The 2014-15 Budget:

Transportation Proposals

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LAO

EXECUTIVE SUMMARY

Overview. The Governor's budget provides a total of $16.7 billion from various fund sources for all departments under the Transportation Agency in 2014-15. This is a decline of $560 million, or 3.2 percent, below estimated expenditures for the current year. The budget includes $10.9 billion for the California Department of Transportation (Caltrans), $1.4 billion for the California High-Speed Rail Authority (HSRA), $2 billion for the California Highway Patrol (CHP), $1.1 billion for the Department of Motor Vehicles (DMV), and $1.2 billion for transit assistance.

Caltrans. The budget proposes $337 million for the early repayment of a General Fund loan from the Highway Users Tax Account (HUTA), with the monies allocated for state highway pavement rehabilitation and maintenance, traffic management systems, and local streets and roads. While the early loan repayment would allow the state to conduct a higher level of highway maintenance and repairs in the next several years than would otherwise be the case, the Governor's proposed allocation of the repaid funds may not be the most cost-effective approach. For example, we note that Caltrans did not use its recently developed pavement management system to determine which types of projects to support with the repaid funds.

HSRA. The Governor's budget proposes $250 million in cap-and-trade auction revenue (Greenhouse Gas Reduction Fund [GGRF]) to support the development of the high-speed rail system. In addition, the Governor is proposing that, beginning in 2015-16, 33 percent of all GGRF revenues be continuously appropriated for high-speed rail. The Governor is also proposing that when the remaining balance of $400 million from a loan made from the GGRF to the General Fund in 2013-14 is repaid, the funds be directed to HSRA. As we discuss in this report, the Governor's high-speed rail proposals raise several issues. Specifically, we find (1) using cap-and-trade auction revenues for high-speed rail may not maximize greenhouse gas (GHG) reductions, (2) there currently is not a funding plan to complete the project's Initial Operating Segment (IOS), (3) it is unclear how much cap-and-trade revenue will actually be available for high-speed rail in the future, and (4) that bond funds approved in Proposition 1A for high-speed rail currently face legal risks.

CHP and DMV. The budget proposes a multiyear plan to replace CHP's aircraft and maintain an air fleet size of 26 aircraft with Motor Vehicle Account (MVA) funds. However, the plan does not provide sufficient information justifying the size of the air fleet proposed. The plan also raises the issue of whether it is appropriate for the MVA to be the sole funding source for this purpose. In addition, the budget proposes additional resources for DMV to implement recently enacted legislation that requires the department to accept driver license applications from persons who are unable to submit satisfactory proof of legal presence in the U.S., provided they meet all other requirements and provide proof of California residency. While the administration's workload estimates appear reasonable, we recommend the Legislature require DMV to regularly report on its progress to help determine the appropriate level of resources for the department in future years.

BACKGROUND

The Transportation Agency has jurisdiction over the state's transportation departments and programs. These departments and programs include Caltrans, HSRA, CHP, DMV, State Transit Assistance (STA) program, California Transportation Commission, and the Board of Pilot Commissioners.

The Governor's budget proposes a total of $16.7 billion in expenditures from various fund sources—the General Fund, state special funds, bond funds, federal funds, and reimbursements—for all departments and programs under the Transportation Agency in 2014-15. This is a decline of $560 million, or 3.2 percent, below estimated expenditures for the current year.

Spending by Major Transportation Programs

Figure 1 (see next page) shows spending for the state's major transportation programs and departments from selected sources.

Caltrans. The Governor's budget proposes total expenditures of $10.9 billion in 2014-15 for Caltrans—$1.9 billion, or 15 percent, less than estimated current-year expenditures. As shown in Figure 1, Caltrans expenditures from bond funds are projected to significantly decline—by about $1.5 billion (or 65 percent). The lower level of bond fund expenditures is primarily due to the completion of many projects that were funded with Proposition 1B bond funds.

HSRA. The Governor's budget proposes total expenditures of about $1.4 billion in 2014-15 for HSRA. This amount is $770 million, or 124 percent, more than the estimated level of expenditures in the current year. The proposed level of expenditures would be supported primarily with federal funds ($1.1 billion), as well as cap-and-trade auction revenues ($250 million).

CHP and DMV. The budget proposes $2 billion for CHP in 2014-15, which is less than 1 percent higher than the current-year estimated level. About 91 percent of all CHP expenditures would come from MVA, which generates its revenues primarily from driver license and vehicle registration fees. For DMV, the Governor's budget proposes total expenditures of about $1.1 billion—about $47 million, or 4.6 percent, more than estimated current-year expenditures. About 95 percent of all DMV expenditures would come from the MVA.

Transit Assistance. The Governor's budget estimates total expenditures of $1.2 billion in 2014-15 for the STA program, which is $508 million, or 74 percent, more than estimated current-year expenditures. The proposed level of expenditures includes $824 million in Proposition 1B funds. The Governor's budget would fully appropriate Proposition 1B funding for the STA program.

CALIFORNIA 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 four programs. Three programs—Highway Transportation, Mass Transportation, and Aeronautics—concentrate on specific transportation modes. Transportation Planning seeks to improve the planning of all modes.

The Governor's budget proposes total expenditures of about $10.9 billion for Caltrans in 2014-15. This is about $1.9 billion, or 15 percent, less than the estimated current-year expenditures. The lower spending level is primarily due to the completion of many projects that were funded with Proposition 1B bond funds. As shown in Figure 2, most of the proposed spending supports the department's highway program, which primarily includes $4 billion for capital outlay, $2.2 billion for local assistance, $1.8 billion for highway maintenance and operations, and $1.7 billion to provide the support necessary to deliver capital highway projects. The total level of spending proposed for Caltrans for 2014-15 supports about 20,000 positions at the department and several thousand transportation improvement projects statewide.

