Implementation of the Transportation Bond

In November 2006, voters approved Proposition 1B, which allows the state to sell $20 billion in general obligation (GO) bonds to fund transportation projects to relieve congestion, facilitate goods movement, improve air quality, and enhance the safety and security of the transportation system. These bonds provide a major one-time infusion of state funds into the transportation system to be spent over multiple years. However, in order to achieve their anticipated benefits, bond funds must deliver effective projects in a timely manner. In this piece, we review the Governor's proposals for bond implementation and recommend measures—statutory and administrative—to ensure effective implementation of the bond program.

Background

In recent years, California has spent about $20 billion annually in state, federal, and local funds to maintain, operate, and improve its multimodal transportation network. These expenditures have been primarily funded on a pay-as-you-go basis from taxes and user fees.

Primary State Fund Sources. There are two primary state revenue sources that have funded transportation programs. First, the state's 18 cent per gallon excise tax on gasoline and diesel fuel (often referred to as the gas tax) generates roughly $3.4 billion annually. Second, revenues from the state sales tax on gasoline and diesel fuel provide about $2 billion a year. Additionally, the state imposes weight fees on commercial trucks, which generate roughly $950 million a year. Generally, these revenues must be used for specific transportation purposes, including improvements to highways, streets and roads, passenger rail, and transit systems.

Bonds Have Played a Limited Role in State Transportation Funding. Since 1990 (and prior to Proposition 1B), voters have approved $5 billion in state GO bonds to fund transportation—less than 5 percent of the total investment in transportation over that period. These bond proceeds have been dedicated to passenger rail and transit improvements, as well as retrofit of highways and bridges for earthquake safety. As of November 2006, only $350 million of these bonds remain unissued and most of these funds are committed to specific projects.

Federal and Local Funds. In addition to state funds, California's transportation system receives federal and local money. The state receives roughly $4.6 billion a year in federal transportation funds. Collectively, local governments invest about $9.5 billion a year into California's highways, streets and roads, and transit systems. Local governments have also issued bonds backed mainly by local sales tax revenues to fund transportation projects.

Major Provisions of Proposition 1B

Allocation of Funds. Proposition 1B, the Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006, approved by voters at the November 2006 election, provides $20 billion in GO bond funds for projects to relieve congestion, facilitate the movement of goods, improve air quality, and enhance the safety and security of the transportation system. Figure 1 (see next page) details the purposes for which the bond money can be used. The bonds will provide a major one-time infusion of state funds into the transportation system to be spent over multiple years.

Bond Act Creates Several New Programs, Involves Many Implementing Entities. As shown in Figure 2 (see page 37), $5.5 billion (28 percent) of the $20 billion in Proposition 1B funding are directed to existing state and local transportation programs, while the majority of the bond revenues—$14 billion (72 percent)—will be used to create new programs. Some of these new programs—including Trade Corridors, Port Security, and Transit Security—address goods movement and security issues that have not historically been a focus of state transportation funding.

The monies for this myriad of programs, in turn, are to be administered by a variety of state and local entities, as highlighted in Figure 2. State entities include primarily the California Transportation Commission (CTC) and the California Department of Transportation (Caltrans). For funds provided directly to locals, recipients include cities and counties, as well as transit authorities, ports, harbors, and ferry terminal operators.

All Funds to Be Appropriated by Legislature. Proposition 1B specifies that all bond funds are subject to appropriation by the Legislature, either through the annual budget process or through other legislation before becoming available to a state or local entity for expenditure. Many

Figure 1

Proposition 1B
Uses of Bond Funds

(In Millions)

	Amounts
Congestion Reduction, Highway and Local Road Improvements	**$11,250**
Corridor mobility: reduce congestion on state highways and major access routes.	$4,500
State Transportation Improvement Program: increase capacity on highways, roads, and transit.	2,000
Local roads: enhance capacity, safety, and operations.	2,000
Highway 99: enhance capacity, safety, and operations.	1,000
State-Local Partnership: grants to match locally funded transportation projects.	1,000
State Highway Operations and Protection Program: rehabilitate and improve operation of highways and roads.	750
Transit	**$4,000**
Local transit: purchase vehicles and right of way.	$3,600
Intercity rail: purchase railcars and locomotives for state system.	400
Goods Movement and Air Quality	**$3,200**
Trade corridors: improve movement of goods on highways and rail, and in ports.	$2,000
Air quality: reduce emissions from goods movement activities.	1,000
School bus retrofit: retrofit and replace polluting vehicles.	200
Safety and Security	**$1,475**
Transit security: improve security and facilitate disaster response.	$1,000
Grade separation: grants to improve railroad crossing safety.	250
Local bridges: grants to seismically retrofit local bridges and overpasses.	125
Port security: grants to improve security and disaster planning in publicly owned ports, harbors, and ferry facilities.	100
Total	**$19,925**

Proposition 1B programs do not require oversight measures (such as reports or audits) to verify how bond funds are actually spent.

Some Programs Allow for Further Statutory Direction. With the exception of $1 billion in Air Quality funds, all monies provided

Figure 2

**Proposition 1B Programs
Implementing Agencies and Oversight**

(In Billions)

Programs	Implementing Agency	Oversight Report/Audit	Funding
New			**$14.4**
Corridor mobility	CTC[a]	Annual report	$4.5
Local transit	Local transit operators	None specified	3.6
Trade corridors	CTC	Annual report	2.0
Highway 99	Caltrans[a]	None specified	1.0
Air quality	ARB[a]	None specified	1.0
SLP[a] grants	CTC	Annual report	1.0
Transit security	None specified	None specified	1.0
School bus retrofit	None specified	None specified	0.2
Port security	OES[a]	Annual report	0.1
Existing			**$5.5**
STIP[a]	CTC	Annual report	$2.0
Local roads	Cities and counties	Controller audits	2.0
SHOPP[a]	CTC	Annual report	0.8
Intercity rail	Caltrans	None specified	0.4
Grade separations	CTC/Caltrans	Annual report/ None specified	0.3
Local bridges	Caltrans	Annual report	0.1
Total Proposition 1B Bond Programs			**$19.9**

[a] CTC = California Transportation Commission; Caltrans = Department of Transportation; ARB = Air Resources Board; SLP = State-Local Partnership; OES = Office of Emergency Services; STIP = State Transportation Improvement Program; SHOPP = State Highway Operations and Protection Program

in Proposition 1B could be appropriated and put to use without additional implementing statute. However, the bond act explicitly allows the Legislature to provide additional conditions and criteria through statute to five new programs created by the measure, involving $5.1 billion. These programs include Trade Corridors, Transit Security, Air Quality, State-Local Partnership (SLP) grants, and Port Security.

GOVERNOR'S PROPOSAL

Proposed Expenditures and New Positions. The Governor's budget proposes appropriating $7.7 billion in Proposition 1B money in 2007-08, with about $2.8 billion of this being expended in the budget year, as shown in Figure 3. This includes:

- About $1.5 billion to be expended by Caltrans or provided as grants for various highway, bridge, transit, and grade crossing projects.
- $600 million to be expended by transit operators on transit capital improvements.
- $600 million to be expended by local governments on street and road improvements.
- $97 million to be expended by the Air Resources Board on school bus retrofit and replacement.

Despite proposing significant expenditures in the budget year, the Governor's budget provides almost no staffing to support the project development activities funded with the bonds. Caltrans advises us that additional personnel resources will be requested in the May Revision.

In addition, the Governor's budget proposes expenditures of $523 million by Caltrans in the current year on projects mainly in the State Transportation Improvement Program (STIP), State Highway Operations and Protection Program (SHOPP), and newly created Corridor Mobility program. Because all Proposition 1B funds are subject to legislative appropriation, these expenditures would require separate legislative action.

Proposed Policy Changes. In addition to appropriations, the administration is also proposing to expand the oversight role for CTC in the implementation of Proposition 1B. Specifically, the administration proposes that Local Transit funds be dispersed by formula to transit operators, as provided by Proposition 1B, but only after projects are approved by CTC. Moreover, the administration has adopted guidelines for the Highway 99 program, which channel funds through CTC rather than directly to Caltrans, as specified in the bond act.

ISSUES FOR LEGISLATIVE CONSIDERATION

The infusion of bond funding is only a first step in improving California's transportation landscape. In order to realize the full benefits of these funds, it is important that the projects funded are cost-effective in achieving desired results—including improved mobility, a more secure transportation system, and cleaner air. Moreover, these projects must be delivered in

Figure 3

Governor's Proposed Expenditures

(In Millions)

Program	2006-07	2007-08
Congestion Reduction, Highway and Local Road Improvements		
Corridor mobility	$100	$317
State Transportation Improvement Program	262	340
Local roads	—	600
Highway 99	—	28
State-Local Partnership grants	—	170
State Highway Operations and Protection Program	141	403
Transit		
Local transit	—	$600
Intercity rail	—	—
Goods Movement and Air Quality		
Trade corridors	$15	$170
Air quality	—	—
School bus retrofit	—	97
Safety and Security		
Transit security	—	—
Grade separation	—	$55
Local bridges	$5	9
Port security	—	—
Totals	**$523**	**$2,789**

a timely manner. In this section, we highlight key challenges to achieving the goals of Proposition 1B and assess how well the Governor's proposals address these challenges. Also, we recommend measures—statutory and administrative—to ensure that bond funds are used to deliver effective projects in a timely manner and that adequate oversight measures are in place. Our recommendations are summarized in Figure 4 (see next page).

Determining Project Eligibility

The bond act varies in the level of detail it provides regarding project eligibility. For three programs totaling $3 billion—Air Quality, Transit Security, and SLP—the act provides little or no guidance as to the types of projects eligible for funding. While no expenditures from the Air

Figure 4

Recommendations to Improve Proposition 1B Implementation

✓ **Determining Project Eligibility**

- Limit all Proposition 1B funds to projects with long-term benefits.
- Decide whether to limit transit security funds to just security-oriented investments.
- Structure state-local partnership program to spur new local investment.

✓ **Adopting Additional Evaluation Criteria for Project Selection**

- Require measures of cost-effectiveness.
- Require fund leveraging be considered.
- Require air quality impacts be considered for new capacity projects.

✓ **Encouraging Timely Project Delivery**

- Establish delivery deadlines to ensure funds do not linger.
- Adopt provisions to remove funds from lagging projects.

✓ **Ensuring Oversight Measures Are in Place**

- Require periodic reports to Legislature.
- Hold joint legislative hearings.
- Enhance commission's oversight capacity.

✓ **Identifying Personnel Resources to Deliver Projects**

- Require annual update of multiyear personnel resource plan.
- Authorize additional use of contracted resources, as necessary to ensure timely delivery.

✓ **Streamlining Measures to Improve Project Delivery**

- Authorize design-build contracting on pilot basis.
- Consider measures to streamline environmental review.

✓ **Appropriating Bond Funds**

- Appropriate all funds through budget bill.

Quality and Transit Security programs are proposed for 2007-08, the Governor's budget shows $170 million in SLP grants to be awarded in the budget year. Before any bond funds are spent, the Legislature should provide eligibility guidelines statutorily to ensure that funds are used for projects that address state priorities. Below we present a general principle for determining project eligibility for all projects. We then discuss eligibility issues particular to two specific programs.

Limit Bond Funds to Projects With Long-Term Benefits. As a general principle, bond funds should be used only for capital improvements or activities that provide benefits over many years to taxpayers who finance the bonds. However, in the case of some Proposition 1B programs, the bond act does not prohibit funding activities that yield only short-term benefits. For example, $1 billion in Air Quality program monies are to be available for "strategies and public benefit projects" to reduce emissions related to goods movement. This language does not exclude short-term operational approaches to emissions reduction, even though the debt-service payments on the bond could outlast the activities they finance. To avoid this issue, we recommend the Legislature enact statute specifying that all Proposition 1B funds are available only for capital purchases or strategies that provide long-term benefits.

Decide Whether to Limit Transit Security Funds to Just Security-Oriented Investments. The bond act limits Transit Security dollars to capital projects, yet provides little additional guidance regarding project eligibility. Language directing the use of these funds is very open-ended—it allows these funds to be used either for transit projects that specifically address a security threat (for example, installing detection devices or security gates at train stations) or for projects that more generally increase a transit system's capacity (such as adding vehicles to a transit fleet). Given this ambiguity, we recommend enacting statute that outlines more explicit eligibility requirements.

Structure SLP Grant Program to Spur New Local Investment. Proposition 1B provides $1 billion in SLP grants to match local funds for transportation projects over the next five years. The measure also allows the Legislature to add conditions and criteria to the program through statute. The CTC proposed guidelines that would provide funding to local jurisdictions that have adopted local sales tax measures or developer fees for transportation. These guidelines, however, do not set aside any of these funds to create incentives for new local revenues to be pursued in the future. In order to spur new local funding for transportation, we recommend that the Legislature adopt guidelines that would set aside a portion of SLP grants for cities and counties that establish new fees or tax measures for local transportation purposes.

Adopting Additional Evaluation Criteria for Project Selection

The bond act specifically authorizes the Legislature to adopt additional conditions and criteria for five new programs, involving $5.1 billion. These programs include Trade Corridors, Air Quality, Transit Security, SLP, and

Port Security. Of these programs, the Governor's budget proposes expenditures of $170 million in SLP grants and $185 million in Trade Corridors funds through 2007-08.

Of the five programs, the bond act provides evaluation criteria only for selecting Trade Corridors projects, but none for the other four programs. We recommend that the Legislature adopt project evaluation criteria for these new programs to ensure that bond funds are used efficiently and deliver effective projects. The following criteria could be applied across multiple Proposition 1B programs.

Require Measures of Cost-Effectiveness. This criterion focuses on the estimated benefit achieved per dollar spent on a project in order to ensure that bond funds consistently deliver the biggest bang for the buck. Depending on the program and its goals, the specific benefits to be measured will vary by program. For example, a measure to evaluate projects competing for Trade Corridors funds could include the volume of goods transported per dollar invested; whereas, the appropriate metric for Air Quality funds would be the level of emissions reduced for the amount spent on the project.

While cost-effectiveness is a useful criterion to evaluate projects competing for a number of Proposition 1B programs, it may not be the most appropriate to use in selecting projects for Transit Security and Port Security funds. This is because the particular benefits achieved by security-oriented projects (for example, lives saved from terrorist attacks) may be difficult to quantify.

