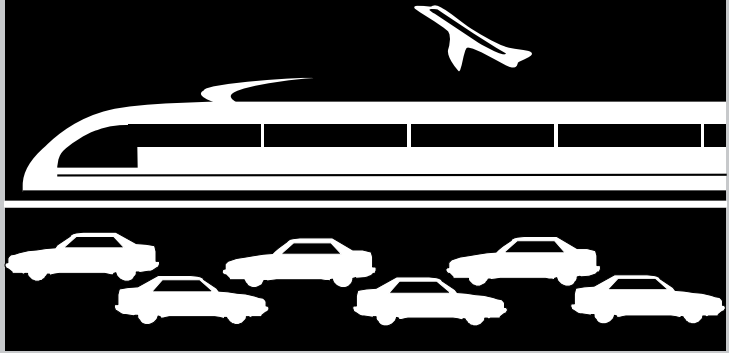


TRANSPORTATION



LAO 
65 YEARS OF SERVICE

2006-07 Analysis

MAJOR ISSUES

Transportation



Governor's Proposals Boost Short-Term Funding

- The budget proposes to fully fund Proposition 42 and repay early \$920 million of a previous suspension. The budget also assumes that \$1 billion in tribal gaming bond revenues will be received. If fully realized, many pending projects will be able to start to “catch up” on prior-year delays. The funding increase, however, would not provide for additional transportation projects beyond what has already been scheduled for delivery. (See page A-24).



Administration Has Failed to Demonstrate Projects' Congestion Benefits

- The general obligation bonds proposed in the Governor's Strategic Growth Plan would provide a one-time infusion of \$12 billion for additional transportation projects.
- The Governor's plan would allocate these funds in a way that is not consistent with the current, well-established process of selecting projects.
- The administration has not provided basic information necessary to assess the merit of these proposed projects. Accordingly, we recommend that the Legislature not approve the Governor's bond proposals until the administration provides the requested information. (See page A-31).



Firewalling Proposition 42 Comes With a Big Downside

- The Governor's proposal to firewall Proposition 42 would increase the long-term stability of state transportation funding, but it would come at the expense of removing a budget balancing tool.

- Instead, we recommend that Proposition 42 be repealed and that the gas tax be increased correspondingly to generate an equivalent amount of funds for transportation. We also recommend that the tax be indexed to inflation to prevent the erosion of the revenue over time relative to road use. (See page A-38).



Revenue Bond Would Crowd Out Highway Maintenance and Rehabilitation

- The Governor proposes to use state gas tax and weight fee revenues to pay debt service on a future revenue bond. Without additional revenues, this would reduce the funding for ongoing highway maintenance and rehabilitation. We recommend that the Legislature reject the proposal absent additional revenues being provided to back the bonds. (See page A-33).



Not Clear if Enhanced Radio System Supports Interoperability

- The CHP proposes to modernize its public safety radio system over five years, at a cost of \$491 million. This would improve communications among CHP officers. How it improves communications with other public safety agencies is not clear. We recommend that the Director of the Office of Emergency Services report on the extent the proposal supports the state's goal of interoperability and whether the proposal would hinder or complicate future development of other radio communications systems. (See page A-52).



Costs of Complying With Federal Real ID Act Will Be Significant

- The DMV will have to update its aging computing infrastructure, as well as hire and train staff to handle additional workload in order to meet the requirements of the federal Real ID Act by mid-2008. We recommend the department report on anticipated workload requirements to implement the act, how it plans to meet these requirements, and the potential costs related to the act's implementation. (See page A-63).

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OVERVIEW

Transportation

The Governor's budget shows total state-funded expenditures for transportation programs to be higher, by 6 percent, in 2006-07 than estimated current-year expenditures. The increase is primarily from higher state-funded expenditures by the Department of Transportation for state and local capital outlay improvements, and additional support for the California Highway Patrol. The higher level of transportation capital outlay expenditures proposed for the budget year is due in part to the partial, early repayment of a loan in 2006-07.

The budget does not reflect any expenditures that would occur in 2006-07 if \$6 billion in general obligation bond funds for transportation are approved in 2006, as proposed as part of the Governor's ten-year Strategic Growth Plan.

EXPENDITURE PROPOSAL AND TRENDS

Budget Proposal. The budget shows total expenditures of about \$10.2 billion from all state funds for transportation programs and departments under the Business, Transportation and Housing Agency in 2006-07. This is an increase of \$582 million, or 6 percent, over estimated expenditures in the current year. The major components of the increase include:

- \$333 million in additional capital expenditures for highways and public transportation improvements.
- \$117 million in additional support for the California Highway Patrol (CHP).
- \$56 million in additional support for the Department of Motor Vehicles (DMV).
- \$35 million in additional funding for the State Transit Assistance (STA) program.

The increase in transportation capital expenditures proposed for the budget year is in part due to the proposed early repayment of a loan to transportation. In 2004-05, the transfer of gasoline sales tax revenue from the General Fund to transportation as required by Proposition 42 was suspended. The suspended amount was to be repaid in 2007-08 with interest. The budget proposes to repay a portion (\$920 million) of the loan in 2006-07, thereby allowing for higher capital expenditures.