Proposition 1B

Background. In 2006, voters approved Proposition 1B (Highway Safety, Traffic Reduction,

Figure 1

Transportation Budget Summary—Selected Funding Sources

(Dollars in Millions)

	Actual 2012-13	Estimated 2013-14	Proposed 2014-15	Change From 2013-14 Amount	Change From 2013-14 Percent
Department of Transportation					
General Fund	$83.4	$81.4	$83.0	$1.7	2.0%
Special funds	3,273.0	3,841.2	3,577.2	-264.0	-6.9
Bond funds	3,281.6	2,333.0	822.8	-1,510.2	-64.7
Federal funds	3,593.0	4,892.8	4,781.2	-111.6	-2.3
Local funds	1,470.9	1,582.2	1,594.2	12.0	0.8
Totals	**$11,702.0**	**$12,730.5**	**$10,858.3**	**-$1,872.2**	**-14.7%**
High-Speed Rail Authority					
Bond funds	$45.0	$48.3	$29.3	-$19.0	-39.3%
Federal funds	185.8	571.3	1,110.7	539.4	94.4
Greenhouse Gas Reduction Fund	—	—	250.0	250.0	—
Totals	**$230.8**	**$619.7**	**$1,390.0**	**$770.4**	**124.3%**
California Highway Patrol					
Motor Vehicle Account	$1,703.5	$1,845.0	$1,852.8	$7.8	0.4%
Other special funds	157.5	165.8	170.7	4.9	2.9
Federal funds	17.4	18.9	19.0	0.1	0.7
Totals	**$1,878.4**	**$2,029.7**	**$2,042.6**	**$12.8**	**0.6%**
Department of Motor Vehicles					
Motor Vehicle Account	$831.2	$978.4	$1,027.5	$49.1	5.0%
Other special funds	83.4	46.4	45.8	-0.6	-1.3
Federal funds	0.7	5.1	4.1	-1.1	-20.8
Totals	**$915.4**	**$1,029.9**	**$1,077.3**	**$47.4**	**4.6%**
State Transit Assistance					
Public Transportation Account	$417.5	$389.8	$373.1	-$16.7	-4.3%
Bond funds	752.9	299.0	823.9	525.0	175.6
Totals	**$1,170.4**	**$688.7**	**$1,197.0**	**$508.3**	**73.8%**

Air Quality, and Port Security Bond Act of 2006), which authorized the state to sell about $20 billion in general obligation bonds for various transportation projects. As specified in the proposition, such projects include those intended to improve state highways and local roads, modernize and expand transit systems, improve rail and freight facilities, and mitigate transportation-related air pollution. Caltrans is responsible for delivering a majority of the Proposition 1B projects. As shown in Figure 3, most of the Proposition 1B projects that are administered by Caltrans are either complete or currently under construction.

Governor's Proposal. For 2014-15, Caltrans plans to spend $745 million in Proposition 1B bond funds on various projects, which is 62 percent less that the estimated level of expenditures for 2013-14. This decline in spending reflects the fact that many of the Proposition 1B projects will be near completion. Much of Caltrans' planned Proposition 1B spending in 2014-15 will be funded from appropriations approved by the Legislature in prior budgets. However, the Governor's budget does propose to appropriate $170 million in Proposition 1B funds to Caltrans in order to complete remaining projects and provide grants to local transportation agencies. Specifically, the budget requests $160 million for intercity rail ($108 million to procure new rail cars and locomotives and $52 million for track and facilities improvements) and $10 million for local bridge seismic retrofits. The Governor's proposal would essentially appropriate all of the funds authorized in Proposition 1B for

Figure 2

Most Proposed Expenditures for Highway Program

2014-15

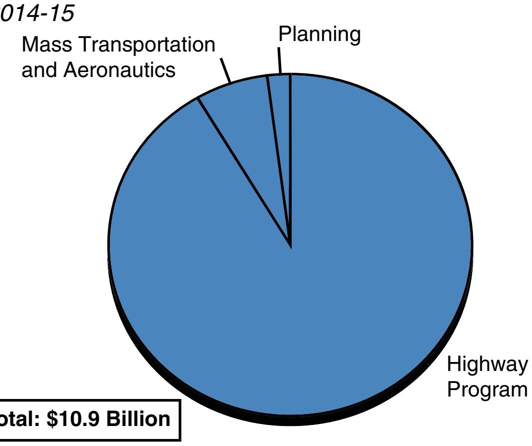
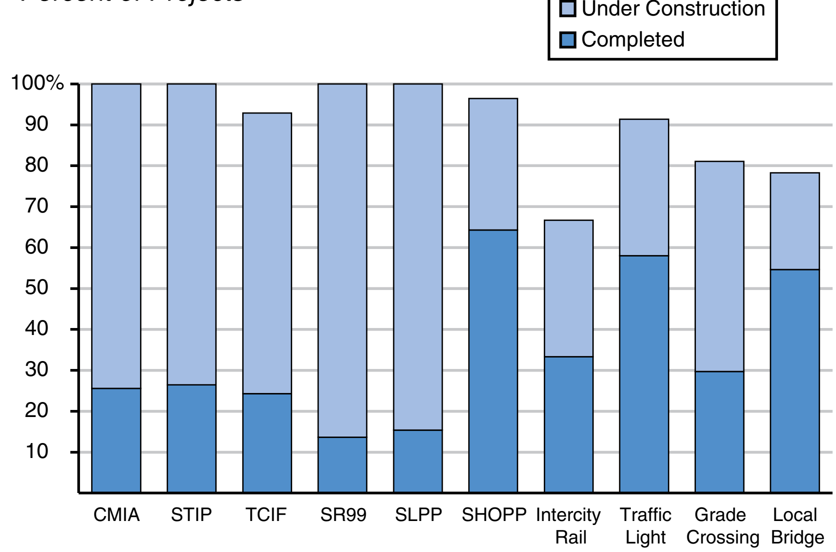


Figure 3

Most Caltrans Proposition 1B Projects Are Complete or Under Construction

Percent of Projects



CMIA = Corridor Mobility Improvement Account; STIP = State Transportation Improvement Program; TCIF = Trade Corridor Improvement Fund; SR99 = State Route 99; SLPP = State-Local Partnership Program; and SHOPP = State Highway Operations and Protection Program.

Caltrans. There would only be about $40 million remaining for future local bridge seismic retrofit projects.

In addition, Caltrans has identified potential savings of Proposition 1B funds that were previously appropriated for the department's administrative expenses. The proposed budget includes provisional language to redirect these savings to fund additional highway projects. The budget estimates that Caltrans will achieve about $113 million in administrative cost savings. However, the administration indicates that this amount of savings is only a rough estimate and will be updated with the May Revision.

LAO Recommendation. The Governor's proposal to appropriate most of the remaining Proposition 1B bond funds is consistent with the goals of the program. Accordingly, we recommend approving this request.