Require Fund Leveraging Be Considered. Because the benefits of transportation investments are felt most at the local level, evaluating projects by their ability to tap into local, federal, and private dollars (so that state funds can be applied to more projects) makes sense. Currently, the bond measure requires fund leveraging in only some instances. These include Local Bridge funds that supplement available federal dollars, as well as SLP, Trade Corridors, and Grade Separation grants, which generally require a one-to-one match of nonstate funds. There are other programs, however, where leveraging should play a role in evaluating projects. In selecting Corridor Mobility projects, CTC indicates it will consider a project's ability to leverage nonstate funds, particularly for large projects where matching funds are available.

In order to stretch bond funds as broadly as possible, we recommend the Legislature require projects be evaluated based on their ability to leverage nonstate funds. For example, statute should require consideration of applicants' ability to leverage Transit Security and Port Security funds with federal grants or private dollars.

Admittedly, there may be cases where leveraging is less feasible. For example, projects located in rural areas may not be able to generate significant investment from local or private sources. To address such concerns, fund leveraging considerations should take into account a region's ability to leverage funds.

Require Air Quality Impacts Be Considered for New Capacity Projects. Given that all of California's major urban areas violate federal air emissions standards, project selection for Proposition 1B programs should consider a project's impact on air quality. Proposition 1B addresses air quality in varying ways. Some programs, including Air Quality and School Bus Retrofit, are specifically targeted at reducing emissions. Language describing the Trade Corridors program lists emissions reduction as one consideration among many in evaluating projects for funding. The CTC's proposed guidelines for the Corridor Mobility and SLP programs list air quality analysis as an optional element in project nominations.

So that entities, like CTC, that are charged with selecting projects can take emissions impacts into account, we recommend that the Legislature require analysis of air quality impacts to be included in all nominations where projects would add capacity to the highway and local road network. This would include projects funded by Trade Corridors and SLP grants.

Federal law requires many California regions to evaluate the emissions impact of transportation projects in their long-range plans. Thus, including air quality analysis as a part of the project nomination process should not impose significant additional analysis workload for these regions. For the few rural regions not subject to emissions reporting in their federal plans, these regions might be exempted from quantifying emissions impacts in project nominations.

Encouraging Timely Project Delivery

Projects must be completed and opened to users in a timely manner in order to offer any mobility, air quality, or safety benefits. Moreover, in an era of rising construction costs, delayed delivery often means increased construction costs, reducing the amount of improvements that can be achieved with available funding.

Establish Delivery Deadlines to Ensure Funds Do Not Linger. Generally, the bond act does not require that projects be constructed and opened to users by a specific date. The Corridor Mobility program is an exception—the bond act requires that these projects start construction by December 31, 2012. (If projects fall behind schedule, CTC is to remove funds.) The administration has adopted the same delivery timeline for Highway 99 funds. Setting timelines enables the Legislature to hold the administration and other fund recipients accountable for the delivery of projects. In other state transportation programs, notably the Traffic Congestion Relief Program, the absence of delivery deadlines has allowed funds to remain available indefinitely, even for stalled projects that show few signs of progress. To avoid repeating this situation with Proposition 1B funds, we recommend the enactment of legislation requiring the establishment of deadlines to begin project construction.

To ensure that adopted deadlines are reasonable on a program-by-program basis, the Legislature should direct CTC to specify project delivery deadlines for each program. For example, CTC could specify later deadlines for programs that fund large or complex projects requiring longer time frames and shorter time frames for programs where the delivery process is less involved.

Adopt Provisions to Remove Funds From Lagging Projects. In addition to setting delivery deadlines, the Legislature should enact statute that requires projects' progress to be monitored and funds to be removed from those projects that are not advancing. The state already has a "use-it-or-lose-it" policy, established under Chapter 783, Statutes of 1999 (AB 1012, Torlakson), which allows CTC to redirect certain federal funds not expended by regions in a timely manner. Prior to the use-it-or-lose-it policy, regions had accumulated a $1.2 billion backlog of unused federal funds. This policy gives regions a strong incentive to expend federal funds in a reasonable time frame and enables the state to make sure funds do not go unused.

Beyond regional agencies, Caltrans has a less than perfect record in delivering projects on time and on budget. Thus, we recommend the Legislature require an entity, like CTC, to regularly check fund recipients' progress in meeting major project milestones, such as plan approval, completion of environmental review, right-of-way certification, and advertising a project for construction. Admittedly, this approach creates additional oversight workload. But, more importantly, it holds fund recipients accountable for delivering projects in a timely manner and provides the opportunity to identify delays and redirect funds, as necessary, to alternative projects that can meet delivery goals.

The Legislature has a few options in deciding how to redirect funds once removed from a stalled project. One approach would be to transfer funds to the highest performing project that did not previously receive funding. This option maximizes the benefit of bond funds on a statewide basis. Another option would be to redirect funds to other projects in the same geographic region, so that regions are held harmless. This option does not maximize the benefit of bond funds at a statewide level, but ensures that a region maintains its level of investment even when a local project loses funding. How the Legislature redirects funds from stalled projects depends on whether project performance or regional equity is the primary consideration.

To ensure that funds can be removed from lagging projects and redirected to other projects that address state priorities, we recommend the enactment of legislation that (1) directs CTC to monitor project milestones and identify delays, (2) authorizes CTC to redirect funds away from lagging projects, and (3) provides guidance on how these funds should be redirected.

Ensuring Oversight Measures Are in Place

In many cases, the bond act does not call for specific program oversight through reports or audits, as shown in Figure 2. Given the large number of programs funded by Proposition 1B, the substantial amount of funding provided, as well as the number of entities charged to implement these programs, we recommend the Legislature adopt additional oversight measures to ensure that bond funds are used effectively.

Require Periodic Reports to Legislature. Current law requires CTC to report annually to the Legislature on funds it allocates to transportation programs and related policy issues. This report provides the Legislature with necessary information to monitor programs and take statutory action, as needed, to ensure funds are used appropriately. The CTC plans to include in future annual reports discussion of all Proposition 1B programs for which it will allocate funds. Under the bond act, this includes about one-half of the monies—Corridor Mobility, Trade Corridors, SLP grants, funds for STIP and SHOPP, as well as $100 million of the Grade Separation grants. If the Legislature concurs with the administration's proposal that CTC allocate an additional $4.6 billion in bond monies, including funds for Highway 99 and Local Transit, these programs would also be included in CTC's annual report.

However, even if the administration's proposals are adopted, there would still be almost $5 billion in Proposition 1B funds that would not be included in CTC's annual report because CTC does not allocate these funds. Though expenditures from some of these programs would be included in other miscellaneous reports, the information would be scattered, making it less conducive to oversight of the total bond program.

We think that having information on the status of all Proposition 1B programs in one place would facilitate legislative oversight. Accordingly, we recommend the enactment of legislation directing CTC to include discussion of all bond-funded programs in its annual report. Additionally, the Legislature should require fund recipients to provide CTC with information on all projects funded by Proposition 1B monies. This information should include each project's annual expenditures and progress in meeting major milestones (including plan approval, completion of environmental review, right-of-way certification, and listing for construction), as well as explanation of any delays in the delivery process.

Hold Joint Legislative Hearings. Beyond requiring project specific information through annual reporting, we further recommend that the policy committees and budget subcommittees of the Legislature hold periodic joint hearings in which CTC, Caltrans, and other key implementing entities report on the use of bond funds and the timeliness of project delivery. This would provide the Legislature an opportunity to monitor the progress of the bond program in the aggregate, and assess whether the programs are being carried out effectively to meet the measure's objectives.

Enhance CTC's Oversight Capabilities. Given the size of the bond program and number of fund recipients, one central entity should provide ongoing oversight of all bond-funded activities. With its experience in overseeing transit and highway programs statewide, CTC is a logical choice to perform that oversight function. The Governor's budget provides two positions to supplement CTC's current staff of 16 personnel-years (PYs). However, depending on the role the Legislature decides CTC is to play, significant workload could be involved. We recommend that the Legislature take action to enhance the commission's oversight capacity.

The Legislature has a few options in doing so. One option is to provide additional staff to CTC, beyond what is proposed in the Governor's budget. An alternative is to provide CTC with the authority and flexibility to use consultant services to perform selected project evaluation and oversight functions, on an as-needed basis to supplement commission staff.

Identifying Personnel Resources to Deliver Projects

Caltrans will play a crucial role in delivering $12 billion in highway, bridge, and transit projects through several Proposition 1B programs. This represents a 33 percent increase in the value of total projects that Caltrans is currently working on. To deliver these projects in a timely manner, Caltrans will need additional personnel resources to plan and construct projects in 2007-08 and beyond. Ensuring that Caltrans has adequate capital outlay support (COS) resources—including both state staff and contracted services—will be essential to the timely delivery of many Proposition 1B projects.

Require Annual Update of Multiyear Personnel Resource Plan. Given the upsurge in workload, it is important that Caltrans inform the Legislature about its estimates of the future-year COS funding needs, as well as what portion of the delivery workload it will have to contract out given constraints in hiring state staff.

Supplemental report language accompanying the *2006-07 Budget Act* requires Caltrans to develop, by May 1, 2007, a multiyear staffing plan that estimates the level of personnel resources Caltrans will need each year through 2010-11 for project development workload related to Proposition 1B. The report is also required to provide (1) the anticipated composition of these resources, in terms of the breakdown between state staff, cash overtime, and contracting out; (2) data on Caltrans' recent experience in recruiting and retaining project delivery employees; and (3) actions the department will take to attract employees, cost-effectively train its new workforce, and minimize attrition rates.

The information in the May 2007 report will help the Legislature determine Caltrans' COS resource requirements in 2007-08. We recommend the enactment of legislation requiring Caltrans to update this report annually, as the Proposition 1B program progresses. We further think that Caltrans should identify in the report administrative as well as statutory actions that can be taken to improve its capacity to efficiently deliver projects.

Authorize Additional Use of Contracted Resources as Necessary to Ensure Timely Project Delivery. In order to deliver the portfolio of bond-funded projects in a timely manner, Caltrans could require as many as 4,800 PY equivalents of additional resources beginning in 2007-08. Meeting this personnel requirement through state staff would mean an estimated 37 percent increase in the level of Caltrans staff currently working on COS activities.

It is virtually impossible that Caltrans could hire this level of state staff in the near term. In 2005-06, for example, Caltrans undertook an ambitious hiring effort for COS staff and was only able to hire a total of 1,040 PYs by the end of the year, an average of 87 new employees per month. Discussions with the department indicate that the 2005-06 hiring effort was likely as fast as the department can possibly employ new COS staff, given the available pool of qualified engineers, right-of-way agents, and environmental planners. Beyond hiring new state staff, Caltrans would have to locate facilities to house these workers. In addition, the department would have to provide extensive training in order for entry-level employees to perform many COS tasks. The department indicates that it has a two-year program to train new employees in the major areas of COS.

Contracted resources have traditionally played a relatively limited role in performing COS workload at Caltrans—about 10 percent of total COS personnel resources in recent years. Contracting out provides a means for Caltrans to perform project development workload that exceeds the capacity of its state staff to deliver. Accordingly, we recommend that the

Legislature authorize and direct Caltrans to utilize a higher level of contracted resources than in prior years so that projects are not delayed.

Streamlining Measures to Improve Project Delivery

To further facilitate project delivery, the Legislature should authorize the use of design-build contracting and consider measures to streamline processes related to environmental documentation.

Authorize Design-Build Contracting. The design-build contracting method awards both the design and construction of a project to a single entity. The use of design-build to construct projects seeks to reduce project delivery times by integrating the design and construction processes. Under the federal transportation act (SAFETEA-LU), virtually any surface transportation project is eligible to be built using this method. Current state law, however, authorizes the use of design-build only for specific transportation projects (for example, I-405). Thus, Caltrans has little experience using this method to deliver projects. While there are potential advantages to using design-build, including the potential shortening of project delivery time, there are also potential pitfalls to avoid.

We recommend that the Legislature authorize a design-build pilot program similar to that proposed by AB 143 (Nuñez), in 2006 and SB 56 (Runner), in 2007. Both bills propose a demonstration program that allows Caltrans and regional agencies to deliver a set number of projects using design-build. In addition, these bills require that transportation agencies report on their experiences so that the state could use the information in deciding whether to pursue future design-build projects. The Governor's budget summary indicates that the administration will propose design-build legislation in the 2007-08 session.

Consider Measures to Streamline Environmental Review. Environmental documentation is typically one of the longest phases of the delivery process. Because environmental review is subject to legal challenges, it is also the least predictable phase of the delivery process in terms of time requirements. Thus, measures to streamline the process and minimize uncertainty may offer significant benefits. One such example of environmental streamlining is Chapter 31, Statutes of 2006 (AB 1039, Nuñez). Among other actions, this statute allows Caltrans to take over federal environmental reporting duties on a pilot basis through January 1, 2009. The pilot may include bond-funded highway projects, as well as others receiving state funds. By allowing Caltrans to communicate directly with involved federal agencies, rather than doing so indirectly through the Federal Highway Administration, the pilot seeks to reduce project delivery times.

Caltrans estimates that per project time savings from the pilot will range from a few weeks on the simplest projects to over six months on large projects requiring a federal environmental impact report. If these estimates hold, the Legislature may want to extend the duration and scope of this pilot for several more years, subject to federal approval. We further recommend that the Legislature direct Caltrans to identify additional environmental streamlining measures to improve delivery times for specific bond-funded programs.

Appropriating the Bond Funds

All funds provided in the Proposition 1B bond program are subject to legislative appropriation before they are available for expenditure. The bond act specifically requires that $7.5 billion in funds from three programs—Corridor Mobility, Highway 99, and Trade Corridors—be appropriated in the annual budget bill. The remaining funds may be appropriated either through the budget or separate statute.

Appropriate All Funds Through Budget Bill. To provide the Legislature with a more comprehensive picture of year-to-year expenditures of Proposition 1B funds, we recommend that all Proposition 1B funds be appropriated in the annual budget, rather than through separate pieces of legislation. Doing so also allows the Legislature to see how these expenditures fit in with other state transportation programs, review program performance, and tie operational resources to the delivery of projects. (Please also see "Appropriating Proposition 1B Funds" following this piece.)

CONCLUSION

The passage of Proposition 1B provides the state with the opportunity to tackle major mobility, air quality, goods movement, and security issues that might not be addressed were it not for the infusion of bond funds. However, it is important that these investments be targeted to address the state's highest priorities, and that available funds are used to deliver projects in a timely manner. In this piece, we have recommended actions that will help the state in meeting these goals.

