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The 2023-24 Budget: Proposed Fund Shift for CHP and DMV Capital Projects

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SUMMARY

In this brief, we analyze the Governor's proposal to shift the funding approach for various California Highway Patrol (CHP) and Department of Motor Vehicles (DMV) capital outlay projects from the General Fund to lease revenue bonds. We find that such a switch is reasonable given the General Fund condition. However, the administration has not identified a funding source for the debt service on the bonds, which is problematic because both potential fund sources—the Motor Vehicle Account (MVA) and General Fund—present important trade-offs. Accordingly, we recommend the Legislature weigh the associated considerations and provide clear direction regarding which fund source to use for debt service payments.

Background

CHP and DMV Supported by MVA. Both CHP and DMV primarily are supported by funding from the MVA. Historically, the departments have received minimal support from the General Fund, typically to support activities that are not eligible for funding from the MVA. Specifically, CHP's estimated expenditures in 2022-23 total $3.2 billion, of which $2.8 billion is from the MVA and $25 million is from the General Fund. Similarly, DMV's estimated expenditures in 2022-23 total $1.7 billion, of which $1.4 billion is from the MVA and $229 million is from the General Fund. The MVA mostly receives revenues from vehicle registration fees, including a base fee and an additional fee that is dedicated specifically for CHP. The MVA also receives some support from other vehicle-related fees, such as those charged for attaining and renewing driver's licenses. Over the past several years, expenditures from the MVA have generally grown faster than revenues, leading to persistent concerns about the MVA's fund condition. As of January 2023, the administration projects that the MVA will face an operational shortfall of $324 million in 2026-27, resulting in a negative fund balance of $314 million.

CHP and DMV Have Significant Facility Needs. CHP and DMV both operate large numbers of facilities across the state, many of which have significant needs. CHP's facilities include 103 area offices that are mostly responsible for traffic management. CHP's facility needs are driven primarily by complying with the seismic safety standards required under the Essential Services Building Seismic Safety Act of 1986, as well as by a desire to update older facilities and add more space to accommodate the department's modern operational needs. Over the past several years, CHP has been implementing a plan to gradually replace its area offices. Similarly, DMV also operates facilities across the state, including 171 field offices that serve as a main point of contact for customers to access various services (such as attaining driver's licenses). DMV's facility needs are driven primarily by the demand for new or larger facilities as a result of population growth and shifts, as well as by the desire to address seismic and other deficiencies in existing aging buildings.

Concern About MVA Fund Condition Has Led to Changes in State's CHP and DMV Facility Funding Approach in Recent Years. Traditionally, CHP's and DMV's facility needs—such as office replacements—have been funded up front with cash from the MVA. However, due to concerns about the condition of the MVA, over the past several years, the state has explored alternative ways to fund CHP and DMV facilities. In 2019-20, this included issuing lease revenue bonds to be repaid from the MVA to spread the cost of the projects over time and limit near-term pressures on the fund. More recently, in 2021-22 and 2022-23, the state provided cash from the General Fund to support such projects. This approach was made possible by the robust condition of the General Fund. Notably, as of 2022-23, the administration's out-year budget plan assumed that the construction of CHP and DMV projects would continue to be funded from the General Fund over the next few years.

Governor's Proposals

In response to concerns about the condition of the General Fund that have emerged in recent months, the Governor proposes a total of $332 million in lease revenue bonds in 2023-24 to support the construction of several CHP and DMV projects that the administration had previously planned to fund using cash from the General Fund. This amount includes (1) a $205 million shift from previously approved General Fund appropriations to lease revenue bonds and (2) $127 million in lease revenue bonds for the next phases of certain projects that were scheduled to be funded from the General Fund in 2023-24. As shown in **Figure 1**, this includes the following specific proposals.

Shifting $205 Million From Existing General Fund Appropriations to Lease Revenue Bonds. The Governor proposes to revert General Fund from several CHP and DMV capital outlay projects and instead fund them using lease revenue bonds. These projects include:

- ***CHP Area Office Replacements—Santa Fe Springs, Baldwin Park, and Quincy.*** The Governor proposes to substitute $184 million of General Fund that was appropriated in 2021-22 with lease revenue bond authority for an equal amount to support the design-build phases of three existing CHP office replacement projects: Santa Fe Springs, Baldwin Park, and Quincy.
- ***DMV Field Office Replacement—Inglewood.*** The Governor proposes to substitute $21 million of General Fund that was appropriated mostly in 2021-22 with lease revenue bond authority for an equal amount to support the construction phase of the Inglewood DMV Field Office replacement.