Use of Loan Repayment Funds

Governor's Proposal. During the past decade, various transportation funds were loaned to the General Fund in order to help address budget shortfalls. The Governor's budget for 2014-15 proposes $337 million for the early repayment of a $328 million General Fund loan from HUTA. The proposed repayment includes $9 million in interest on the loan. The Governor's budget proposes to allocate the repaid funds to three transportation programs.

- $210 million for the State Highway Operation and Protection Program (SHOPP) administered by Caltrans. Specifically, $110 million would go to repair pavement on the state's highway system and $100 million to improve traffic management systems (such as changeable message signs, ramp meters, and equipment that count traffic volumes).
- $100 million for cities and counties to maintain local streets and roads. (The Governor's budget reflects a total of about $1.9 billion to support local streets and roads.)
- $27 million for Caltrans' Highway Maintenance Program. Under the Governor's proposal, funding would be limited to improving pavement conditions on rural highways.

Early Repayment Is Reasonable, but Proposed Allocation May Not Be Cost-Effective. The state's existing highway system is a valuable and necessary asset that should be maintained to ensure that it can continue to serve the public into the future. Over the years, however, the state has not properly maintained its highways. This contributes to the need to completely rebuild portions of the highways, which is significantly more costly than performing routine maintenance on a regular basis. Given the state's overall fiscal condition, repaying the loan from the HUTA early is a reasonable step that would allow the state to conduct a higher level of maintenance and repairs on the state's highways in the next several years than would otherwise be the case. However, as we discuss below, the Governor's proposed allocation of the repaid funds may not be the most cost-effective approach.

Caltrans recently developed a pavement management system (commonly referred to as "PaveM") which can identify the specific pavement projects that are the most cost-effective, including whether to fund projects in the SHOPP or the department's Highway Maintenance Program. The Legislature provided funding in past years for Caltrans to develop the system. Despite the usefulness of the system to determine how to effectively allocate limited funding to maintenance and rehabilitation pavement projects, the department indicates that PaveM was not used to determine which types of projects to support with the repaid loan funds. Since SHOPP projects generally tend to be less cost-effective than maintenance projects, it is unclear whether the Governor's proposal to provide most of the funding to SHOPP projects reflects the best mix of projects given the limited funding available to meet the state's highway needs.

We also note that the $27 million proposed to fund maintenance projects would be limited to only rural highways, even though the state's urban highways have the highest traffic volumes and would also benefit more from maintenance work. In addition, spending $100 million for the SHOPP to repair and improve traffic management systems (such as changeable message signs) may not be an effective use of limited funding for meeting the state's highest maintenance and rehabilitation needs. While traffic management systems are an important component of the highway system, the administration has not been able to document that the benefits from such projects outweigh the benefits of instead allocating the funds to pavement repairs.

As discussed above, the Governor's budget proposes to allocate $100 million of the repaid funds to cities and counties to maintain local streets and roads. However, when the loan was initially taken from HUTA, cities and counties were held harmless and received the full share of HUTA revenues typically provided by the state for the maintenance of local streets and roads. While cities and counties have significant maintenance needs on their roadways, the administration has not been able to demonstrate that providing the additional funds to cities and counties would be a more effective use of the funds than performing additional repairs on the state's highway system—particularly given the state's responsibility in maintaining its highways.

LAO Recommendations. In order to ensure that the $337 million proposed for repayment to HUTA is used in the most effective manner in addressing the state's highway needs, we recommend the following.

- ***Require Caltrans to Use PaveM to Identify Projects.*** We recommend that the Legislature require Caltrans to use its PaveM system to determine the types of projects that are deemed the most effective to fund with the $137 million proposed by the Governor for maintenance and SHOPP pavement projects. Specifically, we recommend that the Legislature require Caltrans to report at budget subcommittee hearings this spring on the types of projects identified by the department's PaveM system as the most cost-effective and allocate the proposed $137 million accordingly.

- ***Require Caltrans to Report on Relative Benefits of Proposed Traffic Management System Improvements.*** We also recommend that the Legislature have Caltrans report at budget subcommittee hearings on the expected benefits that would be achieved from spending $100 million on traffic management systems compared to the benefits of instead allocating these funds to additional pavement repair projects. Depending on the information provided, the Legislature may want to consider allocating some or all of the $100 million proposed for traffic management system improvements to support additional highway pavement repairs instead.

- ***Consider Whether Increased Funding for Local Streets and Roads Should Be Directed to State Highways.*** In reviewing the Governor's proposal, we recommend that the Legislature consider whether some or all of increased funding proposed for the maintenance of local street and roads should be directed to performing additional repairs on the state's highway system. As indicated above, cities and counties were held harmless and received their full share of HUTA revenues when funding from the account was loaned to the General Fund.

Interstate 15 Express Lane Operations

Background. The four Interstate 15 carpool express lanes in San Diego County are 20 miles in length. Single-occupant vehicles are allowed to use the express lanes by paying a toll. The barrier separating the northbound and southbound traffic can be moved allowing for three lanes in the direction of the commute traffic and one lane in the opposite direction. In order to accommodate morning commute traffic headed south and evening traffic headed north, the barrier must be moved twice each day. Although the express lanes were open a few years ago, the movable barrier has not been in operation to accommodate traffic flow.

Governor's Proposal. The Governor's budget proposes an increase of about $800,000 from the State Highway Account to Caltrans for ten full-time maintenance workers to operate the moveable barrier on the Interstate 15 carpool express lanes.

Toll Revenues Available for Operational Costs. The San Diego Association of Governments (SANDAG), which is responsible for operating the Interstate 15 express lanes, collects the toll revenue from single-occupancy vehicles using the express lanes. State law requires SANDAG to enter into agreements with the state to reimburse state agencies for costs incurred from the express lanes. Under the current agreement, any funds remaining after paying or reimbursing state operating expenses are available for SANDAG to improve transit service and carpooling in the corridor. In 2013, SANDAG collected $6.1 million in revenue from the Interstate 15 express lanes. The association spent $3.2 million of these funds to operate the express lanes, mainly for toll collection systems. SANDAG also spent $1 million to improve transit service along the Interstate 15 corridor and counted the remaining $1.9 million as surplus revenue.

LAO Recommendation. As indicated above, existing state law requires that SANDAG and Caltrans develop an agreement for the state to be reimbursed for work performed to operate the Interstate 15 express lanes. In addition, it appears that SANDAG is collecting a sufficient amount of revenue from the express lanes to pay for the operational costs of moving the barrier twice a day. Accordingly, we recommend that the Legislature approve the Governor's budget request for additional maintenance positions to operate the movable barrier on Interstate 15, but provide authority for Caltrans to be reimbursed for such costs by the toll revenues collected by SANDAG.