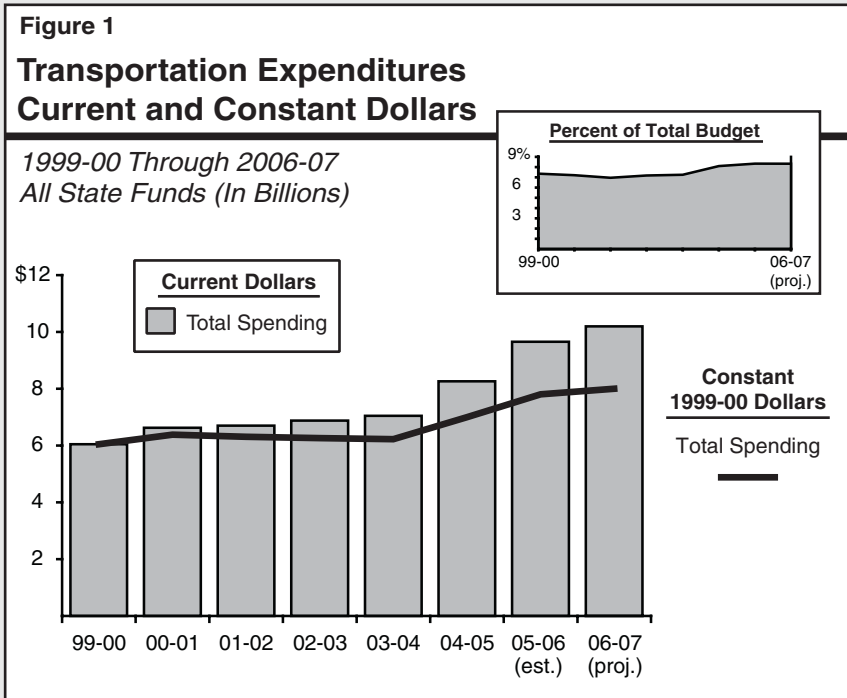
The budget-year increase will likely be substantially higher when compared to actual current-year expenditures. This is because the budget assumes \$1 billion in tribal gaming bond money to fund transportation projects in the current year. However, due to pending lawsuits, it does not appear that the bond funds will be available in 2005-06. Rather, the Department of Finance now expects the bond funds to be available in 2006-07. In that case, expenditures originally expected for the current year would be shifted to the budget year.

Also, as part of the budget, the Governor is proposing a Strategic Growth Plan, a ten-year funding plan for various state infrastructure. Among other things, the plan calls for \$6 billion in general obligation bonds for transportation to be authorized by voters in 2006. The proposed bond funds would be used for various improvements on the state highway system and intercity rail service. To the extent the proposed bond measure is approved and projects are ready to use the bond funding, expenditures of the bond funds could further increase total state transportation expenditures in 2006-07 beyond what is currently reflected in the Governor's budget.

Historical Trends. Figure 1 shows total state-funded transportation expenditures from 1999-00 through 2006-07. As the figure shows, over the period, these expenditures are projected to increase by \$4 billion, or 66 percent. This represents an average annual increase of 7.8 percent. Figure 1 also displays the spending for transportation programs adjusted for inflation (constant dollars). On this basis, expenditures are estimated to increase by 32 percent from 1999-00 through 2006-07, at an average annual rate of 4 percent.

As Figure 1 shows, state-funded transportation expenditures increased slightly from 1999-00 to 2000-01 and stayed relatively constant from then through 2003-04. Since 2003-04, state-funded expenditures on transportation have increased significantly and are proposed to continue to do so into 2006-07. This expenditure trend is driven by a combination of factors. First, state-funded expenditures by the Department of Transportation (Caltrans), which represent about 60 percent of all state-funded transportation expenditures, stayed relatively constant from 1999-00 through 2003-04 and increased steadily from then on. The increase in the current and budget

years is primarily due to the full funding of Proposition 42 gasoline sales tax for transportation. In contrast, Proposition 42 transfers were partially suspended in 2003-04 and fully suspended in 2004-05. Additionally, as mentioned earlier, the budget assumes expenditures of \$1 billion in tribal gaming bond funds to occur in the current year. This amount of expenditures was initially anticipated for 2004-05.



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). The statutory change was made in order that all transportation expenditures are reflected in the Governor’s budget on a consistent basis to facilitate comparison of expenditure trends from year to year. 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.

A second program driving expenditure growth is the CHP. Specifically, CHP's expenditures grew by almost 65 percent from 1999-00 through 2005-06, or at an average annual rate of 8.7 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 an 8.6 percent increase in CHP expenditures in 2006-07 over the 2005-06 level, mainly for additional patrol officers and other staff, as well as to replace and enhance the department's radio equipment.

Compared to CHP and Caltrans, growth in state-funded expenditures for DMV has been modest. From 1999-00 through 2005-06, expenditures grew by 25 percent. The growth was mainly to accommodate higher employee compensation costs and to implement various statutes. The budget proposes a 7.3 percent increase in 2006-07 over the current-year level for cost increases and for implementation of a vehicle registration suspension program.