Using $127 Million in Lease Revenue Bonds for the Next Phases of Certain Projects. The Governor also proposes to fund the upcoming construction-related phases of a few continuing projects in 2023-24 with lease revenue bonds, rather than with General Fund as the administration had originally planned. These projects include:

- ***CHP Area Office Replacements—Humboldt and Gold Run.*** The Governor proposes $86 million in lease revenue bonds for the design-build phase of two CHP area offices: Humboldt and Gold Run.
- ***DMV Field Office Replacement—San Francisco.*** The Governor proposes $42 million in lease revenue bonds for the design-build phase of the San Francisco DMV Field Office replacement project.

Figure 1

Governor Proposes Changing the Funding Approach for Several Office Replacement Projects

Lease Revenue Bonds (In Millions)

Location	2021-22 and 2022-23[a]	2023-24[b]	2024-25[c]	2025-26[c]	Totals
CHP	**$184**	**$86**	**$255**	**—**	**$525**
Santa Fe Springs	$68	—	—	—	$68
Baldwin Park	65	—	—	—	65
Quincy	51	—	—	—	51
Humboldt	—	$42	—	—	42
Gold Run	—	44	—	—	44
Redding	—	—	$61	—	61
Los Banos	—	—	43	—	43
Antelope Valley	—	—	52	—	52
Barstow	—	—	56	—	56
Porterville	—	—	43	—	43
DMV	**$21**	**$42**	**—**	**$62**	**124**
Inglewood	$21	—	—	—	$21
San Francisco	—	$42	—	—	42
El Centro	—	—	—	$62	62
Totals	**$205**	**$127**	**$255**	**$62**	**$649**

[a] Includes projects proposed to be shifted from existing General Fund appropriations to lease revenue bonds in 2023-24.

[b] Includes projects now proposed for lease revenue bonds in 2023-24 for the next project phases.

[c] Includes projects now planned for lease revenue bonds for construction in the out-years.

CHP = California Highway Patrol and DMV = Department of Motor Vehicles.

Also Planning to Fund Future Construction Phases Using Lease Revenue Bonds. In addition to the proposed $332 million in lease revenue bonds in 2023-24, the Governor now also anticipates using lease revenue bonds to fund the construction phases of future projects that were previously planned to be funded after the budget year from the General Fund. For example, as shown in Figure 1, the Governor now plans to submit future proposals to fund the design-build phase of five CHP projects with a total of $255 million in lease revenue bonds in 2024-25 and the design-build phase of one DMV project with $62 million in lease revenue bonds in 2025-26. (Separate from the amounts shown in the figure for lease revenue bonds, the Governor proposes $13 million from the General Fund for the performance criteria for these six projects in 2023-24.)

In total, including all of the projects discussed above, the Governor's overall plan is to use $649 million in lease revenue bonds through 2025-26 for the construction of 13 CHP and DMV projects that the administration had previously planned for General Fund.

Assessment

Switch to Lease Revenue Bonds Is Reasonable, Given General Fund Condition. To the extent the Legislature would like to continue to support the planned replacement of CHP and DMV facilities, we think a shift to lease revenue bonds merits legislative consideration. As we discuss in a separate publication, both cash and lease revenue bonds are reasonable ways to pay for capital projects but each comes with trade-offs. Specifically, one justification for using bonds to spread the costs of capital projects out over time is that these projects are expected to provide services over many years. Also, bonds can be an important tool if insufficient funding is available to pay for the up-front costs of high-priority projects. For example, when the state has a budget problem, bonds can help fund the project while lessening potential pressure on the state to cut into existing programs. On the other hand, one benefit of using cash is that, compared to bonds, it results in a lower overall project cost because the state does not have to pay interest.

Administration Has Not Identified a Funding Source for the Repayment of Bonds. We estimate that the total debt service (including interest) on the $332 million in projects proposed for lease revenue bond financing in 2023-24 would be about $25 million per year for 25 years, resulting in a total cumulative cost of over $600 million. The administration indicates that it has not yet determined which source of funding—whether MVA or General Fund—would be used to make these debt service payments. Either way, municipal bond investors will view the General Fund as ultimately backing the bonds and would include the lease revenue bonds as part of the state's debt portfolio in their assessment of the state's overall creditworthiness.