APPROPRIATING PROPOSITION 1B FUNDS

Proposition 1B authorizes about $20 billion in general obligation bond funds for transportation. The measure allocates specific amounts of bond funding for particular transportation uses, and requires that the funding be subject to legislative appropriation. The 2007-08 budget requests total appropriations of $7.7 billion in Proposition 1B funds for various transportation programs.

Provide Bond Funding Annually to Enhance Legislative Oversight

The budget requests three-year appropriations of Proposition 1B bond funds, totaling $7.7 billion for various transportation programs. However, of that amount, only $2.8 billion is estimated to be used in 2007-08.

We identify no programmatic or fiscal reason to provide three-year appropriations of Proposition 1B funds. In order to maintain oversight of expenditures, the Legislature should appropriate these funds annually, based on estimated allocations for that year. Accordingly, we recommend that only $2.8 billion be appropriated in 2007-08. We further recommend that the administration identify for the Legislature by May 1, a list of potential projects that would be ready for bond fund financing to substantiate the requested amount. (Reduce Item 2640-104-6059 by $700,000,000, Item 2660-104-6053 by $2,000, Item 2660-104-6055 by $450,500,000, Item 2660-104-6056 by $2,000, Item 2660-104-6058 by $100,000,000, Item 2660-104-6060 by $331,500,000, Item 2660-104-6062 by $29,750,000, Item 2660-104-6063 by $2,000, Item 2660-104-6064 by $106,251,000, Item 2660-304-6053 by $142,798,000, Item 2660-304-6055 by $1,351,500,000, Item 2660-304-6056 by $509,998,000, Item 2660-304-6058 by $595,300,000, Item 2660-304-6063 by $118,998,000, Item 2660-304-6064 by $8,499,000, and Item 9350-104-6065 by $450,000,000.)

Governor's Proposal. The budget proposes to appropriate $7.7 billion through various Proposition 1B programs to the Department of Transportation (Caltrans), transit agencies, cities and counties, and the Air Resources

Board. For the amounts appropriated to Caltrans ($5.2 billion), transit agencies ($1.3 billion), and cities and counties ($1.1 billion), these funds are to be available for allocation to projects over three years. As shown in Figure 1, the budget estimates that no more than $2.8 billion of these funds would be used for projects in 2007-08.

Figure 1

Proposals for Proposition 1B Funds

(In Millions)

Program	Proposed Appropriations	2007-08 Estimated Expenditures
Corridor Mobility	$2,119	$317
Trade Corridors	680	170
State-Local Partnership	502	170
STIP[a]	1,035	340
SHOPP[b]	517	403
Transit Capital	1,300	600
Highway 99	171	28
School Bus Retrofit	97	97
Local Bridges	38	9
Grade Separations	174	55
Local Roads	1,050	600
Totals	**$7,683**	**$2,789**

a State Transportation Improvement Program.

b State Highway Operation and Protection Program.

Match Annual Appropriation With Anticipated Fund Allocation. In our January report, *Implementation of the Transportation Bond* (also in the "Crosscutting Issues" section of this chapter), we recommended that the Legislature appropriate Proposition 1B bond funds annually through the budget. By appropriating funds on an annual basis, the Legislature has the opportunity to annually check on program progress and performance, and withhold appropriations, as necessary, if programs are not performing. Providing the administration with a three-year appropriation would significantly reduce this kind of legislative oversight. Accordingly, we recommend that at most, only $2.8 billion be appropriated, instead of $7.7 billion.

Recommend Administration Provide Project Information. At the time this analysis was prepared, it was not known which projects would be eligible and ready to use bond funds in 2007-08. Thus, there is no assurance that there will be $2.8 billion of projects ready for Proposition 1B fund allocations in 2007-08. In order to inform the Legislature of the types and number of projects that would likely be funded, we recommend that the administration identify by May 1, a list of potential projects that would be ready for funding in each Proposition 1B program requesting an appropriation in 2007-08. Based on that information, the Legislature can further adjust the appropriation amount of Proposition 1B bond funds for each program.

Authority to Transfer Bond Funds Circumvents Accountability

We recommend the deletion of budget bill language that allows the administration to transfer appropriated bond funds among Proposition 1B programs. This is because allowing the transfer of bond funds among various uses circumvents accountability in the use of the funds, and runs counter to the bond measure's intent to allocate specific amounts for particular transportation purposes.

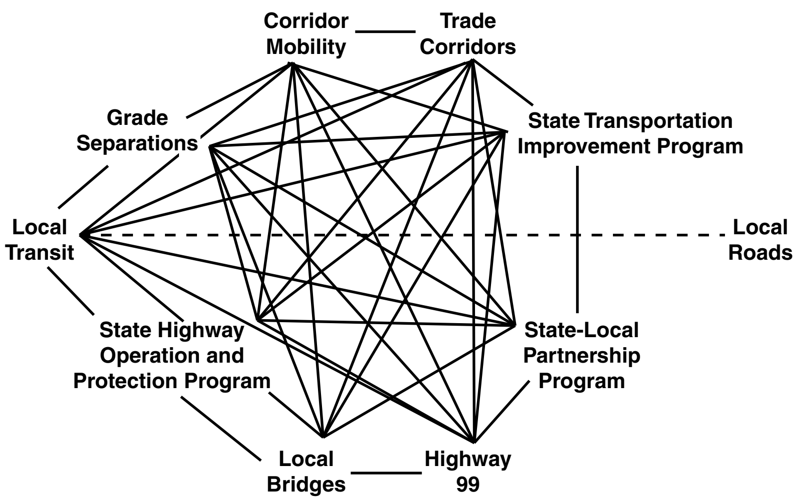
Governor's Proposal. The Governor's budget includes budget bill language that would allow the administration to redirect bond fund appropriations among Proposition 1B programs. Specifically, this language would allow up to 90 percent of bond funds appropriated in most Proposition 1B programs to be transferred to other bond-funded programs, subject to approval by the Department of Finance and 30-day notification of the Joint Legislative Budget Committee and the budget committees of the Legislature.

Proposed Language Circumvents Appropriation Authority and Accountability. The administration maintains that the language is needed so that the California Transportation Commission would have the flexibility to shift funding among programs to meet the demands of projects requesting bond funding. However, if the administration is able to provide the Legislature with a list of projects to be funded by each Proposition 1B program, as we recommend above, this level of flexibility would not be required.

Additionally, we have serious concern with the proposed language. Proposition 1B clearly allocates specific amounts of bond funds to particular purposes. Proposition 1B also specifies that these amounts are subject to appropriation by the Legislature. The "power of the purse"—appropriation authority—is one of the Legislature's most powerful tools to ensure accountability. By allowing the administration to transfer the funds from one purpose to another, as the Governor proposes, the Legislature's appropriation authority, as well as program accountability, would be circumvented. As shown in Figure 2, the administration could shift funding among almost all Proposition 1B programs rendering legislative appropriations in the budget bill meaningless.

Figure 2

Proposed Administrative Fund Transfers Would Circumvent Appropriation Authority



Furthermore, the proposed language is so unconstrained that conceivably bond funds could be transferred among various uses in such a way that, in the aggregate, the bond measure's intent of providing specific amounts for particular purposes would not be met. Accordingly, we recommend that the language be deleted.

Appropriations Requested in Current Year Would Not Be Used

The Governor proposes current-year expenditures of $523 million in specified Proposition 1B funds by Caltrans. Because all Proposition 1B funds are subject to legislative appropriation, these expenditures would require separate urgency legislation. Discussions with Caltrans indicate that these funds are unlikely to be expended in 2006-07. We recommend that the administration provide a list of projects that would be funded to substantiate the request.

Governor's Proposal. The Governor's budget proposes current-year expenditures of $523 million in specified Proposition 1B funds by Caltrans.

As shown in Figure 3, these expenditures would mainly be for projects in the State Transportation Improvement Program, the State Highway Operations and Protection Program, and the newly created Corridor Mobility program.

Figure 3

Proposition 1B Funds Requested Current-Year Appropriations

(In Millions)

Program	Proposed Appropriation
Corridor Mobility	$100
Trade Corridors	15
STIP	262
SHOPP	141
Local Bridges	5
Total	**$523**

STIP = State Transportation Improvement Program;
SHOPP = State Highway Operations and Protection Program.

Funds Unlikely to Be Spent in 2006-07. Discussions with Caltrans indicate that it is highly unlikely that the requested funds would be spent in the current year. This is because it often takes four months to advertise and award a project to a construction bidder. Thus, unless funding is made available by early March, most of the current-year appropriation would not be encumbered before the end of the fiscal year. The department indicates, however, that the current-year appropriation would expedite projects which are ready for construction, as an appropriation is necessary before project advertising can begin.

We do not object to current-year appropriations aimed at expediting project delivery. However, we recommend that the Legislature not appropriate the requested current-year funds until the administration substantiates its request by providing a list of the projects that would be funded.

MOTOR VEHICLE ACCOUNT CONDITION

The Motor Vehicle Account (MVA) derives most of its revenues from vehicle registration and driver license fees. In 2006-07, those fees account for 90 percent of the estimated $2.1 billion in MVA revenues. The majority of MVA expenditures support the activities of the California Highway Patrol (69 percent), the Department of Motor Vehicles (22 percent), and the Air Resources Board (7 percent).

MVA Faces Outyear Deficits Without Corrective Actions

Our forecast shows the Motor Vehicle Account (MVA) is likely to face significant shortfalls beginning in 2009-10, and possibly sooner depending on the timing of a number of pending spending initiatives, as well as potential risks. We will continue to monitor the MVA and offer recommendations as appropriate.

Budget-Year Expenditures Exceed Revenues. The budget proposes total MVA spending of $2.3 billion in 2007-08. This represents an increase of $147 million, or 7 percent, above estimated current-year spending. Figure 1 shows the major proposed changes in MVA spending for 2007-08.

Figure 1

Major Proposed Changes in MVA Spending

2007-08
(In Millions)

California Highway Patrol—support	$143.1
Department of Motor Vehicles—capital outlay	43.5
Air Resources Board—support	-51.3
State mandates	9.2
Department of General Services—capital outlay	2.1
Total	**$146.6**

The proposed increase in MVA spending is mostly the result of increases for employee compensation, the rollout of major multiyear projects previously approved by the Legislature—such as the California Highway Patrol (CHP) radio replacement, the Department of Motor Vehicles (DMV) information technology modernization projects, and various facility improvements. These increases are partially offset by the proposed reduction in the Air Resources Board (ARB) spending from the MVA.

The budget projects MVA revenues to total $2.2 billion in 2007-08. This is an increase of $143 million, or 7 percent, above estimated current-year revenues. The increase mostly reflects anticipated growth in vehicle registration ($77 million) and driver license ($62 million) fee revenues. As a result, proposed MVA expenditures will exceed revenues in 2007-08. Nonetheless, the budget projects a substantial balance of $253 million at the end of 2007-08 because of the large carry-in balance from the current year ($408 million). This carry-in balance largely reflects the residual from the surge in revenues that followed the enactment of various penalty and fee increases in 2003.

LAO Forecast. Figure 2 shows total MVA resources (revenues plus the carryover balance) and expenditures for 2005-06 and the current year, and our forecast for 2007-08 through 2010-11. Our forecast is based on current law and reflects historical trends in revenues and expenditures.

Overall, Figure 2 shows that if revenues and expenditures continue at historical levels, the large balance in the account would be essentially depleted by the end of 2008-09, leaving a small balance of less than $50 million. Without corrective actions, the MVA would face a shortfall of $240 million in 2009-10, growing to more than $600 million in 2010-11.

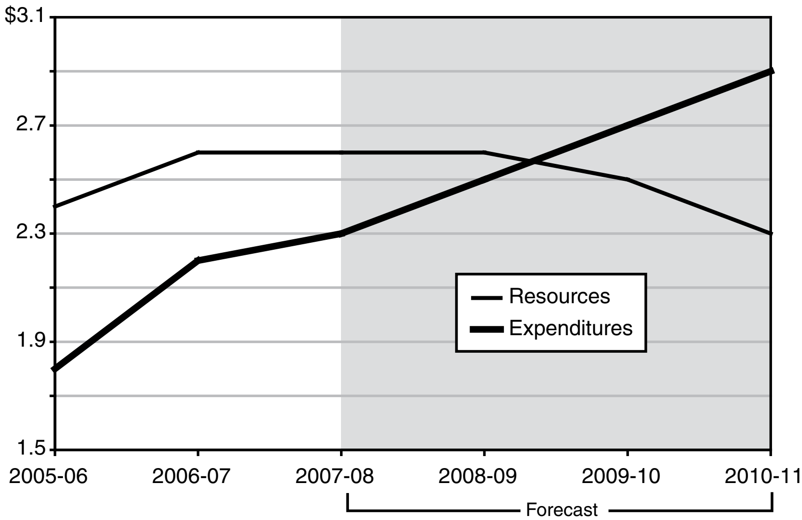
New Pressures and Potential Risks. There are a number of new funding pressures, as well as potential risks, in the programs for CHP and DMV that could bring about significantly higher MVA expenditures and cause the MVA to draw down the reserve faster. These include:

- ***Federal Real ID Act.*** Perhaps the greatest potential new pressure on the MVA is the cost associated with the implementation of the federal Real ID Act. That law requires California to implement new standards for the production and issuance of state driver license and identification cards. The DMV has estimated this could cost $500 million over the next five years to implement in California. The administration has indicated that it may propose Real ID spending in the spring as it learns more of what would be required by the federal government. To date, federal funds have not been set aside to cover the cost of implementing Real ID nationwide. (For more information on Real ID, please see our discussion later in this chapter under the "Department of Motor Vehicles, Item 2740.")

Figure 2

LAO Projected MVA Shortfall

(In Billions)



- ***Global Warming Solutions Act of 2006.*** Another potential pressure is the ongoing funding requirements of the Global Warming Solutions Act (Chapter 488, Statutes of 2006 [AB 32, Nuñez]). The Governor's budget requests $24.4 million for ARB to begin implementation of the act. Of that amount, $15 million is proposed to be funded by a loan from the MVA. As yet, the ongoing cost of implementing the new law is not known and there is no long-term plan to cover these costs. Because mobile source emissions account for a significant amount of the state's greenhouse gases, the MVA may be considered one of several potential sources of funding. Historically, MVA has been used to support ARB's mobile source pollution programs. (We discuss the implementation of the act further in our write-up on climate change expenditure proposals in the "Crosscutting Issues" section of the "Resources" chapter.)
- ***Major Multiyear Projects.*** As an example of a potential risk, last year the Legislature approved a request to replace CHP's radios at an estimated cost to the MVA of more than $500 million over five years. Similarly, a multiyear project was approved allowing DMV to upgrade its information technology infrastructure. This project was estimated to cost $240 million. While we have built

these costs into our expenditure forecast, large projects often take longer and cost more to complete than originally estimated. A 5 percent increase in the estimated cost of these projects would amount to $37 million, enough to nearly wipe out the projected balance in 2008-09.