As a share of total state expenditures, Figure 1 also shows that transportation expenditures have remained relatively stable between 1999-00 and 2004-05, accounting for about 7 percent of all state expenditures. In 2005-06, transportation expenditures are estimated to account for a larger proportion—about 8.3 percent—of all state-funded expenditures, and are proposed to remain at the same proportion for 2006-07.

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 \$11.5 billion in 2006-07—a reduction of almost \$900 million, or 7.2 percent, below estimated current-year expenditures. The decrease is primarily due to two major one-time expenditures anticipated to occur in the current year. However, as we note below, both of the one-time expenditures are likely to slip from the current year to the budget year. Consequently, the budget likely overstates expenditures for the current year and understates expenditures for the budget year.

First, the current-year budget assumes a \$1 billion in tribal gaming bond funds will be available for transportation projects. However, due to litigation it seems unlikely that these funds arrive in the current year, and instead will be shifted to the budget year.

Figure 2
Transportation Budget Summary
Selected Funding Sources

2004-05 Through 2006-07
(Dollars in Millions)

	Actual 2004-05	Estimated 2005-06	Proposed 2006-07	Change From 2005-06	
				Amount	Percent
Department of Transportation					
General Fund	—	\$1,345.1	\$2,326.3	\$981.2	72.9%
Other state funds	\$5,149.9	4,827.1	3,891.5	-935.6	-19.4
Federal funds	2,487.6	3,362.9	3,547.9	185.0	5.5
Bond funds	12.4	57.8	22.2	-35.6	-61.6
Other	637.9	2,847.7	1,753.9	-1,093.8	-38.4
Totals	\$8,287.8	\$12,440.6	\$11,541.8	-\$898.8	-7.2%
California Highway Patrol					
Motor Vehicle Account	\$1,228.3	\$1,286.9	\$1,409.2	\$122.3	9.5%
State Highway Account	49.6	52.6	52.6	—	—
Other	88.2	111.6	113.0	1.4	1.3
Totals	\$1,366.1	\$1,451.1	\$1,574.8	\$123.7	8.5%
Department of Motor Vehicles					
Motor Vehicle Account	\$398.2	\$412.5	\$439.3	\$26.8	6.5%
Vehicle License Fee Account	284.7	297.8	316.6	18.8	6.3
State Highway Account	38.7	39.9	42.9	3.0	7.5
Other	17.3	20.3	19.1	-1.2	-5.9
Totals	\$738.9	\$770.5	\$817.9	\$47.4	6.2%
State Transit Assistance					
Public Transportation Account	\$117.4	\$200.7	\$235.0	\$34.3	17.1%

Second, the budget assumes \$1.8 billion in reimbursed expenditures for the construction of the self-anchored suspension (SAS) portion of the San Francisco-Oakland Bay Bridge as part of the east span replacement. However, due to the recent extension of the contract bidding period for the project, expenditures for the contract may slide into 2006-07.

The budget proposes significantly higher General Fund expenditures for transportation in 2006-07. The amount includes (1) the transfer of

\$1.4 billion in Proposition 42 gasoline sales tax revenues to transportation, and (2) \$920 million in partial repayment of a loan made to the General Fund that is due in 2007-08.

CHP and DMV. Spending for CHP is proposed at \$1.6 billion—\$124 million, or 8.5 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 expenditure is mainly due to various price increases, in addition to proposals to begin replacing and upgrading its radio system, and to hire additional patrol staff as well as staff to handle wireless 911 calls.

For DMV, the budget proposes expenditures of \$818 million—\$47 million, or 6.2 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 primarily to various price increases and expenditures to implement a vehicle registration suspension program and to replace the department's fee payment system.

Transit Assistance. Annual funding for the STA program is determined based on a statutory formula, and the level varies depending on anticipated revenues in the Public Transportation Account. For 2006-07, the budget proposes to fund the program at \$235 million, which is \$34 million, or 17 percent, higher than the current-year level.

MAJOR BUDGET CHANGES

Figure 3 highlights the major changes proposed for 2006-07 in various transportation programs.

Caltrans. The budget proposes an increase of \$775 million in local assistance for highway improvement and mass transportation in 2006-07 over the current-year level. The increase is mainly due to higher anticipated funding available from the proposed early repayment of a loan due in 2007-08 and from federal sources. The budget also shows a huge drop in highway capital outlay expenditures in 2006-07 below the current year level. However, as indicated in the previous section, this is due to the current-year assumptions of very high expenditures of tribal gaming bond funds and the awarding of a contract for the SAS portion of the Bay Bridge replacement.

CHP and DMV. The budget proposes to expand and enhance the CHP's staffing and operations. Specifically, the budget proposes to increase patrol officers and their support by 233 positions to handle increasing workload and to provide additional proactive road patrol. The budget is also request-

ing to add about 170 positions to handle wireless 911 calls. In addition, the CHP also proposes \$57 million to begin a five-year project (with an estimated total cost of \$491 million) to replace and upgrade its radio system in order to improve operability and to improve its connectivity to other state and local law enforcement agencies.