HIGH-SPEED RAIL AUTHORITY

The HSRA was established by Chapter 796, Statutes of 1996 (SB 1420, Kopp), to plan and construct an intercity high-speed train that would link the state's major population centers. The HSRA as an independent authority consisting of a nine-member board appointed by the Legislature and Governor. The Governor's budget proposes total expenditures of $1.4 billion in 2014-15 for HSRA. Below, we provide an update on the high-speed rail project, and then review the Governor's proposals for HSRA.

Background

Construction to Start in Central Valley in 2014. In November 2008, voters approved Proposition 1A, which allows the state to sell up to $9.95 billion in general obligation bonds to partially fund the development and construction of the high-speed rail system. Of that amount, $9 billion is for the high-speed rail system while the remaining $950 million is for existing passenger rail systems to improve their connectivity with the high-speed rail system. The bond funds authorized in Proposition 1A require a match of at least 50 percent from other funding sources such as the state, federal, and local governments, or the private sector. A total of about $5 billion in Proposition 1A funds have been appropriated to date, with a total of about $705 million of bonds sold to date. The state has also received about $3.5 billion in federal funds for planning, engineering, and the construction of high-speed rail, which require matching state funds. All of the federal funds received have been appropriated to the HSRA, with about $200 million having been spent.

The first phase of the high-speed rail system is planned to provide service between San Francisco and Anaheim by 2028. The second phase of the system would expand service to Sacramento and San Diego. The first operation of high-speed rail in the state is planned to begin in 2022 after the construction of the initial segment of the first phase, commonly referred to as the IOS. The IOS would extend 300 miles from Merced to the San Fernando Valley. According to HSRA's 2014 draft business plan, the expected total cost to complete the IOS is about $31 billion, as shown Figure 4. Construction of the IOS will begin on a segment extending 130 miles from Madera to Bakersfield, which HSRA identifies as the Initial Construction Segment (ICS). Chapter 152, Statutes of 2012 (SB 1029, Committee on Budget and Fiscal Review), appropriated a total of $5.9 billion ($3.3 billion in federal funds and $2.6 billion in Proposition 1A bond funds) to complete the ICS. Currently, no funds have been appropriated to HSRA for the capital costs of any portion of the high-speed rail project other than the ICS. The HSRA anticipates that construction of the ICS will begin in 2014 and be completed in 2018, with the IOS being completed by 2021. Figure 5 (see next page) shows the anticipated route of the IOS through the Central Valley, the planned location of stations, and the ICS portion of the IOS.

Increased Staffing Provided in 2013-14. The 2013-14 budget includes a total of 177 authorized staff positions for HSRA to oversee contracts for environmental review, engineering design, right-of-way acquisitions tasks, and complete other workload such as legal counsel, communications, and contractor oversight. This reflects an increase of 105 positions above the level provided in 2012-13. The HSRA indicates that it has faced delays in filling the newly authorized positions because of requirements related to developing new staff classifications, such as creating examinations

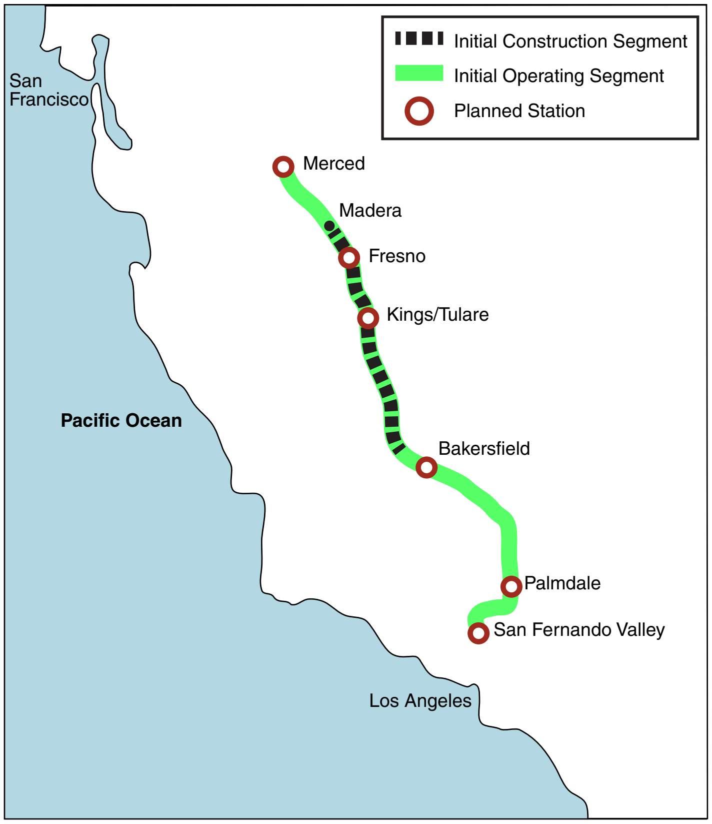
Figure 4

Estimated Annual Capital Costs of Initial Operating Segment

(In Millions)

Year	Amount
2013	$212
2014	751
2015	4,003
2016	4,008
2017	4,229
2018	5,481
2019	5,049
2020	4,732
2021	2,708
Total	**$31,173**

Figure 5
Construction of Initial Operating Segment



for new applicants. At the time of this analysis, 60 positions were vacant.

Litigation Over Use of Proposition 1A Bond Funds. The HSRA has been involved in two major legal cases involving the use of Proposition 1A bond funds. The first case is in regards to the requirement in Proposition 1A that, prior to submitting a request for an appropriation of Proposition 1A bond funds to the Legislature for the costs of completing a usable segment of the high-speed rail system, HSRA must submit to the Legislature a funding plan for that segment. The funding plan must identify all of the funds that will be invested in the usable segment and the authority must certify that all environmental clearances necessary to proceed to construction of the usable segment have been completed. On November 25, 2013, the Sacramento Superior Court found that the funding plan that HSRA submitted to the Legislature in November 2011 in conjunction with a request for an appropriation of Proposition1A bond funds for the IOS did not meet the above requirements. Specifically, the court found that the funding plan's description of additional funding beyond the funds currently committed to the project was not sufficient. The court found also that all necessary environmental clearances had not been completed for the IOS at the time that the November 2011 funding plan was submitted to the Legislature. As a result, the court ordered the HSRA to rescind the funding plan, thereby halting any Proposition 1A bond proceeds expenditures to support the construction of the IOS.