Depending on the spending proposed as part of the spring revision process for the departments that rely heavily on MVA funding, and more specifically for Real ID, it may be necessary for the Legislature and administration to consider measures to address the solvency of the MVA sooner (in 2007) rather than later. The alternatives include increasing revenues, reducing program spending, or identifying other funding sources for some programs.

In 2002-03, the last time the MVA faced a shortfall, the Legislature and the Governor adopted several increases in fees and penalties to generate higher revenues for the MVA. Specifically, legislation was enacted to increase (1) penalties for late vehicle registration, and (2) fees for the purchase of driver information and the re-issuance of a license for former driving-under-the-influence (DUI) offenders. In addition, two new fees were established: a $5 fee for retaking a driving test, and a $120 fee for second appeals of DUI sanctions.

We will continue to monitor the MVA and provide recommendations as appropriate.

Departmental Issues

Transportation

State Transit Assistance (2640)

The state provides assistance to regional and local transit systems in two ways through the Public Transportation Account (PTA). First, the state provides financial support for transit operations through the State Transit Assistance (STA) program. In the current year, STA receives $624 million to be allocated to over 100 transit operators statewide, largely to support operating costs. Second, the state funds transit capital improvements, such as equipment purchase and facility and track construction. The current-year budget appropriated about $700 million mainly from PTA for transit capital improvements. Since 2000, certain transit capital projects have also received funding from the Traffic Congestion Relief Fund.

For 2007-08, the budget requests appropriations totaling $1.5 billion to provide assistance to transit. The amount includes (1) $184.6 million from PTA for STA to provide operating assistance, and (2) $1.3 billion in Proposition 1B bond funds for transit capital improvements.

Budget Proposes No Spillover for STA

The Governor's budget proposes to discontinue the allocation of spillover revenue to the State Transit Assistance (STA) program on a permanent basis. While this would result in less funding to STA in years when there would have otherwise been spillover revenue, the proposal would increase the predictability and stability of the program's funding level from year to year.

Under current law, the STA program is allocated one-half of the revenues deposited into PTA. Historically, the PTA received revenues from two sources: (1) diesel sales tax and (2) a portion of the state sales tax on gasoline, including spillover revenue and revenue from the sales tax on

9 cents per gallon of gasoline (referred to as the Proposition 111 gasoline sales tax revenue). Since 2005-06, PTA has also received a portion of Proposition 42 gasoline sales tax revenue. Because spillover revenue depends on gasoline prices and the sales of all other goods, it is a volatile funding source both in terms of whether it is available at all, and if so, at what amount. As a result, it is difficult to project spillover revenue from year to year. For instance, as we noted in the "Funding for Transportation Programs" write-up, there was no spillover revenue for 12 out of the 15 years from 1986-87 through 2000-01. For those years, STA funding relied only on diesel sales tax revenues and Proposition 111 gasoline sales tax revenues.

Governor's Proposal. The budget proposes to discontinue allocating spillover revenue to STA permanently, beginning in 2007-08. Any spillover revenue would instead remain in the PTA to fund other purposes. For 2007-08, these other purposes include funding the state's intercity rail service and the Department of Transportation's (Caltrans') mass transportation program, as well as to fund Home-to-School transportation, regional center transportation, and pay the debt service on transportation bonds. Beyond 2007-08, any spillover revenue would provide continued funding to Home-to-School transportation in addition to intercity rail services and Caltrans' mass transportation program.

The Governor's proposal would result in less STA funding in years when there would have otherwise been spillover revenue. However, by not including spillover revenue in STA, the proposal would eliminate the volatility that spillover revenue creates in the program's funding level. As a result, this would make STA funding more stable and predictable from year to year. (Please see the discussion of the Governor's proposals for PTA use and the spillover formula in "Funding for Transportation Programs " in the "Crosscutting Issues" section of this chapter.)

Budget Overestimates Offset Amount

The budget overestimates by $4.5 million the amount needed to offset the funds allocated to State Transit Assistance (STA) in 2006-07. Accordingly, we recommend increasing STA funding in 2007-08 by a corresponding amount.

The 2006 budget overestimated the amount of spillover revenue into PTA, using projections of gasoline prices that were too high. As a result, the current-year budget appropriated more to STA than is required by law. The Governor's budget estimates that the program is allocated $102 million more than law requires, and proposes to offset that amount by reducing the 2007-08 allocation by a corresponding amount.

Offset Amount Is Overstated. Discussions with the Department of Finance indicate that the allocation in the current year is $97.5 million, instead of $102 million, more than law requires. Accordingly, the 2007-08 STA funding level should be higher, by $4.5 million.

Future STA Funding Level Sizeable

Our projections show that beginning in 2008-09, ongoing allocations to State Transit Assistance would be sizeable, around $350 million, and increasing annually thereafter, even if the program receives no spillover revenue.

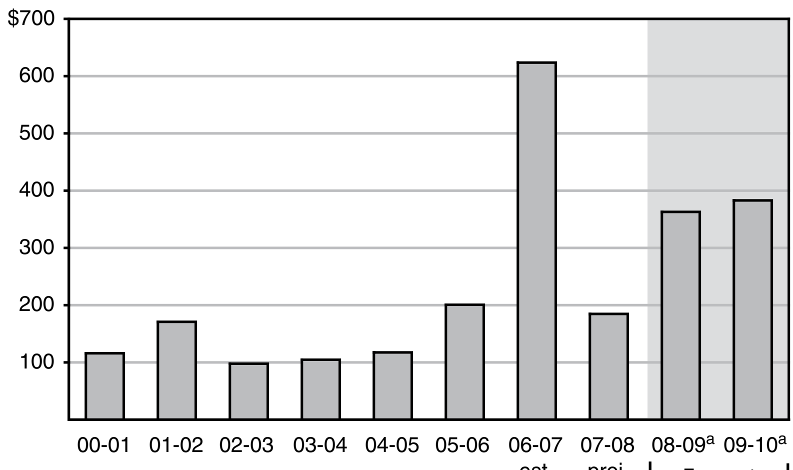
Historically, STA funding has been modest. From 1996-97 through 2005-06, program funding averaged $118 million annually. The current-year funding level of about $624 million is exceptionally high mainly due to loan repayments from the General Fund to Proposition 42 (a portion of which eventually finds its way to STA) and high spillover revenue resulting from high gasoline prices in 2006.

The budget proposes to permanently discontinue the allocation of spillover revenue to STA beginning in 2007-08. This, as we noted earlier, would result in less STA funding than current law provides, in the years when there otherwise would be spillover revenues. Nonetheless, as shown in Figure 1, we forecast that starting in 2008-09, STA would receive

Figure 1

State Transit Assistance

2000-01 Through 2009-10
(In Millions)



aAssumes no spillover revenue is allocated to program.

sizeable allocations of over $350 million each year, more than double what it has received on average in recent history. This is because beginning in 2008-09, PTA will receive 20 percent of Proposition 42 gasoline sales tax revenue annually. Under current law, one-half of this amount, together with one-half of all other PTA revenues (from diesel sales tax and Proposition 111 gasoline sales tax) would be allocated to STA. Because gasoline and diesel sales tax revenues are substantial and increase with rising fuel sales, ongoing STA funding would be sizeable and relatively stable, even if no spillover revenue is allocated to the program as proposed by the Governor's budget.

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 system. 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 modes and Administration encompasses management of the department.

The budget proposes total expenditures of $13 billion by Caltrans in 2007-08. This is $1.5 billion, or 14 percent, more than estimated current-year expenditures. This increase is explained in large part by budget-year encumbrance of Proposition 1B bond funds. The proposed staffing level of 21,758 personnel in 2007-08 is similar to the current year. Caltrans' total support in 2007-08 will be provided by a variety of sources, including $4.1 billion (32 percent) from the State Highway Account (SHA), $4.1 billion (32 percent) from federal funds, $1.6 billion (12 percent) from the Proposition 42 transfer and repayment of prior-year loans, and $1.5 billion (12 percent) from Proposition 1B funds. The remaining support will be funded from reimbursements, as well as from various smaller transportation accounts.

ADDRESSING ISSUES IN THE TRAFFIC CONGESTION RELIEF PROGRAM (TCRP)

In 2000, the Traffic Congestion Relief Act committed $4.9 billion to 141 specified transportation projects intended to provide congestion relief, increased connectivity, and faster goods movement. Originally, TCRP was to be funded by a combination of General Fund (one-time) and gasoline sales tax (ongoing) revenues between 2000-01 and 2005-06. Due to funding delays, the program has been extended through 2007-08. In the following section, we examine issues affecting the TCRP and recommend legislative actions to address them.

State Funding for Projects Has Been Delayed, Repayment Could Span Far Into Future

Due to the state's fiscal condition in 2001-02 through 2004-05, a significant portion of the funding for the Traffic Congestion Relief Program was delayed or loaned to the General Fund. Current law allows repayment of $1.2 billion in outstanding loans to span over the next ten years.

TCRP Funding Delayed, Loaned to General Fund. Due to the state's fiscal condition in 2001-02 through 2004-05, a significant portion of the funding for TCRP was delayed or loaned to the General Fund. Current law extends funding for TCRP through 2007-08 and establishes repayment of past loans. Through 2006-07, TCRP will have received about $3.1 billion. The program is scheduled to receive its last annual payment in 2007-08, in the amount of $602 million.

Loan Repayment Will Stretch Far Into Future. Outstanding loans owed to TCRP currently total about $1.2 billion. This amount will be repaid in two ways. First, about $750 million will be repaid from the General Fund under conditions set up in Proposition 1A (passed by the voters in 2006). Proposition 1A requires that this amount be repaid by June 30, 2016, at a minimum annual rate of one-tenth the amount owed. The Governor's budget proposes to repay $82 million to TCRP in 2007-08, approximately one-ninth the amount owed.

Second, $482 million is to be repaid from bonds backed by tribal compact revenues, pursuant to Chapter 91, Statutes of 2004 (AB 687, Nuñez). However, as we mention in "Funding for Transportation Programs" (in the "Crosscutting Issues" section of this chapter), it is uncertain if or when the state will issue tribal bonds to repay the debt to the TCRP. This is because pending lawsuits make bond issuance unlikely in the near future. As a result, the Governor's budget assumes that until bonds can be issued it will repay TCRP using $100 million in annual tribal compact revenues, as allowed under Chapter 91. While this makes certain the timing and amount of repayment to be received by TCRP, it stretches repayment until 2016-17, making some projects wait many years to receive funding.

As a result of the repayment timeline reflected in the Governor's budget, funding for the program could stretch over the next ten years instead of over a six-year period ending in 2005-06, as originally envisioned by the act. Figure 1 shows that funds for TCRP projects could trickle in over many years if repayment from the General Fund is spread over nine years, as permitted under Proposition 1A, and tribal bonds are not issued.

Figure 1

Estimated Revenues to Traffic Congestion Relief Program 2007-08 and Future Years

(In Millions)

	Loan Repayment			
Fiscal Year	Proposition 1A[a]	Tribal Revenues[b]	Annual Payment	Total
2007-08	$82	—	$602	$684
2008-09	82	—	—	82
2009-10	83	$86	—	169
2010-11	83	100	—	183
2011-12	83	100	—	183
2012-13	83	4	—	87
2013-14	83	—	—	83
2014-15	83	21	—	104
2015-16	83	100	—	183
2016-17	—	71	—	71
Totals	**$745**	**$482**	**$602**	**$1,829**

[a] Assumes the state repays the Traffic Congestion Relief Fund (TCRF) at the rate of one-ninth the amount owed each year. Actual repayment level may vary in some years.

[b] Assumes tribal bonds are not issued and instead the state uses ongoing tribal compact revenues to repay the TCRF in the amounts and order provided in Chapter 56, Statutes of 2006 (SB 1132, Committee on Budget and Fiscal Review).

Delayed State Funding and Cost Increases Have Impeded Project Delivery

Seven years into the Traffic Congestion Relief Program (TCRP), only 26 of the 141 projects have been completed. In addition, many project sponsors have yet to identify full funding for their TCRP projects. As a result, $544 million in applications have not been approved. While development work continues on many other projects, cost increases have made total project funding uncertain which in turn threatens project delivery.

Allocation Process. The California Transportation Commission (CTC) allocates funds to TCRP projects by discrete project development phases. These phases include environmental clearance, design and engineering, right-of-way acquisition, and construction. Typically, funding provided through the program only covers a portion of the cost of a project phase. While projects were earmarked with specific funding amounts in the act, project sponsors (typically local agencies) are required to submit applications to CTC prior to being allocated funding for each phase. These applications define the most basic information about a project phase—scope, cost, and schedule. Applications must also identify how a project will be fully funded. Without each of these elements being fully defined, project sponsors cannot proceed for a TCRP funding allocation.

Status of TCRP Fund Allocations. Our review of the status of the TCRP fund allocations shows that there has only been limited progress in the delivery of TCRP projects. Figure 2 summarizes the status of fund allocations for the program. Specifically, slightly more than one-half of the funds ($2.6 billion) had been allocated through December 2006. Of that amount, about $1.7 billion had been expended—$304 million on completed projects and $1.4 billion on projects still under development. Beyond the monies allocated by CTC, regional and local project sponsors have advanced $566 million for projects using "Letters of No Prejudice" (LONPs), as discussed below. Still, seven years into the program, over $1.7 billion in projects have not come in for an allocation, including $544 million in project phases that do not have an approved application.

Most Projects Not Complete. As of December 2006, only 26 of the 141 projects designated in the TCRP had been completed. These projects accounted for $304 million of the program's total funding. Five of the projects were transportation studies (such as studies of corridor improvements), the other projects included primarily highway interchange improvements, transit fleet acquisitions, and construction of rail tracks. These projects, in general, were fairly simple and thus required shorter lead times for project design and engineering, or were able to move forward faster than other projects.