Figure 3

Transportation Programs Proposed Major Changes for 2006-07

Department of Transportation	Requested: \$11.5 Billion
	Decrease: \$898.8 Million (-7.2%)

- + \$775 million in local assistance expenditures.
 - + \$4 million for two information technology projects.
-
- \$1.3 billion highway capital outlay.

California Highway Patrol	Requested: \$1.6 Billion
	Increase: \$123.7 Million (+8.5%)

- + \$57 million to replace and enhance radio system.
- + \$34 million for 233 additional officers and support staff.
- + \$6 million for 89 additional staff to handle 911 calls.

Department of Motor Vehicles	Requested: \$817.9 Million
	Increase: \$47.4 Million (+6.2%)

- + \$9.3 million to implement a vehicle registration suspension program.
- + \$5.4 million to replace a fee payment system.
- + \$2.6 million to relocate seven field offices.

Regarding DMV, the budget proposes about \$9 million to contract with a private vendor to implement a vehicle registration suspension program. Chapter 920, Statutes of 2004 (SB 1500, Speier), requires that such a program be effective by October 2006. The department also proposes to replace its functionally obsolete system that handles mailed-in fee remittances.

CROSSCUTTING ISSUES

Transportation

FUNDING FOR TRANSPORTATION PROGRAMS

In recent years, transportation funding has been both constrained and uncertain due to various factors including the use of transportation funds to help the General Fund. The 2006-07 Governor's Budget proposes to reverse this trend. Specifically, it proposes to fully fund Proposition 42 and partially repay a previous loan of transportation funds to the General Fund. In addition, as part of his Strategic Growth Plan, the Governor proposes to provide \$12 billion in general obligation bond funding and \$14 billion in revenue bond funding for state transportation over the next ten years. Furthermore, he proposes to permanently firewall Proposition 42 funds after 2006-07 by prohibiting suspension of the transfer from the General Fund.

In aggregate, these proposals would provide additional investment in transportation over the next decade and make the funding more predictable. The Governor's proposed methods for project selection and fund allocation, however, stray from established processes and lack detail in how bond funds would contribute to congestion relief. Accordingly, we highlight a number of policy issues that the Legislature should consider.

California's state transportation programs are funded by a variety of sources, including special funds and federal funds. 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 is funded through revenues from an 18 cent per gallon excise tax on gasoline and diesel fuel (generally referred to as

the gas tax), in addition to weight fees. The PTA is funded by sales tax on diesel fuel and a portion of the sales tax on gasoline.

Additionally, in 2000, the Legislature enacted the Traffic Congestion Relief Program (TCRP), which created a six-year funding plan for state and local transportation needs. Later statutes have delayed much of the funding for this program, so that funding for TCRP projects now extends through 2007-08. The program is funded by two sources—the Traffic Congestion Relief Fund (TCRF) and the Transportation Investment Fund (TIF)—from a combination of General Fund revenues (one-time) and ongoing revenues from the sales tax on gasoline. In March 2002, voters passed Proposition 42, which permanently extended the transfer of gasoline sales tax revenues to the TIF and dedicated the funds to various transportation programs. These programs include local street and road improvements, the State Transportation Improvement Program (STIP), State Transit Assistance, and other mass transportation activities.

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

The TCRP. The TCRP is the second major project construction program. It mainly consists of 141 statutorily-defined projects located throughout the state, with each project receiving a specified amount of money. Collectively, these projects are to receive about \$4.9 billion through 2007-08 from the General Fund and sales tax on gasoline. Through 2005-06 they will have received about \$2.4 billion. (This amount assumes \$1 billion in tribal gaming bond funds arrive in the current year which, as discussed later, is not likely to occur until the budget year.) Because TCRP does not provide full funding for all of the projects, many of them are funded from multiple sources, including STIP money.

In addition to funding specified projects, TCRP provides funding for STIP projects, local street and road improvements, and mass transportation programs. Including all of these purposes, TCRP was to provide a total of \$7.8 billion to transportation by 2005-06. Because of loans to the General Fund and Proposition 42 suspensions, TCRP will have only received \$3.4 billion through 2005-06. (This amount again assumes \$1 billion in tribal gaming bond funds arrive in the current year.)

Funds Redirected. In the past five years, funds designated for transportation have annually been redirected to help the General Fund. The repeated diversion of transportation funds has led to delay and additional costs in many STIP and TCRP projects.

In the following sections, we discuss the condition of transportation funding in the current year, describe the Governor's proposals for transportation funding in 2006-07 and later years, and discuss the implications of these proposals for transportation funding in both the near and the long term.

FUNDING CONDITION IMPROVED SUBSTANTIALLY IN CURRENT YEAR

A year ago, in our review of the 2005-06 *Governor's Budget*, we noted that transportation funding in California faced substantial uncertainties in four major areas. These included:

- The Governor's budget proposed to suspend the Proposition 42 transfer of funds to transportation.
- The receipt of tribal gaming proceeds to repay past-year loans to transportation was uncertain.
- The future demand on state funds to complete the toll bridge seismic retrofit program was unknown.
- Congress had not yet reauthorized federal funding for transportation.