The second legal case involves a request from the administration that the court validate the issuance of Proposition 1A bonds, in order to prevent future legal challenges to their issuance. Specifically, on March 19, 2013, the administration filed a validation claim in the Sacramento Superior Court requesting that the court validate the High-Speed Passenger Train Finance Committee's approval of the issuance of more than $8 billion in Proposition 1A bond funds. (Proposition 1A established the committee to determine "whether or not it is necessary or desirable to issue" Proposition 1A bonds.) On November 25, 2013, the court found that the committee's proceedings in determining the issuance of Proposition 1A bonds contained no evidence explaining the factors the committee examined in making its determination. Based on this finding, the court denied the administration's validation request and the State Treasurer's Office currently does not plan to sell Proposition 1A bonds. The state is currently in the process of appealing both of the above rulings.

Governor's Budget Proposals

The Governor's budget proposes a total of $1.4 billion to HSRA for the high-speed rail project in 2014-15—$250 million in cap-and-trade auction revenue (GGRF) and $1.1 billion in federal funds. As shown in Figure 6, this is an increase of $770 million from the 2013-14 level. Most of the funding proposed for the budget year would be for the construction of high-speed rail.

The major proposals in the Governor's budget for HSRA in 2014-15 include:

- $250 million from the GGRF to support the development of the high-speed rail system. This includes (1) $58.6 million for environmental planning for the first phase of the project and (2) $191.4 million to purchase land and partially support construction of the ICS. In addition, the Governor is proposing budget trailer legislation that, beginning in 2015-16, 33 percent of all GGRF revenues be continuously appropriated to HSRA for the high-speed rail system. According to the administration, HSRA could seek to leverage this continuous revenue stream to secure a loan from the private sector or the federal government to support the completion of the IOS within the 2022 time frame. The Governor is also proposing that when the remaining balance of $400 million from a loan made from the GGRF to the General Fund in 2013-14 is repaid, the funds be directed to HSRA for the IOS.

- $29 million loan from the Public Transportation Account (PTA) to fund the operation of the HSRA while Proposition 1A bond funds are not available because of legal challenges to their use.

Funding in Other Departments for High-Speed Rail Workload. In addition to the above funding requests for HSRA, the Governor's budget also proposes increased funding at the

Figure 6

High-Speed Rail Authority Expenditures

(Dollar in Millions)

	Actual 2012-13	Estimated 2013-14	Proposed 2014-15	Change From 2013-14 Amount	Change From 2013-14 Percent
State Operations					
Proposition 1A bond funds	$17.7	$26.4	$29.3	$2.9	11.0%
Local Assistance					
Federal funds	—	—	$32.0	$32.0	—
Capital Outlay					
Proposition 1A bond funds	$27.3	$22.0	—	-$22.0	-100.0%
Greenhouse Gas Reduction Fund	—	—	$250.0	250.0	—
Federal funds	185.8	571.3	1078.7	507.4	88.8
Subtotals, Capital Outlay	($213.1)	($593.3)	($1,328.7)	($735.4)	(124.0%)
Totals	**$230.8**	**$619.7**	**$1,390.0**	**$770.4**	**124.3%**

California Public Utility Commission (CPUC) and the Department of Conservation (DOC) to handle workload related to high-speed rail. First, the budget proposes $355,000 (PTA) and $1.5 million (reimbursed by the utilities) for three permanent positions at CPUC to support the administration of contracts for technical consultants to perform environmental analysis and review permit applications from utilities for new electrical infrastructure. According to the administration, CPUC will experience an increase in workload as the state's electrical infrastructure is expanded to accommodate the operation of the high-speed rail system. Second, the budget proposes $5 million (reimbursed by HSRA) for DOC to perform agricultural land conservation for the HSRA, which is required to mitigate the environmental impacts of land acquisition for the ICS.

Issues for Legislative Consideration

In reviewing the Governor's proposals to support the high-speed rail project, we find that the proposals raise several issues that merit legislative consideration. Specifically, we find that (1) using cap-and-trade auction revenues for high-speed rail may not maximize GHG reductions, (2) there currently is not a funding plan to complete the IOS, (3) it is unclear how much cap-and-trade revenue will actually be available for high-speed rail in the future, and (4) HSRA is expending federal funds while matching Proposition 1A funds face legal risks. Addressing these issues will help the Legislature make informed decisions regarding the completion of the high-speed rail project as planned, while balancing its other priorities (such as maximizing GHG reductions).

Using Cap-and-Trade Auction Revenues for High-Speed Rail May Not Maximize GHG Reductions. As we discussed in our recent report, *The 2014-15 Budget: Cap-and-Trade Auction Revenue Expenditure Plan*, in order to minimize the negative economic impact of cap-and-trade, it is important that auction revenues be invested in a way that maximizes GHG emission reductions for a given level of spending. It is unclear the extent to which using such revenues to support high-speed rail will maximize GHG emission reductions. First, the high-speed rail project would not contribute significant GHG reductions before 2020, which is the statutory target for reaching 1990 emissions levels as required by Chapter 488, Statutes of 2006 (AB 32, Núñez/Pavley). This is because, as mentioned above, plans for the high-speed rail system indicate that the first phase of the project will not be operational until 2022. Second, the construction of the project would actually generate GHG emissions of 30,000 metric tons over the next several years. (The HSRA plans to offset these emissions with an urban forestry program that proposes to plant thousands of trees in the Central Valley.) We also note that HSRA's GHG emission estimates for construction do not include emissions associated with the production of construction materials, which suggests that the amount of emission requiring mitigation could be much higher than currently planned.

No Complete Funding Plan for IOS. As mentioned above, the HSRA indicates that the IOS will cost about $31 billion to complete. In its recent 2014 draft business plan, the authority identified a total of $10 billion in funding available to support the construction of the IOS. This level of funding consists of (1) $3.3 billion in federal funds already received and (2) $6.8 billion in Proposition 1A bond funds. The plan states that an additional $21 billion will need to be identified in order to complete the IOS, which is about two-thirds of the total cost.

An infusion of funds from the private sector to address the current IOS funding shortfall is unlikely, given that the HSRA stated in its 2012 business plan that private sector funds will only become available after the IOS is completed and demonstrated to have a net positive operating cash flow. Additionally, given the federal government's current financial situation, the current focus in Washington on reducing federal spending, and the lack of a federal budget appropriation to support the state's high-speed rail system since 2009-10, it is uncertain at this time that any additional federal funding for the state's high-speed rail project will become available. Thus, the state will likely be the only source of additional funding to address the $21 billion shortfall identified by HSRA.