Expenditures of State Funds. While few projects are complete, $1.4 billion (29 percent of the total program funding) had been spent through December 2006 on TCRP projects that are still under development. For some of these projects, recent cost escalations may hinder completion, requiring project sponsors to identify additional funds for construction.

Locals Expend Their Own Funds to Advance Projects Ahead of State Funds. To minimize project delays resulting from the lack of state funds in past years, a number of local agencies have received LONPs from CTC. Created by Chapter 908, Statutes of 2001 (AB 1335, Cohn), LONPs allow local agencies to use their own funds to continue work on phases of TCRP projects that do not have allocations. These letters indicate that, should TCRP funds become available, the local agencies will be reimbursed for the local funds they have spent. Local agencies have advanced $686 million worth of TCRP projects in this manner. As of December 2006, $120 million in LONPs had been reimbursed, leaving about $566 million outstanding.

Figure 2

Status of Traffic Congestion Relief Program Funding As of December 2006

(In Millions)

Status of Funding	Amount
Allocated	**$2,594.1**
Expended, projects completed[a]	304.0
Expended, projects not yet complete[b]	1,393.6
Allocated, not yet expended	896.5
Not Allocated	**2,314.7**
Application approved, no allocation or LONPs[c]	1,204.3
Local funding with LONPs	566.5
Application not yet approved	543.9
Total	**$4,908.8**

a Includes $1 million in reimbursed LONPs.

b Includes $119 million in reimbursed LONPs.

c Letters of No Prejudice.

Some Project Applications Yet to Be Approved. The CTC's annual report shows that almost seven years after the program was established, funding applications for $544 million for certain phases of TCRP projects have yet to be approved. Discussions with CTC indicate that in many cases, applications have not been approved because project costs have increased and full funding for these phases has not yet been identified by regional or local project sponsors.

Reasons Why Projects Are Taking So Long. Much of the slowness in TCRP project delivery can be traced to funding delays that occurred in the early 2000s when TCRP funds were loaned to the General Fund. However, it is also true that TCRP funds constitute, on average, less than one-third of total project costs. Thus, project delays may also be tied to other factors. Specifically, projects initially were earmarked funding in statute without assurance of when they could be completed or that local and federal monies were available to provide the balance of the funding required. To the extent uncertainties have persisted, it is unknown when or if some projects will be completed. Below, we discuss actions that can be taken to provide more certainty regarding when projects will be completed using TCRP funds.

Address Issues in the TCRP

Transportation projects must be completed and in use in order to achieve the Traffic Congestion Relief Program's (TCRP's) objectives of providing congestion relief, connectivity, or goods movement benefits. Accordingly, we recommend that the Legislature direct the California Transportation Commission (CTC) to (1) establish project completion deadlines and (2) identify projects that are no longer viable so funds may be redirected to other projects. We further recommend the enactment of legislation to provide guidance as to how funds should be redirected.

It is also important that CTC has adequate flexibility in implementing the program, given the potentially long timeline for repayment of past loans. Accordingly, we recommend the enactment of legislation to eliminate the annual cap on reimbursing local agencies who have used their own funds to advance TCRP projects.

Delayed state funds and cost increases still threaten TCRP project delivery. Nevertheless, as we discuss below, there are steps that the Legislature can take to ensure that funds are used to deliver projects which meet the program's goals and to ensure that CTC has adequate flexibility in implementing this program, given the potentially long funding timeline.

Establish Project Delivery Deadlines. At present, there are no deadlines for delivery or completion of any of the 141 projects in the TCRP. Without project delivery deadlines, funds may remain available indefinitely to projects that show no signs of progressing. While the potentially long timeline for TCRP repayment poses a challenge to project delivery, we believe that without establishing some sort of deadline, funds may linger on stalled projects indefinitely. Accordingly, we recommend that the Legislature direct CTC, by January 2008, to establish final delivery deadlines in order to ensure that funds are used to construct projects in a timely manner.

Identify Projects That Are No Longer Viable. As previously mentioned, projects were earmarked for funding without assurance of when they could be completed or that other funds were available to provide full funding. To the extent uncertainties regarding full project funding and other factors related to project delivery have persisted, some projects may no longer be viable. Accordingly, we recommend that the Legislature direct CTC, by January 2009, to identify projects that are no longer viable so that funds may be put to other projects.

Redirect Funds From Failed Projects. For projects that cannot meet their delivery deadline or which CTC deems as no longer viable, the Legislature should redirect remaining TCRP funds to other transportation projects. While the Legislature has a number of options in how it reallocates the freed-up funds, we recommend that the Legislature redirect these funds to the SHA. By consolidating funds into the state's major transportation account, this would help simplify total state transportation funding. To the extent the freed-up funds, once in the SHA, are used for projects in the State Transportation Improvement Program (STIP), there would be congestion relief benefits in keeping with the goals of the TCRP.

Provide CTC With Additional Flexibility in Repaying LONPs. Chapter 375, Statutes of 2005 (SB 66, Torlakson), limits to 50 percent the amount of annual TCRP funding that CTC can use to reimburse local transportation agencies that advanced projects ahead of state funds using LONPs. The cap on reimbursement of LONPs was established prior to Proposition 1A, with the idea of encouraging new TCRP allocations. However, with the potential of funds trickling in over many years, we believe it makes sense to provide incentives for locals to advance additional TCRP projects using LONPs so that projects can be completed and open to users sooner. Providing CTC with the flexibility to reimburse LONPs at a higher level may help achieve this. Given the change in the TCRP funding landscape, we recommend the enactment of legislation to eliminate the annual cap on reimbursement of LONPs.

OTHER ISSUES

Maintenance Needs Not Fully Funded in Budget

The 2007 Five-Year Maintenance Plan recommends that the state increase its annual investment in preventive maintenance of pavement, structures, and drainage by $147 million in order to address the maintenance backlog. The budget includes $85 million for pavement preservation, but omits $62 million for structures and drainage preservation. Given that preventive maintenance is the most cost-effective means of protecting the state's infrastructure investment, we recommend that the department report at budget hearings on why it is not augmenting funds for structures and drainage preservation.

In addition to developing and constructing the state highway system, Caltrans is responsible for maintaining the system. This work is carried out by the maintenance division. With a 2006-07 budget of $1 billion and 5,819 personnel years (PYs), the division is responsible for the upkeep of all aspects of the system, including pavement, structures, roadsides, and signage. Maintenance activities range from litter removal, guardrail repair, and filling potholes to preventive maintenance. Preventive maintenance includes activities that seek to prevent deterioration and extend the life of various aspects of the highway system. The division does not, however, perform major rehabilitation and reconstruction projects on the state highway system. Those activities are included in the State Highway Operation and Protection Program (SHOPP) and are performed as part of the capital outlay program.

Maintenance Plan Findings. Chapter 212, Statutes of 2004 (SB 1098, Committee on Budget and Fiscal Review), requires that Caltrans adopt biennially a five-year maintenance plan. This plan is to assess preventive maintenance needs on the highway system and recommend investments that would cost-effectively address these needs. The 2007 Five-Year Maintenance Plan recommends that the state increase its annual investment in preventive maintenance of pavement, structures (such as bridges and overpasses), and drainage (such as culverts) by $147 million in order to address the maintenance backlog.

Of this annual amount, $85 million is for pavement maintenance contracts to eliminate the backlog of 7,784 lane-miles in need of preventive maintenance over ten years. Additionally, $41 million is to reduce by one-half the number of structures in need of major maintenance—the plan estimates that about 20 percent of the state's 12,500 bridges are in need of major maintenance. Lastly, the plan recommends an additional $21 million to maintain 355 culverts annually, which would reduce, but not eliminate, growth in the drainage maintenance backlog.

Governor's Proposal. For 2007-08, the Governor proposes to augment funding for highway maintenance by $117 million. This increase is explained in large part by several budget-year requests, including $85 million for pavement preservation contracts, $9.7 million for maintenance of intelligent transportation system elements (like traffic signals and changeable message signs), $12 million for cost increases in materials and contracted services to enhance maintenance worker safety, as well as $7.2 million for new radios. While the budget would significantly increase maintenance spending over the current-year level, it does not fully address the recommendations in the 2007 Five-Year Maintenance Plan. Specifically, the budget ignores the plan's recommendation to increase the investment in structures and drainage maintenance by $62 million annually.

Preventive Maintenance Is Highly Cost-Effective. Preventive maintenance activities include repairing damaged concrete, sealing bridge decks, and repairing culverts. Because these activities delay the need for major rehabilitation, reconstruction, and replacement investments in the SHOPP, they are highly cost-effective. For example, the department estimates that $1 spent on preventive pavement or drainage maintenance saves $5 to $6 in future SHOPP costs. Moreover, the plan estimates that preventive maintenance on structures is twice as cost-effective, saving $12 in future SHOPP costs. Given that the plan identifies preventive maintenance on structures as the most cost-effective investment, it is unclear why the budget does not fully fund this activity.

Recommend Department Report on Maintenance Funding. We recommend that Caltrans report at budget hearings on the findings of the 2007 Five-Year Maintenance Plan and explain why it is not adopting the plan's recommendation for additional investment in structure and drainage preventive maintenance. The department should also explain why it chose to fund preventive maintenance on pavement, rather than structures, given its finding that preventive maintenance of structures is twice as cost-effective as preventive pavement or drainage maintenance.

Capital Outlay Support (COS) Request Will Be Amended

We withhold recommendation on the $1.6 billion requested for COS staff because staffing needs will be revised during the May Revision when more accurate information on the workload of various state transportation programs becomes available. The Department of Transportation (Caltrans) will likely require significant COS resources—including both contracting out and state staff—to deliver Proposition 1B funded projects in a timely manner. In its May supplemental report on COS, Caltrans should separately report COS resource needs for each Proposition 1B program. The requested COS resources should tie to the list of bond-funded projects that we have recommended be submitted by May 1.

Capital outlay support is the term used by the department to refer to 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. The 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 projects budget.

No Change in COS Level in Governor's Budget. The budget proposes $1.6 billion to fund COS activities—this is essentially the same level as estimated current-year expenditures. The department indicates that it will revise these estimates in the spring when it has better workload estimates.

Anticipate Significantly Higher COS Request. In our January report, *Implementing the 2006 Bond Package* (a portion of which is reprinted in the "Crosscutting Issues" section of this chapter), we note that Caltrans will play a crucial role in delivering $12 billion in projects through several Proposition 1B programs. This represents a 33 percent increase in the total value of projects that the department is currently working on, including STIP, SHOPP, TCRP, and local partnership projects. Absent project workload data, our rough estimate shows that Caltrans could need as many as 4,800 PY equivalents in additional personnel resources to plan and construct projects in 2007-08 and beyond. Ensuring that the department has adequate COS resources—including both state staff and contracted services—will be essential to the timeliness of all projects that Caltrans is responsible to deliver. Currently, Caltrans contracts out about 10 percent of its COS workload. In order to deliver the large number of projects funded by Proposition 1B, the Legislature should consider authorizing Caltrans to use a higher level of contracted resources.

In the "Crosscutting Issues" section of this chapter, we recommended that the administration provide, by May 1, a list of projects to be funded in 2007-08 for each Proposition 1B program. (Please see "Appropriating Proposition 1B Funds.") As Caltrans prepares its COS request for 2007-08, it should identify separately the COS resources that would be needed to deliver projects in each Proposition 1B program. Furthermore, the department should identify the composition of these COS resources, in terms of state staff and contracted services. This information will enable the Legislature to assess the COS request and monitor how these COS resources are used to deliver projects.

Department Should Report on Virtual Traffic Monitoring Stations Pilot

The budget requests $1.2 million for a two-year pilot project to determine the effectiveness of purchasing real-time traffic data from private vendors. We think this proposal is reasonable, but recommend that the Legislature adopt supplemental report language directing the department to report on its experience.

The Governor's budget provides $1.2 million in 2007-08 to begin a two-year pilot that will determine the effectiveness of purchasing real-time traffic data from private vendors.

Department Primarily Collects Traffic Data Using Loop Detectors. Caltrans has traditionally collected its own traffic data through loop detectors installed in highway pavements. While loop detectors are a proven technology for collecting traffic data, loops are expensive to install and maintain. This is because loop detectors are installed beneath the roadway and thus in order to repair damaged loops, maintenance workers often have to close part of the road to access loops inside the pavement. The department estimates annualized costs of loops at $12,800 per mile. Because of these high costs, Caltrans has only installed loop detectors on one-half of the urban highway system. Moreover, the department indicates that approximately 30 percent of existing loop detectors and related infrastructure are in disrepair.

Proposes Pilot to Test Drive New Detection Technologies. In the proposed pilot, Caltrans requests funding to contract with a vendor to use new traffic data collection technologies, instead of loop detectors, at a significantly lower cost. An example of the new technologies that may be used by the vendor is Global Positioning Satellite tracking information that is already collected by various entities, but not currently used by Caltrans to monitor traffic conditions. Because these data collection methods do not require equipment installation in the highway rights-of-way, Caltrans estimates that vendors could provide real-time traffic data, which are similar in quality to loop data, for an annualize cost of about $700 per mile. If this pilot is approved, the department indicates that it would implement the pilot both in locations that are not currently covered by loop detectors (to increase total coverage), as well as in locations that are covered by loops (to verify the quality of the data provided by the vendor).

Recommend Supplemental Report on Pilot. Given the high costs of installing and maintaining loop detectors, we think it is reasonable for the department to explore less expensive traffic data collection methods. However, before the state makes a long-term commitment to purchasing traffic data from vendors, we believe that further investigation is warranted to better identify the costs and benefits of these newer traffic-monitoring methods. Accordingly, we recommend that the Legislature adopt the following supplemental report language directing the department to provide specific information that would enable the Legislature to determine whether this program should continue:

> By April 1 of 2008 and 2009, respectively, Caltrans shall report on the Virtual Traffic Monitoring Station (VTMS) pilot to the Joint Legislative Budget Committee, fiscal subcommittees, and policy committees on transportation, as follows:

(1) The number of vendors that participate in the pilot. For each contract, provide:

- The number of lane-miles included in the pilot, including a break out of those lane-miles that were also covered by functional loop detectors.
- A description of the data collection method used by the vendor.
- An analysis of whether or not the data collection method used by the vendor was more or less reliable and accurate than existing loop detector data.
- An analysis of the annualized per-mile cost of purchasing these data from the vendor versus collecting these data using loop detectors.
- An analysis of whether the vendor data were able to accomplish the following purposes:
  - Calculate vehicle miles traveled for use by the Federal Highway Administration to determine California's federal funding allocation.
  - Provide data that are useful to the management of traffic flow (such as ramp metering and signal timing).
  - Compute and report on congestion measures (such as delay).
  - Provide real-time information (such as travel times and roadway speeds) to travelers and other entities (such as the California Highway Patrol).