Funding Outlook Has Significantly Improved. Since then, the state transportation funding picture has improved significantly. First, the adopted 2005-06 budget provides the full amount of Proposition 42 money to transportation. Second, legislation was enacted in July 2005 to address the long-term funding for the seismic retrofit of toll bridges. Third, in August 2005, the federal government reauthorized a multiyear transportation funding act. Together, these actions have increased the total funding level for state transportation programs and substantially reduced the uncertainties regarding future funding levels.

Bay Bridge Funding Settled; Demand on State Funds Certain

Legislation adopted in 2005 provided an additional \$3.6 billion in funding for the completion of the toll bridge seismic retrofit program, and specified that any excess costs above the amount provided would be borne by the Bay Area Toll Authority. This provides certainty that

any excess costs for the program would not create an additional burden on future state transportation funding.

Chapter 71, Statutes of 2005 (AB 144, Hancock), provided \$3.6 billion in additional funding to complete the state toll bridge seismic retrofit program, including the replacement of the east span of the San Francisco-Oakland Bay Bridge. Figure 1 summarizes the major provisions of Chapter 71. Together with previously committed funding, the added funds represent a total funding commitment of \$8.7 billion for the program. The funding provided by Chapter 71 will come mostly from new toll and bonding authorization, as well as from redirection of other transportation funds. Chapter 71 also specified that any future cost overruns would be paid by the Bay Area Toll Authority through raising bridge tolls or issuing bonds. As a result, if costs for the program exceed \$8.7 billion, there would be no additional draw from state transportation funds. Thus, Chapter 71 reduces the uncertainty of future demands on state funds.

Figure 1

**Funding of Toll Bridge Seismic Retrofit Program
Key Provisions of Chapter 71, Statutes of 2005
(AB 144, Hancock)**

- ✓ **Identifies \$3.6 Billion in Additional Funding**
 - No less than \$2.15 billion paid by the Bay Area Toll Authority (BATA) from revenues derived from a new \$1 toll dedicated to seismic projects authorized to begin January 1, 2007.
 - No less than \$820 million paid by BATA from revenues derived from refinancing debt on all other toll bridge revenues.
 - \$300 million from the State Highway Operation and Protection Program or state resources gained from project savings or federal funds from the Highway Bridges Rehabilitation Program.
 - \$330 million in transfers from the State Highway Account, Public Transportation Account, and Motor Vehicle Account.
- ✓ **Savings Shared by State.** If future project costs are less than the \$3.6 billion identified, savings would be credited to the above mentioned accounts in proportion to contribution (with exception of the \$820 million provided by BATA from toll revenue refinancing).
- ✓ **Future Cost Overruns Borne by BATA.** If future project costs exceed \$3.6 billion, BATA will pay by charging additional tolls and/or issuing bonds.

New Federal Transportation Act Provides Funding Through 2009

The new federal act will provide \$23.4 billion to California through 2009, including \$18 billion for highways, \$5 billion for transit, and \$452 million for safety. The new act also presents opportunities for financing transportation through nontraditional sources and expediting project delivery.

There are a number of issues for the Legislature to consider and areas where further legislative actions are warranted to facilitate implementation of the act in California. These issues and our recommendations for legislative actions are detailed in our January 2006 report regarding the new federal act.

Key Features of the Federal Act. The federal government enacted the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU) in August 2005. It provides federal funding for transportation through 2009. Figure 2 (see next page) summarizes the key provisions of SAFETEA-LU. The act authorizes \$241 billion nationwide for transportation between 2005 and 2009. This represents a 42 percent increase in average annual funding over the previous program, the Transportation Equity Act for the 21st Century (TEA-21). The general structure of SAFETEA-LU is relatively similar to TEA-21. The act also guarantees “donor” states such as California a minimum rate of return on state fuel tax contributions annually, with the rate increasing from 90.5 percent in 2006 to 92 percent in 2009. Additionally, the act includes a number of provisions that influence the way that transportation facilities are planned, built, and administered. Specifically, SAFETEA-LU encourages private investments and partnerships in constructing transportation facilities, in addition to providing opportunities for environmental streamlining, design-build contracting, and private toll projects.

Funding to the State. Figure 3 (see page A-21) lists California’s funding authorization by purpose. The new federal act will provide \$23.4 billion to California through 2009, including about \$18 billion for highways, \$5 billion for transit, and \$452 million for safety improvements. Funding for highways accounts for 76 percent of all funding allocated to California, with formula grant programs comprising the majority (\$15 billion) of highway funding. The remaining \$2.4 billion in the state’s highway allocation will come from earmarked funding (from discretionary programs).

California will receive about \$5 billion for transit purposes. This amount includes approximately \$3.9 billion in formula grant programs and \$1.3 billion earmarked in discretionary grants. The transit funding level represents 22 percent of California’s total transportation funding allocation under SAFETEA-LU. This share, however, could increase as the

state applies for and receives additional funding for transit projects from discretionary programs like High Priority Bus and New Starts.