Unclear How Much Cap-and-Trade Funding Will Support High-Speed Rail in Future. Although the administration proposes to use revenue from the state's cap-and-trade program to help address the $21 billion shortfall, it is unclear how much cap-trade auction revenue will actually be allocated to high-speed rail in 2015-16 and beyond to complete the IOS under the Governor's plan. As indicated above, the Governor is proposing that beginning in 2015-16, 33 percent of all state auction revenues be continuously appropriated to HSRA. At this time, however, the administration has not provided an estimate of projected cap-and-trade auction revenues. Moreover, it is unclear for how long the administration expects there to be cap-and-trade auctions and the availability of revenue resulting from such auctions.

The absence of a detailed plan projecting the estimated amount of cap-and-trade auction revenue that would be appropriated to HSRA by year is problematic for two reasons. First, it makes it difficult for the Legislature to determine if such revenues, along with available federal funds and Proposition 1A bond funds, would be sufficient to fund the expected costs per year to complete the IOS. To the extent that there would not be sufficient revenues in a given year, the Legislature would need to identify alternative funding sources, likely from other state resources. Second, the absence of projected cap-and-trade auction revenues also makes it difficult for the Legislature to weigh the relative trade-offs of dedicating a fixed percentage of cap-and-trade auction revenues to high-speed rail each year (without further legislative action) versus allocating the funds on an annual basis to other programs intended to reduce GHG emissions, including programs that the Legislature deems to be of higher priority and could maximize GHG reductions in a more cost-effective manner. This is because it is uncertain whether there would be a sufficient amount of funding available under the Governor's proposal to support such programs.

HSRA Expending Federal Funds While Matching Proposition 1A Bond Funds Face Legal Risks. For the remainder of 2013-14 and 2014-15, the HSRA plans to spend about $1.6 billion in federal funds on the high-speed rail project, which require a match of state funds. Currently, the only state funding source available to provide matching expenditures are Proposition 1A bond funds. However, as we mentioned above, the availability of Proposition 1A bond funds has been the subject of litigation. If the federal funds are expended as planned, and the state does not provide matching expenditures, the Federal Railways Administration reserves the right to require that the state repay the federal government up to the entire amount of federal funds spent on the project.

LAO Recommendations

In light of the concerns expressed above, we make several recommendations intended to help the Legislature ensure that the high-speed rail project can be completed as planned, while balancing other priorities such as maximizing GHG emission reductions. Specifically, we recommend:

- ***Requiring Administration to Provide Complete Funding Plan.*** Given the concerns described above, we recommend that the Legislature require the administration and HSRA to provide a funding plan that identifies all the funding sources (including cap-and-trade auction revenues) by amount and year that would be used to complete the IOS. As such, the plan should detail how the administration intends to address the $21 billion shortfall identified by HSRA. The requested funding plan would help the Legislature in its deliberations on the Governor's funding proposals for high-speed rail.

- ***Withholding Action on Various Proposals.*** Pending the receipt of the above funding plan, we recommend that the Legislature withhold action on the Governor's high-speed rail proposals (including those proposed for CPUC and DOC).

- ***Weighing Options for Use of Cap-And-Trade Auction Revenue.*** As we recommended in our recent report on the administration's cap-and-trade auction revenue expenditure plan, we recommend that the Legislature consider a full array of options for the use of cap-and-trade auction revenue funds to help achieve the goals of AB 32 and meet legislative priorities.

CALIFORNIA HIGHWAY PATROL

The primary mission of the CHP 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. The operations of the CHP are divided across eight geographic divisions throughout the state.

Air Fleet Replacement

Background

Currently, CHP operates an air fleet of 15 planes and 15 helicopters. According to CHP, the air fleet is used to provide assistance to CHP field-related operations and allied agencies across the state for (1) emergency response, (2) homeland security missions (such as patrolling the state's electrical and water infrastructure), (3) patrol of rural roadways, (4) speed enforcement, (5) enforcement other than speed, (6) special events, and (7) transportation. Some of the allied agencies that are provided assistance include local police departments, county sheriffs, state departments (such as the Department of Water Resources and Department of Fish and Wildlife), and federal departments (such as the Department of Homeland Security).

Most of CHP's air fleet was purchased several years ago with one-time federal grants that the state received to promote traffic safety or homeland security. For example, 14 of CHP's 15 airplanes were purchased with federal funds. According to CHP, an aircraft is typically in need of replacement after 10,000 flight hours as the cost to maintain and repair such an aircraft significantly increases thereafter. This is consistent with the best practices used by other law enforcement agencies in regards to air fleet replacement. The CHP states that 19 of its 30 aircraft currently have been flown for more than 10,000 hours. In addition, CHP spends about $2 million annually to operate and maintain each aircraft.

In adopting the 2013-14 budget, the Legislature approved CHP's request for $17 million from the MVA to replace four of its oldest aircraft. As part of its request, the CHP indicated its desire to replace its entire air fleet over the next several years. In order to properly assess such future requests from CHP, the Legislature adopted supplemental report language (SRL) as part of the 2013-14 budget requiring CHP to provide a report by March 1, 2014 that includes (1) an overall assessment of its air fleet needs and (2) a detailed plan regarding the replacement and maintenance of its air fleet, including specific timelines and cost projections associated with aircraft replacement and maintenance.

Governor's Proposal

The Governor's budget proposes a multiyear plan to replace CHP's aircraft that have exceeded 10,000 flight hours and maintain an air fleet size of 26 aircraft. Specifically, the Governor proposes one-time funds from the MVA of $16 million to replace four aircraft in 2014-15, $14 million to replace three aircraft in 2015-16, and $14 million to replace three aircraft in 2016-17. Additionally, the Governor's proposal would provide CHP with $8 million (MVA) each year on an ongoing basis beginning in 2017-18 to replace two aircraft per year to continuously maintain an air fleet size of 26 aircraft. Under the proposal, each of CHP's eight geographic divisions would maintain two airplanes and one helicopter, with two additional helicopters distributed to divisions at CHP's discretion. As part of its request for funding, CHP provided a report in response to the SRL discussed above.