Using Either MVA or General Fund for Repayments Would Raise Issues for Legislative Consideration. Having clarity about what fund source would be used to support debt service payments on the lease revenue bonds is important. This is not only because the fund source is a key component of any proposal, but also because, in this case, the two potential options for fund sources for repayments—the MVA and General Fund—both have important implications. These include the following:

- ***Using MVA Would Strain Fund, Raise Pressure to Address Fund Condition.*** We think the MVA is generally the most appropriate fund source to support CHP's and DMV's core operating costs, such as facility costs. This is because both departments provide services that primarily benefit motorists, and thus motorists should generally bear their associated costs. However, under current projections, the MVA cannot support its existing commitments in the out-years without corrective actions to improve its condition. Adding additional commitments to the fund—such as the $25 million in annual debt service for current proposed projects and additional debt service for forthcoming projects—would accelerate the fund's anticipated insolvency and necessitate legislative action to address the fund condition somewhat sooner than would otherwise be the case. As we discussed in previous publications, such as our February 2020 report, *The 2020-21 Budget: Transportation*, the Legislature has various options to address the condition of the MVA.

For example, it could reduce spending from the fund. Alternatively, it could raise one or more of the fees—such as vehicle registration and/or driver's license fees—that support the fund. (For reference, we estimate that roughly $35 million in additional revenue could be generated annually from a $1 increase in the base vehicle registration, and roughly $6 million from a $1 increase in the driver's license fee.) As we discuss in a recent report, *The 2023-24 Budget: Proposed Reauthorization of AB 8 Vehicle Fees*, the Governor is requesting that the Legislature reauthorize a set of expiring vehicle fees (known as "AB 8" fees) and continue using them for the clean transportation programs they currently support. The Legislature could opt to extend those fees but instead direct their revenues to support the MVA, CHP, and DMV. None of these available options for addressing the MVA's fund condition is without trade-offs.

- ***General Fund Would Be a Notable Change in Approach.*** Occasionally but infrequently, the General Fund has been used for CHP and DMV on a one-time basis when it had surpluses and could support up-front facility costs. However, using the General Fund for debt service would mean providing ongoing General Fund to support CHP's and DMV's facilities. This approach would raise important questions about deviating from the past practice of applying the "user pays" principle to these departments by having general taxpayers pay for a portion of their core activities on an ongoing basis. While non-drivers may benefit from some of CHP's and DMV's services, this proposal does not include an analytical justification tying the level of payment to an assessment of the broad-based benefits the departments provide. Moreover, using the General Fund for ongoing debt service payments would also put some incremental pressure on the General Fund, which is projected to face out-year deficits under both the Governor's and our office's projections.

Recommendations

Weigh Trade-Offs Regarding Whether to Finance Projects and Fund Sources. We recommend the Legislature weigh the trade-offs associated with using up-front cash versus lease revenue bonds for CHP and DMV projects, such as the resulting implications for the timing and level of costs. Additionally, to the extent the Legislature would like to use lease revenue bonds for these projects, we recommend it carefully weigh the trade-offs involved in the fund sources for debt service payments on the bonds. For example, as we discuss above, while we think the MVA is generally the most appropriate source of funding to support CHP's and DMV's core operations—including their ongoing area office and field office costs—relying on it to pay debt service would precipitate the need to take near-term actions to address the condition of the fund. Ultimately, the source of funding to use for the debt service is an important policy choice for the Legislature.

Specify Fund Source for Repayments. Whatever the Legislature chooses as a fund source for debt service payments, making this intent clear now is important given the implications of both available options. Accordingly, we recommend the Legislature provide clear direction to the administration regarding which source of funds to use for debt service. The Legislature could provide this direction in various ways, such as through provisional language in the budget act or intent language included in budget trailer legislation.

LAO PUBLICATIONS

This report was prepared by Helen Kerstein, and reviewed by Rachel Ehlers and Anthony Simbol. The Legislative Analyst's Office (LAO) is a nonpartisan office that provides fiscal and policy information and advice to the Legislature.

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