Figure 2

The Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users

Major Provisions

General:

- Maintains overall structure of previous federal transportation act (TEA-21), but increases emphasis on safety.
- Continues TEA-21's flexibility allowing up to 50 percent of most program formula funds to be redirected.

Funding Nationwide:

- Provides 42 percent increase in average annual funding over TEA-21. Authorization of \$241 billion for fiscal years 2005 through 2009 includes \$190 billion for highways, \$45 billion for transit, and \$5.7 billion for safety enhancements.
- Earmarks over \$26 billion worth of congressionally specified projects, including \$14.8 billion for High Priority Projects and \$1.8 billion for Projects of National and Regional Significance.

Highways:

- Guarantees "donor states" a minimum of 90.5 percent return on state fuel tax contributions in 2005 and 2006, 91.5 percent in 2007, and 92.0 percent in 2008 and 2009.
- Provides incentives for private sector participation in construction of major transportation facilities.
- Pilots include: federal delegation of environmental review responsibilities to states and toll programs on interstate highways.

Transit:

- Most discretionary funds remain available for competitive project applications.
- Provides capital funding for smaller transit projects requiring less than \$75 million in federal funds.

Funding for safety improvement programs accounts for a relatively small portion of the state's total authorization. The majority of California's federal safety funds will flow through the Highway Safety Improvement and Safe Routes to School programs.

High Level of Earmarks. While formula funds provide the most flexible source of funding for addressing state priorities, these funds experienced only modest growth over TEA-21 levels. However, earmarked funds to the state are substantially higher under SAFETEA-LU. Specifically, \$3.7 billion

(16 percent) of California's authorization are earmarked for more than 500 specific projects. This more than quadruples the total amount of earmarked funds received by the state (\$877 million) under TEA-21.

Figure 3
SAFETEA-LU
Authorized Funding for California

(In Billions)

	Formula	Earmarks	Totals
Highway	\$15.4	\$2.4	\$17.8
Transit	3.9	1.3	5.2
Safety	0.4	—	0.4
Totals	\$19.7	\$3.7	\$23.4

Many Earmarks Provide Partial Funding for Large Projects. About two-thirds (\$2.5 billion) of the state's earmarked funds are associated with large highway, transit, and goods movement projects. The act authorizes funding of \$20 million or more for each of 24 projects around the state. However, in few cases do the earmarked amounts cover the full project costs. As such, state and local agencies must identify substantial additional funding from other sources to fully cover project costs. For example, the \$130 million earmarked for carpool lanes on I-405 does not come close to meeting full project costs, which recently were estimated to exceed \$500 million.

State Has Little Discretion in Use of Earmarked Funds. While earmarked funds infuse the state with federal dollars, these grants are not very flexible. Specifically, the state has little discretion to transfer earmarked funds to other projects that it may deem to have higher priority. In cases where earmarked funds are for projects that are a high statewide priority this lack of flexibility may be less of an issue. Some earmarks, however, are tied to projects less crucial from the state's perspective. If an earmarked project is not a state priority, dedicating state funding to fully pay for the project would limit the state's ability to address higher priority demands.

Need to Assess How Earmarks Align With Priorities, Resources. In order to utilize California's allotment of earmarked funds, significant additional funding must be made available. While many of the earmarked projects are high in statewide priority, others may not be so. Providing all

of the additional resources to fully fund earmarked projects could potentially skew the state's priorities, resulting in state funds being directed to lower priority projects.

To address this issue, we recommend the enactment of legislation that directs CTC, in cooperation with Caltrans and local transportation agencies, to estimate the remaining funds required to fully finance the state's earmarked projects. Additionally, CTC should provide an assessment of which earmarked projects rank higher in state priorities and which earmarks rank lower. With this information, the state would be able to make better decisions regarding the allocation of state funds to supplement the earmarked projects.

(For more detailed information about SAFETEA-LU, please see our report *Funding of Transportation: What the New Federal Act Means for California*, January 19, 2006, which is reprinted in "Part V" of our companion volume, *The 2006-07 Budget: Perspectives and Issues*.)

2006-07 BUDGET PROPOSALS

The 2006-07 Governor's Budget includes a number of proposals related to transportation funding, which in aggregate, would result in significantly higher levels of transportation funding in 2006-07 than in recent years. Specifically, the budget proposes the following:

- Transfer to transportation the full amount required by Proposition 42. For the budget year, this amount is projected to be \$1.4 billion.
- Repay early a portion—\$920 million (including principal and interest)—of a loan due in 2007-08 from the General Fund.
- No "spillover" for the PTA as required by existing law.
- Transfer \$9.3 million in non-Article XIX revenue in the SHA to the General Fund.

The Governor's budget assumes \$1 billion in tribal gaming bond revenues to be available in the current year for transportation.

Proposition 42 to Be Fully Funded in 2006-07. The budget proposes to transfer \$1.4 billion of gasoline sales tax revenues to the TIF, the full amount required under Proposition 42. Of these funds, \$678 million will be available to fund construction of TCRP projects, \$146 million will be allocated to the PTA for public transportation, and \$582 million will be used for STIP projects. Consistent with current law for the budget year, none of the revenues will be allocated for local streets and road purposes.