Proposal Raises Several Issues for Legislative Consideration

We recognize that most of CHP's existing air fleet are reaching the end of their useful life and these needs will need to be addressed. However, we find that the Governor's proposed plan to replace 26 of the 30 aircraft raises three main issues that merit legislative consideration.

Unclear What Size of Air Fleet Is Needed. While the report provided by CHP on its air fleet includes various information (such as each aircraft's record of maintenance and fuel costs), the report does not provide sufficient information justifying the size of the air fleet being proposed. For example, the report simply states that CHP needs 26 aircraft to achieve its goal to perform 26,000 total flight hours per year and provide each CHP division with three aircraft. However, it is unclear from the information provided to the Legislature whether this number of flight hours and aircraft is the right amount to support CHP's core activities, particularly given limited resources and the high cost to purchase, operate, and maintain the aircraft. For example, the report did not include specific metrics that describe the benefits that the state would receive from the proposed air fleet size, as compared to a smaller or larger size. It is possible that a fewer number of flight hours and aircraft would provide similar benefits to the state as the level proposed. For example, providing only two aircraft for each regional division might be sufficient.

Future Ongoing Replacement Funding "Locks in" Air Fleet Size. As indicated above, the Governor's proposal includes $8 million beginning in 2017-18 on an ongoing basis for CHP to replace future aircraft as needed to maintain 26 aircraft. This assumes that CHP will always need 26 aircraft in the future and that the aircraft will require replacement on a set schedule. However, it is uncertain if that will be the case, as several factors could influence the need for a smaller or larger fleet size in the future (such as less assistance requested by allied agencies). In addition, it is possible that the future aircraft could last longer than planned, due to less hours flown than expected and improvements in the quality of aircraft being purchased.

Appropriateness of Using MVA Funds to Support All Replacement Costs. As described above, CHP's current air fleet was primarily purchased with one-time federal funds to promote traffic safety and homeland security missions. Under the Governor's proposal, all of the new aircraft would be purchased with monies from the MVA, which generates its revenues primarily from driver license and vehicle registration fees. The Governor's proposal raises the issue of whether it is appropriate for the MVA to be the sole funding source for this purpose. Under Article XIX of the State Constitution, any revenues from fees and taxes on vehicles or their use—such as driver license and vehicle registration fees—can only be used for the state administration and enforcement of laws regulating the use, operation, or regulation of vehicles used upon the public streets and highways. It is unclear whether all of the activities supported by CHP's air fleet meet this requirement, such as patrolling the state's electrical and water infrastructure.

Moreover, CHP reports that it frequently uses its air fleet to assist various allied agencies (such as local law enforcement offices). According to CHP, such assistance increased several years ago as some allied agencies (particularly local law enforcement agencies) faced fiscal constraints during the economic downturn in operating and maintaining their own existing air fleets. Given the high cost to the state in maintaining CHP's air fleet and that the budgets of the allied agencies may have begun to recover, the Legislature may want to consider requiring certain allied agencies to reimburse CHP for some or all of the costs it incurs in providing them with air support. We also note that requiring such reimbursements might encourage allied agencies to be more efficient and selective when requesting air support assistance from CHP.

LAO Recommendation

In view of the above issues, we recommend the Legislature withhold action on the Governor's proposal pending additional information from CHP and legislative deliberations regarding (1) the need for the size of the air fleet proposed and (2) the appropriateness of using the MVA as the sole funding source to purchase aircraft (including whether allied agencies should reimburse CHP for some of the costs).

Area Office Replacement

Background

The CHP operates 103 area offices across the state, which usually include a main office building for CHP staff, CHP vehicle parking and service areas, and a dispatch center. According to the Department of General Services (DGS), about 80 of CHP's area offices are seismically deficient and require replacement. In addition, CHP indicates that many offices are experiencing workspace shortages. For example, many existing facilities were not designed to accommodate some of the additional program responsibilities that the department has undertaken over the years (such as commercial vehicle inspection).

Area office replacements can be procured in one of a few ways. The most common are "build-to-suit" leases and direct capital outlay. With the build-to-suit procurement method, CHP contracts with a private developer to construct a facility and agrees to lease the facility from the developer for a predetermined number of years. At specified times during the build-to-suit lease, CHP has the option to purchase the facility from the developer. With the direct capital outlay procurement method, DGS uses funds from the MVA to both purchase the property and contract with a private contractor to build the CHP facility. Under direct capital outlay, the state owns the facility and does not have ongoing lease payments.

In recent years, both build-to-suit leases and direct capital outlay have been used to replace CHP area offices. For example, in September 2012, the Director of DGS notified the Joint Legislative Budget Committee (JLBC) of his intent to execute three separate build-to-suit lease agreements on behalf of CHP to replace existing area offices. At this time, DGS has executed one of these agreements. In addition, the 2013-14 budget provided $1.5 million for advanced planning and site selection to replace up to five unspecified CHP area offices using the direct capital outlay method. Due to concerns regarding the lack of an assessment of the relative benefits of financing projects with the build-to-suit process or capital outlay, the Legislature adopted SRL requiring that the Department of Finance (DOF), in consultation with DGS, report to the Legislature by April 1, 2014, on the guidelines that help determine whether a proposed new state facility should be procured using capital outlay or through a build-to-suit lease. The guidelines shall include, but not be limited to, guidelines for new CHP area offices.

Governor's Proposal

The Governor's budget for 2014-15 provides $1.7 million from the MVA to CHP for advanced planning and site selection to replace five additional area offices that will be financed with the direct capital outlay procurement method. The budget does not identify the specific five area offices that would be replaced. According to the administration's 2014 Five-Year Infrastructure Plan, the proposal is to replace five area offices per year for the next five years. According to CHP, it would cost a total of $820 million to replace 25 area offices.

Additional Information Needed

We recognize that many of CHP's area offices have deficiencies that will need to be addressed in the coming years. However, given the magnitude of the cost to replace these offices, it is important to ensure that the most cost-effective delivery method is used and that the area offices most in need of replacement are prioritized.

Pending Report From Administration on Procurement Methods. As indicated above, the administration is required to provide a report to the Legislature by April 1, 2014 that includes guidelines to determine if a new facility should be procured using capital outlay or a build-to-suit lease approach. This information will assist the Legislature in determining whether the Governor's proposal to replace five area offices with the direct capital outlay procurement is justified.