(2) If multiple contracts are let, an assessment of the data collection methods that were best suited and least well suited for meeting the department's data collection needs.

(3) An assessment of the net cost and benefit of implementing the pilot.

(4) An assessment of whether VTMS is a viable long-term strategy for collecting traveler data and in what situations VTMS should replace existing loop detectors.

Department and CTC Should Report on Proposition 1B Administrative Costs

Every dollar spent on administrative costs in a bond program is one less dollar for infrastructure projects. Discussions with the administration indicate that 10 percent of Proposition 1B funds are being reserved for administrative costs. In order for the Legislature to monitor bond program administrative costs, we recommend the enactment of legislation requiring administrative expenditures to be reported sepa-

rately in the California Transportation Commission's annual report on Proposition 1B bond programs.

Administrative Costs Should Be Minimized. Each dollar spent on administrative costs in the implementation of a bond program is one less dollar that is available for capital projects the bond program is set up to fund. In order to limit the use of bond funds for administrative costs and maximize the amount of funds available for grants and projects, the Legislature should review requests for staff and other administrative costs. For other areas of state government, for example in housing and resources, we have recommended in the past that no more than 5 percent of a bond program's funding should go towards administrative costs. In the case of competitive grant programs, this level of administrative cost is generally sufficient to provide enough staff to effectively manage the grant program.

Project Development Activities Are Separate From Administrative Costs. It should be noted that the types of administrative costs that we discuss here are different from those costs related to actually designing and constructing projects. At Caltrans, these activities are generally performed through COS and capital outlay programs. Given the nature of these, we do not believe bond funding for these project development activities should be subject to a uniform cap.

Governor's Proposal. Discussions with the administration indicate that it is reserving 10 percent of Proposition 1B bond proceeds for potential administrative costs. These administrative costs include the costs of bond issuance, as well as oversight activities performed by Caltrans and CTC staff such as developing program guidelines, allocating bond funds, and monitoring projects.

Proposition 1B Administrative Costs Should Be Separately Identified in CTC's Annual Report. Proposition 1B provides bond funds for many programs. For some new programs, such as the $2 billion Trade Corridors program, administrative costs might be higher because this program will fund goods movement projects that have not traditionally been a focus of state transportation funding and CTC will likely have to spend considerable time establishing guidelines and processes. For existing programs funded by Proposition 1B, such as STIP and SHOPP, Catrans and CTC's administrative costs should be lower as guidelines and processes are already in place. Overall, we think that an average of 10 percent for administrative costs across all programs may be excessive. Discussions with the administration indicate that it has not done any estimation of the administrative costs that would be necessary to implement Proposition 1B programs.

In our January 2007 report, *Implementation of the 2006 Bond Package* (a portion of which is reprinted in the "Crosscutting Issues" section of this chapter), we recommended that the Legislature direct CTC to include in its annual report a discussion of expenditures made for all Proposition 1B programs. So that the Legislature can monitor how much bond funds are spent for administrative costs on an ongoing basis, we further recommend that the Legislature require CTC to report administrative expenditures on each bond program separately in its annual report.

High-Speed Rail Authority
(2665)

The California High-Speed Rail Authority (HSRA) is responsible for planning and constructing an intercity high-speed rail system. Chapter 796, Statutes of 1996 (SB 1420, Kopp)—the California High-Speed Rail Act of 1996—established HSRA as an independent authority consisting of nine board members appointed by the Legislature and Governor.

The authority was due to expire December 31, 2003. Chapter 696, Statutes of 2002 (SB 796, Costa), repealed the expiration date, making HSRA permanent. Chapter 696 also authorized the sale of $9.95 billion in general obligation bonds, including $9 billion of which would be for planning and construction of a high-speed rail segment between San Francisco and Los Angeles. The bond measure was scheduled to be placed on the November 2004 ballot.

Since Chapter 696, the bond measure has been postponed twice. First, Chapter 71, Statutes of 2004 (SB 1169, Murray), postponed the measure to the November 2006 ballot. Chapter 44, Statutes of 2006 (AB 713, Torrico), further pushed back the bond measure to the November 2008 ballot.

Time to Bite the Bullet for the Bullet Train

The Governor proposes to indefinitely postpone submitting a high-speed rail bond measure to the voters. The budget provides $1.2 million to support the High-Speed Rail Authority through 2007-08, however, it provides no funds for contract services. We recommend that the Legislature decide whether or not to continue the project. If the Legislature decides to terminate the project, we recommend deleting the authority's funding and disbanding the High-Speed Rail Authority.

Budget Proposes to Stop High-Speed Rail Project Indefinitely. As part of the 2007-08 budget, the administration is proposing $29.4 billion in general obligation bonds for various infrastructure projects, principally in education, to be placed on the ballot in 2008 and 2010. The administration believes that setting aside bonding authority for high-speed rail would take up the state's capacity to issue bonds for most other purposes. Therefore, the administration proposes to indefinitely postpone submitting the high-speed rail bond measure to the voters. This would essentially end the project unless another source of funding is provided. The budget, however, requests $1.2 million to support the continued operation of HSRA during 2007-08. This amount does not include funding for the authority to continue to contract for work related to the development of a high-speed rail system.

The HSRA has worked since its creation to develop a high-speed rail system in anticipation that the bond to fund the first segment would go to voters. In the current year, HSRA entered into several contracts for that purpose. These contracted services would develop processes and plans to manage and finance the project, as well as perform preliminary environmental and engineering work on segments of the high-speed rail line. Discussions with the authority indicate that $13 million has been committed toward these efforts in the current year. Although these contracts are funded on a year-to-year basis, the work outlined in them spans several years. The HSRA estimates that the cost to continue funding the contracts in 2007-08 would be about $70 million. (This cost does not include the cost to acquire any rights-of-way.)

Legislature Should Decide Fate of Project. Each year the authority operates, it is getting further along in the development of a high-speed rail system, and more money is being spent on the project. Through 2006-07, the state will have spent approximately $47.4 million on this project.

Not knowing if the state is committed to the project makes it difficult for HSRA to determine how quickly it should develop the project. For instance, if a system is to be constructed, certain critical rights-of-way should be acquired before they are taken up by growth and development. However, without certainty that the system will be constructed, HSRA does not know whether funds should be expended for rights-of-way acquisition. Additionally, repeatedly delaying the decision on whether the state will seek voter approval of project funding creates uncertainties and makes it more difficult for the state to seek financing from other sources. For instance, funding support from the Federal Railroad Administration may not be forthcoming until it is clear that the state is committed to the project.

Discussions with the authority indicate that if the project is to proceed in a timely manner, several hundreds of millions of dollars will be needed in the next few years to acquire critical rights-of-way and to complete preliminary engineering on various segments of the rail system. We recommend that the Legislature decide on whether the state is committed to the project before substantial amounts of additional state resources are expended.

If the Legislature decides that the project should proceed, it should provide funding for HSRA to continue its system development work in 2007-08. Otherwise, there is no reason to continue funding the authority. In that case, we recommend deleting the $1.2 million from the budget and enacting legislation to disband the authority.

CALIFORNIA HIGHWAY PATROL
(2720)

The California Highway Patrol's (CHP's) core mission is to ensure safety and enforce traffic laws on state highways and county roads in unincorporated areas. The department also promotes traffic safety by inspecting commercial vehicles, as well as inspecting and certifying school buses, ambulances, and other specialized vehicles. The CHP carries out a variety of other mandated tasks related to law enforcement, including investigating vehicular theft and providing backup to local law enforcement in criminal matters. In addition, the department provides protective services and security for state employees and property. Since September 11, 2001, CHP has played a major role in the state's enhanced antiterror activities.

The CHP's overall level of staffing is about 10,900 positions. The department is comprised of uniformed (sworn) and nonuniformed (nonsworn) personnel, with uniformed personnel accounting for approximately 7,600 positions, or 70 percent, of total staff.

The budget proposes $1.8 billion in support for CHP in 2007-08, about $150 million (9 percent) above estimated current-year expenditures. The increase is primarily related to the second-year funding ($51 million) of a multiyear radio system upgrade, a pro rata adjustment for administrative services provided by other agencies ($26 million), and a staffing augmentation for patrol services ($18 million).

Most of CHP's budget is funded from the Motor Vehicle Account (MVA), which derives its revenues primarily from vehicle registration and driver license fees. For 2007-08, MVA funds would comprise nearly 90 percent of CHP's support costs.

Biennial Inspection of Terminals Proposal Is Flawed

The budget proposes to increase the number of truck terminal inspections conducted by the California Highway Patrol (CHP) in the

Biennial Inspection of Terminals program. The budget also proposes a new fee structure to make the program self-financed. While we think that increased inspections and the move toward self-financing make sense, we find the proposed fee structure is flawed, the projected revenues from it are overstated, and many of the positions are not justified on a workload basis. We recommend the administration develop a more rational fee proposal. Also, we recommend 32 of the 71.5 positions requested be rejected for a savings of $3.3 million. Finally, we recommend CHP advise the Legislature on operational efficiencies it can implement to reduce the amount of time it takes to complete a terminal inspection. (Reduce Item 2720-001-0044 by $3.3 million.)

Chapter 1586, Statutes of 1988 (AB 2706, Katz), established the Biennial Inspection of Terminals (BIT) program. Under the program, all motor carrier (truck) operators are required to have their truck "terminals" inspected by CHP every 25 months to ensure that the operator is in compliance with state laws and regulations designed to promote highway safety. A terminal is the location where the vehicles are garaged and maintained. According to CHP, as of July 2006 about 68,000 terminals had enrolled in the program. These terminals range in size from one truck (owner-operator) to more than 100 trucks.

During the inspection, CHP inspectors (nonuniformed staff) check the physical condition of a sample of the trucks and trailers in a given terminal, as well as review the maintenance and driver records (including vehicle inspection reports, repair records, and time cards for drivers) for compliance with state laws and regulations. Terminals that pass inspection are issued a safety compliance report, while those that fail are required to be reinspected every 120 days until safety compliance is achieved.

Operators enrolled in the program are required to pay a fee for each terminal inspection. For terminals with one truck and up to three trailers, operators pay $400 for the initial inspection, and $100 for subsequent inspections. For larger terminals, with two or more trucks and four or more trailers, operators pay $650 for the first inspection, and $400 for subsequent inspections. Fee revenues are deposited into MVA for support of the BIT program, as well as roadside safety inspections.

Budget Proposes to Expand Inspections and Increase Fees. The Governor's budget requests an increase of $7.7 million and 71.5 positions to enable CHP to double its terminal inspections from about 18,000 to 37,000 annually. The proposal represents a 69 percent increase over estimated current-year spending, and a 48 percent increase in staffing. The administration also proposes legislation to implement a new fee structure to increase funding for the program. The proposed fee would be based on terminal size and the same amount would be levied for initial and subsequent inspections. The CHP estimates the proposed fees would generate approximately $20 million in 2007-08, which is about $12 million more than is generated currently.

Idea Has Merit, but Proposal Is Flawed. We think the overall goal of the budget request has merit. The department currently inspects only about one-half of the terminals required to be inspected in a given year. By doubling the number of inspections, CHP will be able to ensure that a greater number of terminals are compliant with traffic safety laws, thereby improving highway safety. Moreover, the higher fees would eventually bring the program's revenues more in line with its expenditures. The BIT program was designed to be self-funded, so the proposed fee increase is consistent with the Legislature's intent when the program was established in 1988.

However, the actual proposal is flawed. Specifically, our analysis finds that the proposed fee structure lacks rationale, and is unlikely to generate $20 million in 2007-08. Moreover, many of the positions are not justified on a workload basis. We discuss these issues in greater detail below.

Proposed Fee Schedule Charges Small Operators More Than Large Operators. The BIT inspections of larger terminals involve more work and take longer to complete than the inspections of smaller terminals. This is because there are more trucks, more drivers, and more maintenance records to inspect in the larger terminals. Yet, as Figure 1 shows, the proposed fee schedule would charge the small terminals more on a per vehicle basis than the large terminals. For example, under the Governor's proposal, the operator of a terminal with two trucks would be required to pay $400, or $200 per truck inspected, whereas the operator of a terminal with 100 trucks would pay $1,600, or $80 per truck inspected.

Figure 1

Proposed Fee Charges Small Operators More Than Large Operators

Terminal Fleet Size	Required Number of Vehicles to Inspect[a]	Governor's Proposed Fee	Cost Per Vehicle Inspected
1 or 2	All	$400	$200-400
3 to 8	3	650	217
9 to 15	4	800	200
16 to 25	6	1,000	167
26 to 50	9	1,200	133
51 to 90	14	1,400	100
91 or more	20	1,600	80

[a] Statute requires this number of vehicles to be inspected. Administration does not propose to change this.

BIT Program Unlikely to Generate Projected Revenue. The CHP's revenue estimate assumes that all terminals inspected during 2007-08 will pay the higher fee. However, the program allows carriers to pay the inspection fee up to nine months, but not later than seven months, prior to the expiration of their BIT certification period or "inspection term." This means that the fees for over one-half of the terminals that are due for inspection in 2007-08 will have been paid by the time the higher fee becomes effective. Given the potential fiscal impact of the new fee on individual companies, it is reasonable to expect that many will pay the fee at the earliest possible date, rather than wait until the fee increases. For this reason, we think at best, $6 million in additional revenues would be generated in 2007-08 with the new fees, rather than the $12 million projected by CHP.

Positions Not Fully Justified. Our review shows that the staffing request is not justified in two areas. First, in calculating the number of inspector positions needed to conduct the proposed 37,000 BIT inspections in 2007-08, CHP included workload associated with the inspection of bus terminals, which is not part of the BIT program. In addition, CHP assumed that all truck terminals require approximately eight and a half hours to complete when, in fact, about 25 percent of the terminal inspections in a given year are subject to an "administrative review" which takes approximately two hours. After adjusting for these factors, our analysis shows that only 33 of the 60 inspector positions (30 Motor Carrier Specialist I and 3 Motor Carrier Specialist II positions) are justified on a workload basis. Figure 2 shows a summary of our estimates compared to the department's request.