Early Repayment of Previous Suspension. In 2004-05, due to the state's fiscal condition, the entire Proposition 42 transfer was suspended. The suspended amount of about \$1.3 billion must be repaid with interest by 2007-08. The Governor's budget proposes to repay early a portion of the loan—\$920 million (principal and interest)—in the budget year. The balance, approximately \$430 million (including interest), would be repaid in 2007-08.

Early Repayment Not Guaranteed. According to Caltrans staff, the timing of the \$920 million in repayment of the 2004-05 suspension depends on the fiscal health of the General Fund and therefore may not occur until late in 2006-07. To the extent that this repayment occurs before 2007-08 (as was originally scheduled), it would provide a jump start for stalled STIP and TCRP projects, as well as delayed improvements on local streets and roads. However, if these funds arrive late in the budget year or are delayed to 2007-08, they will provide less timely assistance to these projects.

No Spillover Revenues for Public Transportation in 2006-07. Current law provides that, in years in which revenue from the state's sales tax on gasoline is relatively high and revenue from the sales tax on all other goods is relatively low, some of the gasoline sales tax revenue that would otherwise go to the General Fund is to be transferred to the PTA for mainly rail and transit uses. This is known as spillover.

In recent years, due to the state's fiscal condition, spillover revenues have often been retained in the General Fund. From 2003-04 through 2005-06, a total of \$735 million in spillover to the PTA was suspended. For 2006-07, current law requires that the first \$200 million of spillover be retained in the General Fund with the next \$125 million used to fund the toll bridge seismic retrofit program. Any remaining spillover revenues (in excess of \$325 million) would then be available for public transportation. The Governor's budget projects spillover revenue to be less than \$325 million in 2006-07. Accordingly, the Governor's budget proposes no spillover for rail and transit uses.

Tribal Gaming Bond Revenue Will Likely Be Delayed to 2006-07; Availability Still Uncertain. To aid the state's fiscal condition, a total of about \$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 tribal gaming revenues.

Due to pending lawsuits, the state did not issue tribal gaming bonds in 2004-05. Instead, the sale of the bonds was assumed to occur in the current year. The current-year budget also reduced the amount of the loan to be repaid by bond revenues to \$1 billion. The Governor's budget assumes that \$1 billion in bond revenues would be available in 2005-06. However,

there is currently one pending lawsuit with the potential to further delay the issuance of the bonds and another case is being appealed. On this basis, the Department of Finance recently indicated that the funding would most likely not be available until 2006-07. If these funds materialize in 2006-07, total transportation funding for the budget year would be correspondingly higher.

Delay in Tribal Gaming Bond Proceeds Could Adversely Impact TCRP Project Delivery. Failure to generate \$1 billion in tribal gaming bond revenue in 2006-07, however, would cause major delays to TCRP projects. This is because \$290 million of the bond funds are designated for TCRP projects, which is roughly 20 percent of the proposed funding for these projects in 2006-07. In addition, current law requires TCRF to repay SHA, by the end of 2006-07, \$465 million for a past loan. If TCRF does not receive tribal gaming bond funds in 2006-07, the repayment to SHA would have to come from Proposition 42 resources (\$678 million) allocated to TCRF in 2006-07 or from its proposed share (\$410 million) of the 2004-05 suspension repayment. To the extent that neither the 2004-05 suspension repayment nor the tribal gaming bond revenues materialize in the budget year, funding for TCRP projects would be significantly lower than what is proposed in the 2006-07 budget.

Budget Proposes Transportation Funds for General Fund Use. The Governor is also proposing to transfer to the General Fund \$9.3 million in SHA revenues that are not restricted by Article XIX of the State Constitution. The amount includes mainly income from rental property and revenue from the sale of documents. Similar transfers have been made in past years to aid the General Fund.

Budget Proposals Boost Short-Term Funding

If all of the transportation funding proposed for 2006-07 materializes, it would enable many transportation projects to proceed, and begin to "catch up" on prior-year delays. The funding increase, however, would not provide any additional transportation projects beyond what has already been scheduled for delivery.

If the proposed early repayment of the 2004-05 Proposition 42 loan materializes, together with the full transfer of Proposition 42 funds in 2006-07, a substantial amount of transportation capital projects would be able to be funded sooner than expected. Many of these projects have been delayed repeatedly as transportation funds were loaned to the General Fund. As Figure 4 shows, the proposals combined would provide about \$1.1 billion for TCRP projects, \$837 million for STIP projects, \$146 million for public transportation, and \$255 million for local streets and road improvements.