Prioritization of Offices Proposed for Replacement. As mentioned above, the Governor's budget does not identify which five area offices will be replaced. While the administration has provided a list of about 80 area offices it deems to be in need of replacement, it has not provided the criteria used to determine the order in which the area offices should be replaced. Thus, the Legislature is currently unable to determine if and when the offices that are in the worst condition and most in need of replacement will be replaced under the Governor's five-year plan. Such prioritization would help the Legislature weigh the full scope of the Governor's five-year replacement plan versus other demands that could be placed on the MVA in the future.

LAO Recommendation

In view of the above, we recommend that the Legislature withhold action on the Governor's proposal pending receipt of (1) the administration's forthcoming report on direct capital outlay and build-to-suit procurement methods and (2) a list in priority order of the area offices proposed for replacement and the criteria used to determine such prioritization.

DEPARTMENT OF MOTOR VEHICLES

The DMV is responsible for registering vehicles and for promoting safety on California's streets and highways by issuing driver licenses. Currently, there are 24 million licensed drivers and 30 million registered vehicles in the state. Additionally, DMV licenses and regulates vehicle-related businesses such as automobile dealers and driver training schools, and collects certain fees and tax revenues for state and local agencies. The DMV operates 313 facilities, which include customer service field offices, telephone service centers, commercial licensing facilities, headquarters, and driver safety and investigations offices. Over half of DMV facilities are customer service field offices. In 2013, the department reports that it processed 67 million transactions, with 25 million transactions occurring in field offices.

Implementation of AB 60

Background. Chapter 524, Statutes of 2013 (AB 60, Alejo), commonly referred to as AB 60, requires that, beginning January 1, 2015, DMV accept driver license applications from persons who are unable to submit satisfactory proof of legal presence in the U.S. (such as a social security number), provided they meet all other application requirements and provide proof of identity and California residency. As required by the legislation, DMV is in the process of developing and adopting regulations to implement certain provisions of the measure, such as specifying the appropriate documents necessary to prove identity and California residency and the procedures for verifying the authenticity of the documentation. Assembly Bill 60 specifies that the department must submit a report on January 10 of each year to the Governor and Legislature detailing the costs of verifying the citizenship or legal residency of applicants for driver's licenses. In addition, AB 60 states that DMV could assess an additional application fee on individuals applying for a driver's license pursuant to the provisions of the legislation that is sufficient to offset the administrative costs of implementing such provisions. Under the legislation, such additional fees could only be assessed until June 30, 2017.

Governor's Proposal. The Governor's budget for 2014-15 provides DMV with an additional $67.4 million from the MVA to implement AB 60. Specifically, the proposed funds would support 822 new limited-term positions and five temporary facilities to process additional driver's license applications. According to DMV, these facilities would be located in San Jose, Santa Barbara, Los Angeles, Orange County and San Diego and will only process applications for driver's licenses. The Governor's budget assumes that DMV will not assess an additional application fee to support these costs.

Based on recent data from the Department of Homeland Security on the number of unauthorized immigrants living in California and the percent of unauthorized immigrants in the U.S. who are age 18 and over, the administration estimates that 2.5 million California residents would be eligible to submit applications under the provisions of AB 60. (Federal data on unauthorized immigrants does not specifically delineate those who are age 16 and older.) Of these particular residents, the administration assumes that 1.4 million (or 55 percent) will choose to apply for a driver's license. The Governor's budget assumes that 38 percent of these individuals will apply in the second half of 2014-15, 50 percent in 2015-16, and 12 percent in 2016-17. As such, the administration's proposal reflects adjustments to the above proposed funding and positions levels for 2015-16 and 2016-17.

The Governor's budget also includes provisional language to allow DOF to augment DMV's budget item if it determines that DMV requires additional resources to implement AB 60. Under the proposed language, DOF would be required to provide notification to the JLBC at least 30 days prior to authorizing the augmentation.

Administration's Workload Estimates Appear Reasonable. In determining how many additional individuals will apply for a driver's license as a result of AB 60, the administration assumed an application rate of 55 percent—meaning the percent of undocumented individuals age 16 and over who would apply for a license. (In comparison, roughly 80 percent of California residents age 16 and over currently submit applications for driver's licenses.) According to the administration, this assumption is based on various sources, including data from the Congressional Research Service and other states that have implemented similar programs. While there is some uncertainty in estimating how many additional individuals—and in which year—will apply for a driver's license due to the implementation of AB 60, the administration's estimates appear reasonable.

Based on the above estimates, our analysis also finds that the administration's proposed staffing levels appear consistent with DMV's current workload standards. In addition, the proposed use of temporary facilities is consistent with the legislative intent expressed in AB 60. The proposed location of the facilities also appear to be aligned with where individuals who will be eligible for driver's licenses under AB 60 reside. According to data from the Public Policy Institute of California, about 70 percent of the population eligible under AB 60 resides in Southern California.

Given the difficulty in estimating the exact number of additional individuals who will apply for a driver's license, the Governor's proposed funding and staffing levels for 2014-15, 2015-16, and 2016-17 could end up being too high or too low. Thus, it will be important for DMV to regularly report on its progress in implementing AB 60. Such a report should include data on the (1) total number of driver's license applications submitted pursuant to AB 60, (2) number of such applications by region, (3) average cost and time to process each AB 60 application, and (4) changes in the number of driver's license applications received under the current process (meaning not pursuant to AB 60). Such information would help the Legislature determine the appropriate level of resources for DMV to effectively and efficiently implement AB 60 in future years.

Proposed Budget Bill Language Not Necessary. We find that the proposed budget bill language authoring DOF to augment DMV's budget is unnecessary to account for the event that DMV's actual workload to implement Chapter 524 ends up being higher than budgeted in 2014-15. This is because the proposed budget bill already includes funds and a process for departments to seek funds for unanticipated expenses. Specifically, Item 9840-001-0494 includes $15 million in unallocated special funds for unanticipated expenses, as well as identifies a process for the administration to seek a supplemental appropriation from the Legislature for funding higher than the thresholds specified in the item.

LAO Recommendations. In view of the above, we recommend that the Legislature approve the

Governor's proposal to provide DMV with an additional $67.4 million and 822 limited-term positions to implement AB 60 in 2014-15. We also recommend that the Legislature expand the data that DMV must submit every January 10—as required under AB 60—to include the number and location of applications and application workload data that would help determine the appropriate level of resources needed to implement AB 60 in an efficient and cost-effective manner. Finally, we recommend that the Legislature reject the proposed budget bill language to provide DOF the authority to augment DMV's budget, as such language is not necessary.

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