Figure 2

CHP BIT Position Request Versus LAO Recommendation

(Dollars in Millions)

	Number of Positions		
Classification	**CHP Request**	**LAO Recommendation**	**Savings**
Motor Carrier Specialist I	55.0	30.0	$2.8
Motor Carrier Specialist II	5.0	3.0	0.3
Office Technician	10.5	5.5	0.2
Accounting Technician	1.0	1.0	—
Totals	**71.5**	**39.5**	**$3.3**

CHP=California Highway Patrol; BIT=Biennial Inspection of Terminals.

Second, the request for 10.5 office technicians is not substantiated. While we think an augmentation of office technicians is reasonable given the additional inspections that would be completed if the request is approved, the department provided no workload analysis or other information to justify these positions. As such, we recommend that the Legislature reduce from 10.5 to 5.5 the number of office technicians. This would increase the level of support staff commensurate with the proposed increase in annual inspections.

Overall, we recommend the Legislature reject on a workload basis 32 of the 71.5 positions requested by CHP for savings of $3.3 million.

"Backlog" of Inspections Would Continue. In 2006-07, CHP is on track to inspect about one-half of the terminals due for inspection. This leaves a backlog of about 18,000 terminals yet to be inspected. The administration is not proposing to eliminate the backlog in the budget year. However, the proposed higher level of inspections would gradually reduce its size. We support this approach for a couple of reasons. First, as we noted, only a limited amount of the projected revenues from the proposed fee structure are likely to materialize in the budget year. Therefore, adding the staff required to address the backlog immediately would likely increase the program's expenditures above its revenues, thus drawing MVA monies away from other programs. Second, the proposed doubling (a 100 percent increase) of the number of BIT inspections represents a significant expansion in a single year. Based on discussions with CHP, it appears there may be a limit to the department's capacity to hire, train, and house the increase in staff all in one year.

Lastly, there are other potential strategies for addressing the backlog. One potential approach would be for CHP and the industry to explore and identify strategies that can be employed to reduce the average time required to complete an inspection. As another example, under current law, the CHP commissioner has the authority to extend a terminal's safety compliance period. This authority could be used to, in effect, allow certain operators in the backlog to maintain compliance until their next scheduled BIT inspection. We recommend CHP advise the Legislature on potential operational efficiencies that can be implemented to reduce the time required for a BIT inspection.

Patrol Staffing Request Overbudgeted

For 2007-08, the department requests $17.5 million to hire an additional 120 road patrol officers, as well as 41 nonuniform staff to support the officers. While the staffing augmentation is warranted, the requested funding is too high in three areas: cadet overtime, general expenses, and vehicle operations. Accordingly, we recommend a reduc-

tion of $1.1 million due to overbudgeting. (Reduce Item 2720-001-0044 by $1.1 million.)

Most traffic accidents and fatalities occur because individuals are not observing the traffic safety laws. The primary responsibility of the patrol officer is to conduct "proactive patrols," which serve both as a deterrent to drivers who might otherwise drive unsafely, as well as a tool to enforce the law by issuing citations and/or arresting individuals found in violation of traffic laws designed to promote highway safety. To the extent that proactive patrols prevent drivers from breaking these laws on California's highways, accidents may be prevented and lives may be saved.

Governor's Budget. For 2007-08, the department requests $17.5 million to provide partial-year funding for 120 additional road patrol officers and full-year funding for 41 nonuniformed staff, for a total of 161 additional staff. This is the second consecutive year of major increases of patrol officers. As part of the *2006-07 Budget Act*, the Legislature approved funding for 240 road patrol officers and a complement of 70 support staff. The CHP has indicated that its goal is to increase the number of hours that CHP officers spend on proactive road patrol. The additional staff furthers that goal.

Request Is Overbudgeted. We recommend approval of the 161 positions. As we noted last year, some of CHP's divisions have experienced large increases in vehicle registrations and highway travel. In addition, vehicle collisions in some divisions have far outpaced officer hiring between 2000 and 2005. However, our review indicates the request is overbudgeted in three areas: cadet overtime, general expense, and vehicle operations. We discuss each of these areas below.

- ***Cadet Overtime.*** The new Bargaining Unit 5 (BU 5) contract provides that while at the CHP training academy, cadets may earn a total of 152 hours of overtime, with the first 103 hours compensated with compensatory time off at time and a half, and the remainder (49 hours) paid at the hourly overtime rate. Instead, CHP's request would provide salary payment for the entire 152 hours of cadet overtime. Additionally, in calculating the overtime costs for these positions once they become officers, CHP used an overtime rate that is based on pay for all officers (including more senior officers) and sergeants instead of using an overtime rate that is based on the midstep pay for newly-minted officers. We find no justification for using a higher overtime pay rate than that provided for in the BU 5 contract. Based on our calculations, we recommend reducing the $1.3 million requested for overtime to $686,500, for savings of $569,000.

- ***General Expense.*** The general expense category includes funds for a variety of items ranging from paper clips to guns. For the 161 positions, the department has requested \$1.5 million to cover general expenses. We identified a technical error that resulted in the department requesting about \$200,000 more than needed in 2007-08. The department concurs with this finding. We therefore recommend a reduction of \$200,000.
- ***Vehicle Operations.*** For the 48 vehicles proposed to be purchased for the new officers, the department has also requested \$615,000 for operating expenses, about \$12,200 per vehicle, mostly for gasoline. The department, however, did not adjust the request to reflect the fact that the new officers will spend much of the coming year in the cadet training academy and will not require a patrol vehicle during that time. We recommend a reduction of \$350,000 to account for the period of time that the officers will not be driving the vehicles. Based on information provided by the department, the remaining \$265,000 should cover gasoline and other costs for the period the vehicles are in operation.

In total, we recommend a reduction of \$1.1 million.

Overtime Funding for Tactical Alerts: Legislative Oversight Needed

We recommend a reduction of \$19.8 million in overtime funding for the California Highway Patrol because the funds are no longer needed for tactical alerts. We further recommend the adoption of budget bill language requiring that any unused portion of the \$5 million provided for tactical alerts revert to the Motor Vehicle Account. (Reduce Item 2720-001-0044 by \$19.8 million.)

Following the terrorist attacks of September 11, 2001, CHP officers were placed on 12-hour shifts, or "tactical alerts," to enhance preparedness and provide an immediate increase in the level of security services. In 2002-03, the Legislature provided CHP \$32.5 million to continue the tactical alerts and adopted budget bill language requiring that any unused funds revert to MVA. The budget bill language was not included in 2003-04, but the department retained most of the funding.

According to CHP, in 2003-04, the \$32.5 million for tactical alerts was reduced to \$24.8 million by the Department of Finance through a baseline reduction (\$5.9 million) and a redirection (\$1.8 million) to cover workers' compensation costs. However, at the time this analysis was prepared, the department had not provided documents showing these adjustments.

Data provided by the department do not justify retaining the full \$24.8 million in its 2007-08 budget. Specifically, CHP data show that in

2002-03 it only used 149,000 overtime hours for tactical alerts at a cost of $17.4 million; and, in 2003-04 it used 71,000 hours and $3.2 million for tactical alerts. The department reports that after 2003-04 it stopped tracking hours and costs for tactical alerts.

Based on this information, we recommend a reduction of $19.8 million in CHP's overtime funding for 2007-08. We are not recommending a reduction of the full amount, as the department may be required at some time during the budget year to resume the tactical alerts. Based on the amount spent in 2003-04 (the most recent year for which data are available), we think the remaining $5 million is a reasonable set-aside in the event tactical alerts are needed in 2007-08.

In order to improve legislative oversight of this funding, we further recommend that the Legislature adopt the following budget bill language requiring that unused funds revert to MVA. This means CHP will need to reinstate tracking of its use of tactical alerts.

> Item 2720-001-0044. Of the funds appropriated in this item, the amount of $5 million is allocated for security tactical alerts. If the amount used for tactical alerts is less than $5 million, the remainder of the sum shall revert to the Motor Vehicle Account.

CHP Radio Replacement: Report Due in March

The budget requests $51 million for the second-year funding of a multiyear project to replace and upgrade the California Highway Patrol's radio system. We withhold recommendation on the request pending receipt and review of a March report on the project's status.

In 2006-07, the Legislature provided $57 million for the first stage of a multiyear project to replace and upgrade CHP's radio communication system. The CHP estimates the project will cost more than $500 million when completed. The Legislature also adopted budget bill language requiring CHP to report annually in March on the status of the project. Specifically, the department is required at a minimum to report on any revised costs, changes in project scope, and adverse effects on interoperability caused by new technology being used by local governments or state agencies.

The budget requests an additional $51 million for the second year of the radio replacement project, bringing the total 2007-08 appropriation to $108 million. Prior to receipt of the report, there is little information upon which to determine if the funds requested are reasonable and consistent with CHP's current schedule and costs. We therefore withhold recommendation on the request pending receipt and review of the required report. The report will allow the Legislature to determine if the project is on schedule and budget before committing the additional funds.

DEPARTMENT OF MOTOR VEHICLES (2740)

The Department of Motor Vehicles (DMV) is responsible for protecting the public interest in vehicle ownership by registering vehicles and promoting public safety on California's streets and highways by issuing driver licenses. Additionally, DMV licenses and regulates vehicle-related businesses such as automobile dealers and driver training schools, and also collects certain fees and tax revenues for state and local agencies. The department operates 215 facilities, which include customer service field offices, telephone service centers, commercial licensing facilities, a headquarters, and driver safety and investigations offices.

The budget proposes total expenditures of $903 million for support of DMV in 2007-08. This represents an increase of $19 million, or 2 percent, above estimated current-year expenditures. This increase is mostly the result of increases for employee compensation, the second-year funding of a multiyear information technology (IT) modernization project, and higher credit card processing fees for Internet-based customer transactions. The budget proposes a staffing level of 8,280 personnel for 2007-08, which is a slight decrease compared to the current year.

About $483 million (53 percent) of the department's total support will come from the Motor Vehicle Account (MVA) and $349 million (39 percent) from the Motor Vehicle License Fee Account. The remaining support will be funded primarily from the State Highway Account and reimbursements.

Update on Federal Real ID Act

Federal regulations implementing this act are expected to be delayed until July or August of 2007. Several key implementation issues hinge on these federal requirements. Also, there is no federal plan to fund the costly mandate. Nonetheless, the administration has indicated that it may request funding for implementation of the act as part of the spring revision process. Given the current lack of information regarding federal

requirements for this program and its related funding, as well as growing opposition to the act in other states, we recommend the state go slowly for now, and limit spending to planning activities.

In 2005, federal legislation, known as the Real ID Act, was signed into law. The act mandates states to modify driver licenses and identification cards to meet federal standards. It also requires the states to follow certain procedures in the issuance of these documents. The law stems from the recommendations of the 9/11 Commission, and is intended to strengthen national security by making it more difficult for terrorists to gain access to certain services. Under the act, a state may choose not to meet the federal requirements; however, its citizens would not be able to use the state-issued driver license and identification cards for federal purposes, such as receipt of federal services, or air travel.

Federal Real ID Requirements Still Unknown. The federal regulations for the Real ID Act were originally expected to be released in January 2007. The department now expects the regulations to be released in July or August. This new release date leaves states little time to implement the act by the federal statutory deadline of May 2008. Based on our discussions with the department, it seems virtually impossible for California—or any other state—to comply with the act by that deadline, especially in light of the delayed regulations.

Until the state receives federal direction on a variety of related issues, it is not possible to design a program that complies with the law. Some of the key issues that hinge on the federal regulations include issues related to the issuance of Real ID compliant cards to existing cardholders, the information verification process, and card security features. We briefly discuss these issues below.

- ***Issuance of Real ID Compliant Cards.*** Under the act, all Californians who currently hold a driver license or identification card would be required to get a new Real ID compliant card. Most, if not all, of the 25 million cardholders will be required to visit a DMV field office to verify their identity and legal presence before obtaining the new cards. This will significantly increase the volume of customers in DMV field offices. One major implementation question that needs to be addressed in the federal regulations is how long states will have to issue the new card. The time frame for issuing the cards will make a significant difference in the complexity as well as the cost of Real ID implementation. If, for example, states are required to reenroll current licensed drivers over a five-year period, the demand for personnel and physical space would be greater (due to the increased volume of customers to process) than if the existing cardholders are reenrolled over a ten-year period. Based on DMV's projections, the process of issuing new cards to existing cardholders is the most expensive aspect of Real ID compliance, accounting for nearly 60 percent of the estimated total cost. The department's preliminary estimate of about $300 million assumes a five-year period to issue the new cards to existing California cardholders.

- ***Real ID Verification Processes.*** Among other things, the act requires states to verify the authenticity of each applicant's identification documents, such as birth certificates, social security numbers, and passports, with the issuing agency. It also requires states to verify that the applicant does not already possess a driver license issued by another state or territory. This verification will be accomplished through the establishment and use of five national verification systems. Based on DMV estimates, this is the second most costly aspect of Real ID (estimated to cost about $150 million), due largely to the amount of computer programming required to adapt and synchronize new and existing systems to form the national databases. We would note that there is a high level of uncertainty in this estimate because of the lack of detail available as to how these systems will be configured. Depending on the federal requirements and the technology required to meet those requirements, the cost could be higher or lower. Our discussions with the department indicate that the national databases are not likely to be established and fully operational by the May 2008 deadline. Some examples of significant unresolved fiscal and policy issues related to the verification process include (1) whether federal agencies will be allowed to charge states transaction fees for the required verification of federal information and (2) what documents will be required of noncitizen applicants for purposes of determining lawful status.

- ***Card Security Features.*** The act requires states to incorporate certain security features into the Real ID card to prevent tampering or counterfeiting. It is anticipated that the federal regulations will detail the specific requirements. One of the most significant unresolved issues related to the card security features is whether the regulations will require all states to use the same security features, or grant states the flexibility to use multiple security technologies to achieve a given standard. If the states are granted flexibility, this would reduce the costs of Real ID implementation to the extent that some states already meet or exceed the federal standard. According to the department, there is also a possibility that the federal regulations would require states to use a special material (polycarbonate) in the production of the driver license and identification cards instead of the lower-cost material assumed in its preliminary cost estimate. The department estimates this would add about $200 million to the overall cost.

The federal requirements on these and other issues will have a significant impact on the amount of time required to implement the act, as well as the overall cost to carry out its requirements. The bottom line is that until the federal regulations are promulgated, the Legislature has no way of assessing the fiscal effect of the act on California.

Still No Federal Funding on Horizon. While the actual cost of Real ID will depend on the final regulations, early estimates suggest it will be costly to implement. The DMV's preliminary estimate indicates it could costs as much as $500 million for the additional staff, facilities, and technological improvements required to implement the act in California. (This estimate assumes the state is allowed to use the lower-cost material currently used to produce the cards, rather than polycarbonate.) A survey by the National Governors Association, the National Conference of State Legislatures, and the American Association of Motor Vehicle Administrators concluded that Real ID will cost more than $11 billion to implement nationwide.

At present, there is no federal plan to fund Real ID. It is our understanding, based on discussions with the department, that the federal Office of Management and Budget is currently developing an estimate of the measure's cost and will be making recommendations to the federal administration on whether and how to finance Real ID. Absent federal funding, the mandate will place significant pressure on state coffers, and potentially the MVA. The Legislature and Governor would likely need to increase fees, such as the driver license and vehicle registration fees to fund the program and maintain viability of the MVA. Assuming Real ID costs $500 million to implement over the next five years, the driver license fee, for example, would have to increase by about $16 (going from the current $27 to about $43) to cover the costs. (For more discussion on the MVA, please see our analysis of the MVA fund condition in the "Crosscutting Issues" section of this chapter.)

No Authority Exists to Implement Real ID; Enabling Legislation Required. Real ID implementation will require statutory changes to conform state law to the federal act and regulations. In December 2006, the department issued a report pursuant to the *2006-07 Budget Act* describing the status of Real ID. The report indicates that the administration has already started to develop legislation to address the known requirements of the act. Some of the issues identified by the report as requiring statutory changes include the following:

- ***Documentation of the Applicant's Principal Residence.*** The act requires that driver license/identification card applicants provide their address of principal residence. California law currently does not provide for documenting the address of principal residence.

- ***Verification of Document Authenticity.*** The act requires states to verify all documents presented as part of the driver license and identification card application process. Current state law only requires DMV to verify social security numbers and legal presence, but not birth certificates or other documents as required by federal law.
- ***Period of Validity of Driver License and Identification Cards.*** The act limits the term of a driver license or identification card to no more than eight years. Currently, state law allows drivers with good records to renew their licenses for up to two renewal cycles by mail, or as long as 15 years, before they must renew their license in person. California identification cards issued to senior citizens are valid for ten years.

These are just a few examples of the issues that will require legislative action. It is reasonable to expect that additional issues requiring legislation will be identified when the final federal regulations are released.

State Should Go Slow on Real ID Implementation. Real ID is a federal mandate. Unless Congress amends or repeals the law, California will essentially be required to comply. While the budget does not request additional funds to implement the act, the administration has indicated that it may request funds as part of the spring revision process. Given the magnitude of the effort required to comply with the federal mandate, we think the state should continue to take steps to prepare for implementation as previously directed by the Legislature. For example, the department should continue the multiyear project to modernize its IT system and implement strategies to reduce in-person transactions in field offices. However, it is unlikely that California or other states will be able to meet the May 2008 deadline. At this time, the Legislature lacks key information regarding what the federal government would ultimately require. Additionally, it is unclear whether the federal government intends to cover any of the mandate's costs. Moreover, the future of Real ID is uncertain. At the time this analysis was prepared, one state legislature had already passed a resolution refusing to implement the act, and at least four other state legislatures had pending bills expressing their opposition as well.

Real ID Planning Money: Report Due in February

The budget provides $8.7 million for the Department of Motor Vehicles to continue planning and upgrading its information technology systems in anticipation of Real ID implementation. Without prejudice

to the proposal, we recommend that the Legislature reject the request pending additional information on the department's current-year spending for Real ID, and the federal regulations. (Reduce Item 2740-001-0044 by $8.7 million.)

2006-07 Budget Act *and Actions to Date.* As part of the 2006-07 budget, the administration requested $18.8 million to begin planning and upgrading its IT infrastructure for implementation of the Real ID Act. The Legislature approved the funding request. However, it adopted budget control language limiting use of the funds. Specifically, the department activities were limited to (1) enhancing its Internet capability to reduce required visits to field offices for nondriver license related transactions, and strengthen the security of the Internet-based programs and (2) planning for Real ID, and upgrading its IT systems to protect the privacy and integrity of data and accommodate any new requirements on the department.

Of the $18.8 million provided in the current year, $9.4 million was immediately made available to address increased demands on the department's IT systems. The remaining $9.4 million was not to be available until after January 1, 2007, pending receipt and review of a report to the Legislature describing how the first one-half of the appropriation was spent, and how the department intends to use the remainder of the money. At the time this analysis was prepared, the report had not been submitted. The department has indicated that it intends to submit the report to the Legislature in February.

Governor's Budget. The budget proposes to retain $8.7 million of the $18.8 million to cover ongoing Real ID-related costs in 2007-08. According to the department, this request has three components: (1) establishment of a Real ID Program organization within DMV, (2) expansion of the name field in the department's information database, and (3) movement of certain transactions from DMV field offices to the department's Internet Web site.

Reject Request Pending Receipt and Review of Report. The purpose of the report to the Legislature is to determine whether the department has complied with the parameters placed on the appropriation. Also, at the time the funding was provided, it was the Legislature's expectation that the federal regulations would have been released so that future funding decisions could be evaluated in the context of the total program requirements. Absent the report on the department's current-year spending, and information on the federal regulations, the request for 2007-08 is premature. For this reason, and without prejudice to the administration's proposal, we recommend a reduction of $8.7 million pending receipt of the additional information.

FINDINGS AND RECOMMENDATIONS

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Crosscutting Issues

Funding for Transportation Programs

A-21 ■ **Slim Public Transportation Account (PTA) Balance Could Evaporate; Expenditure Priorities Should Be Established.** Recommend Legislature establish priorities for PTA expenditures in 2007-08 to clarify what expenditures would not be made if PTA funds are insufficient. Further recommend the administration advise the Legislature at budget hearings on transit capital projects that would be delayed or not funded as a result of the budget proposals.

A-24 ■ **Home-to-School Transportation Proposal Requires Substantial Spillover.** The proposal to fund Home-to-School transportation from PTA, rather than the General Fund, raises significant issues regarding the impact on transit capital improvements and the financing of K-12 education.

A-25 ■ **Reduce PTA Funding Volatility; Increase State Transit Assistance (STA) Funding Stability.** Recommend enactment of legislation to eliminate "spillover" revenue into the PTA beginning 2008-09 to simplify the state's transportation funding structure. This would also reduce the volatility in the PTA and increase the predictability and stability of STA funding. Any spillover amount (that otherwise would have been generated) would instead become available for broader transportation uses.

A-28 ■ **If Tribal Bonds Not Issued, Repayments to Transportation Would Span Far Into Future.** Due to pending litigation, the

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Governor's budget proposes to use tribal compact revenues to repay transportation loans in 2006-07 and 2007-08, rather than issuing bonds. This would provide almost $200 million for highway rehabilitation over the two years. If bonds are not issued, it would take until 2016-17 to repay the loans with tribal compact revenues as they become available. The impact on transportation projects funded by these monies is unknown.

A-30 ■ **Maintenance and Rehabilitation Needs Outpacing Funds Available.** As the state highway system ages, the costs to maintain and rehabilitate state highway miles are increasing. While the budget proposes more funding for highway maintenance and rehabilitation in 2007-08, it does not address the long-term issue that needs are growing faster than the revenues which pay for these activities. We recommend actions to ensure sufficient revenues are available to address long-term maintenance and rehabilitation needs.

Implementation of the Transportation Bond

A-34 ■ **Implementation of the Transportation Bond.** Proposition 1B provides $20 billion in general obligation bonds to fund transportation projects over multiple years. In order to relieve congestion, facilitate goods movement, improve air quality, and enhance the safety of the transportation system, bond funds must deliver effective projects in a timely manner. Recommend statutory and administrative measures to ensure effective implementation of the bond program.

Appropriating Proposition 1B Funds

A-50 ■ **Provide Bond Funding Annually to Enhance Legislative Oversight. Reduce Item 2640-104-6059 by $700,000,000, Item 2660-104-6053 by $2,000, Item 2660-104-6055 by $450,500,000, Item 2660-104-6056 by $2,000, Item 2660-104-6058 by $100,000,000, Item 2660-104-6060 by $331,500,000, Item 2660-104-6062 by $29,750,000, Item 2660-104-6063 by $2,000, Item 2660-104-6064 by $106,251,000, Item 2660-304-6053 by $142,798,000, Item 2660-304-6055 by $1,351,500,000, Item 2660-304-6056 by $509,998,000, Item 2660-304-6058 by $595,300,000, Item 2660-304-6063 by $118,998,000, Item 2660-304-6064 by $8,499,000, and Item 9350-104-6065 by**

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$450,000,000. Recommend reduction because only $2.8 billion (out of the requested $7.7 billion) would be allocated to projects in 2007-08. This would enhance the Legislature's ability to monitor the use of bond funds. Further recommend that the administration provide the Legislature by May 1, a list of potential projects that would be ready for bond funds to substantiate the requested amount.

A-52 ■ **Authority to Transfer Bond Funds Circumvents Accountability.** Recommend deletion of budget bill language that allows administration to transfer appropriated bond funds between Proposition 1B programs. Allowing the transfer of bond funds among various uses would circumvent accountability in the use of funds and runs counter to the measure's intent to allocate specific amounts for particular purposes.

A-53 ■ **Appropriations Requested in Current Year Would Not Be Used.** Proposed current-year expenditures are unlikely to be expended in 2006-07. Recommend administration provide a list of projects that would be funded to substantiate the request.

Motor Vehicle Account (MVA) Condition

A-55 ■ **MVA Faces Outyear Deficits Without Corrective Actions.** The MVA is likely to face significant shortfalls beginning in 2009-10, and possibly sooner depending on the timing of a number of pending spending initiatives, as well as potential risks. We will continue to monitor the MVA and offer recommendations as appropriate.

State Transit Assistance (STA)

A-59 ■ **Budget Proposes No Spillover for STA.** Discontinuing the allocation of spillover revenue to the STA program on a permanent basis would result in less funding to the program in years when there would otherwise have been spillover revenue; but would increase the predictability and stability of the program's funding level from year to year.

A-60 ■ **Budget Overestimates Offset Amount.** Recommend increase of $4.5 million because the budget overestimates the amount

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needed to offset the current-year amount allocation to STA since it is more than what current law requires.

A-61 ■ **Future STA Funding Level Sizeable.** Ongoing allocations to STA would be sizeable, around $350 million in 2008-09 and increasing annually thereafter, even if the program receives no spillover revenue.

Department of Transportation

A-63 ■ **Addressing Issues in the Traffic Congestion Relief Program (TCRP).** Delays in TCRP funding have impeded project delivery. Recommend the Legislature (1) direct the California Transportation Commission (CTC) to establish project completion deadlines and identify projects that are no longer viable so that funds may be redirected to other projects, and (2) enact legislation to provide guidance in how funds should be redirected. Given the potentially long timeline for repayment to TCRP, further recommend the enactment of legislation to eliminate the statutory cap on reimbursing local agencies that have used their own funds to advance projects.

A-69 ■ **Maintenance Needs Not Funded in Budget.** The budget omits $62 million for structures and drainage preservation needs identified in the 2007 Five-Year Maintenance Plan. Recommend the department report on why it is not funding these preventive maintenance needs.

A-71 ■ **Capital Outlay Support (COS) Request Will Be Amended.** Withhold recommendation on $1.6 billion requested for COS staff because staffing needs will be revised during the May Revision when more accurate information on the workload becomes available.

A-72 ■ **Department Should Report on Virtual Traffic Monitoring Stations Pilot.** The budget requests $1.2 million for a two-year pilot project to determine the effectiveness of purchasing real-time traffic data from private vendors. We think this proposal is reasonable, but recommend the Legislature adopt supplemental report language directing department to report on its experience.

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A-74 ■ **Department Should Report on Proposition 1B Administrative Costs.** The administration is reserving 10 percent of Proposition 1B funds for administrative costs. In order to monitor bond program administrative costs, recommend enactment of legislation to require administrative expenditures be reported separately in CTC's annual reporting on Proposition 1B bond programs.

High-Speed Rail Authority (HSRA)

A-77 ■ **Time to Bite the Bullet for the Bullet Train.** Recommend that the Legislature decide whether or not to continue the project. If the Legislature decides to terminate the project, we recommend deleting the authority's funding and disbanding HSRA.

California Highway Patrol (CHP)

A-80 ■ **Biennial Inspection of Terminals (BIT) Proposal Is Flawed. Reduce Item 2720-001-0044 by $3.3 Million.** Recommend reduction because 32 out of the 71.5 requested positions are not justified on a workload basis. Further recommend the administration develop a more rational fee proposal, and advise the Legislature on operational efficiencies CHP can implement to reduce the time it takes to complete BIT inspections.

A-84 ■ **Patrol Staffing Request Overbudgeted. Reduce Item 2720-001-0044 by $1.1 Million.** Recommend reduction because the request is overbudgeted in three areas: cadet overtime, general expense, and vehicle operations.

A-86 ■ **Overtime Funding for Tactical Alerts: Legislative Oversight Needed. Reduce Item 2720-001-0044 by $19.8 Million.** Recommend reduction in overtime funding for CHP because the funds are no longer needed for tactical alerts. Further recommend adoption of budget bill language requiring that any unused portion of the remaining $5 million for tactical alerts revert to the Motor Vehicle Account.

A-87 ■ **CHP Radio Replacement: Report Due in March.** Withhold recommendation on second-year funding for CHP's radio re-

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placement project ($51 million) pending receipt of the required annual report from CHP. The report will allow the Legislature to determine if the project is on schedule and budget prior to committing additional funding.

Department of Motor Vehicles

A-88 ■ **Real ID Update.** Federal regulations are delayed until July or August of 2007. Consequently, many requirements of the act are still unknown. The future of the federal mandate is uncertain, especially in light of growing opposition to the mandate in other states. As yet, there is no federal plan to finance the act. Recommend the Legislature limit spending to planning activities only until the requirements of the law are fully known.

A-92 ■ **Real ID Planning Money: Report Due in February. Reduce Item 2740-001-0044 by $8.7 Million.** Recommend reduction of $8.7 million requested to continue planning efforts related to Real ID pending receipt and review of a report from the Department of Motor Vehicles detailing its use of funding provided in the current year for Real ID planning, as well as any information on federal requirements for Real ID.