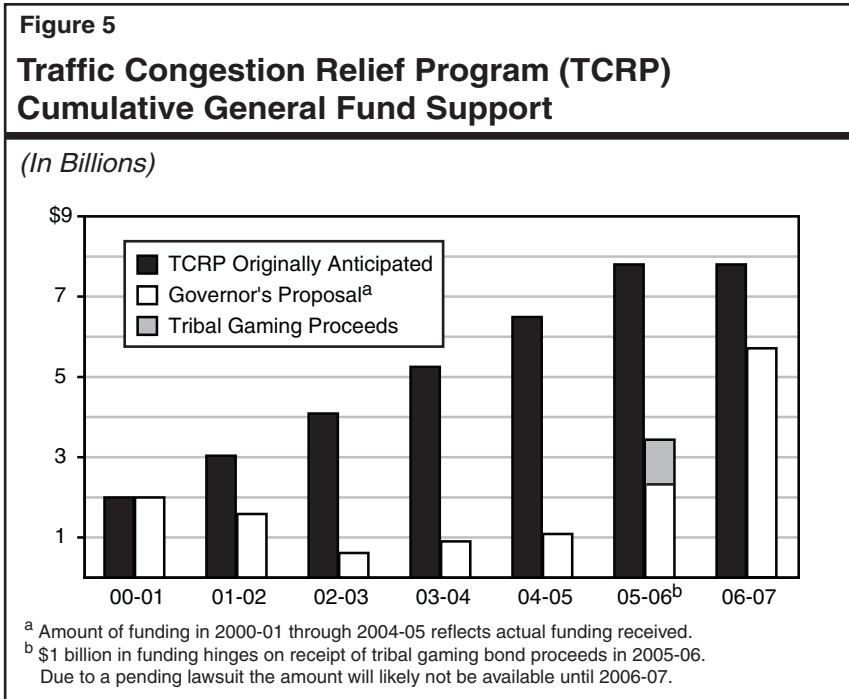
Figure 4**Governor's Budget Proposal
Allocation of Proposition 42 Funds and Loan Repayment***2006-07
(In Millions)*

	Proposition 42	Loan Repayment	Totals
Traffic Congestion Relief Program	\$678	\$410	\$1,088
State Transportation Improvement Program	582	255	837
Public Transportation Account	146	—	146
Local streets and roads	—	255	255
Totals	\$1,406	\$920	\$2,326

The budget proposals are of particular significance for the progress of TCRP. As Figure 5 shows (see next page), lack of funding in prior years has set the program far behind the originally anticipated funding level. Assuming further delays in the availability of tribal gaming bond revenues in 2005-06, the program will have received slightly more than one-fourth of the total funding intended for the program by the end of the current year. As regards 2006-07, if the Governor's budget proposal materializes with full funding of the Proposition 42 transfer, early partial repayment of the suspension and receipt of tribal gaming proceeds, then cumulative funding for TCRP would be much closer to the amount that was originally anticipated, as shown in Figure 5. (However, as we indicated earlier, there is still some uncertainty as to whether these funds would be available in the budget year.)

The budget year proposals would also have a positive impact on the STIP. Specifically, the proposed funding levels would allow CTC to allocate funds for STIP projects that have been programmed but up until now have not received funding.

While a number of projects can proceed due to the substantial funding level proposed for 2006-07, it is important to note that the funding would allow only a "catching up" of prior-year delays in the state's transportation programs. This is because there is still about \$1.4 billion in loans yet to be repaid to fund various transportation projects, even if \$1 billion in tribal gaming bond revenues and the partial 2004-05 suspension repayment materialize in the budget year.



Allocation of Proposed Loan Repayment Does Not Align With Statute

Current law specifies how any repayment of the 2004-05 Proposition 42 suspension will be allocated among various transportation programs. The Governor proposes to allocate the \$920 million early repayment in a different manner. We recommend that Caltrans and the California Transportation Commission report at budget hearings on how the programmatic impacts of the proposed allocation would differ from the allocation required under current law.

The Governor's proposed early repayment of \$920 million for the 2004-05 Proposition 42 suspension, if received, would help advance many TCRP and STIP projects, as well as local street and road improvements. The proposed allocation of the \$920 million, however, is not consistent with the repayment requirement set forth in current law. Chapter 212, Statutes of 2004 (SB 1098, Committee on Budget and Fiscal Review), requires that repayment of the 2004-05 suspension, regardless of the fiscal year in which it is made, be allocated in the same manner as funds would have been allocated had the suspension not occurred. This means that rather than receiving \$410 million (as proposed in the budget), the TCRF should receive the first \$720 million (principal plus interest) out of the \$920 mil-

lion in repayment. According to Chapter 212, the remaining funds would be allocated as follows: 40 percent to local streets and roads, 40 percent to STIP and 20 percent to PTA. Figure 6 displays how the \$920 million would be distributed in accordance with Chapter 212 compared to the allocation proposed in the Governor's budget. As the figure shows, the Governor's proposed allocation would provide a lower funding level for TCRP projects and PTA than required by Chapter 212, but provides significantly higher funding levels for STIP projects and local streets and roads.

Figure 6
Early Repayment of 2004-05 Proposition 42 Suspension

(In Millions)

	Chapter 212 ^a	Governor's Proposal
Traffic Congestion Relief Program	\$720	\$410
Local streets and roads	80	255
State Transportation Improvement Program	80	255
Public Transportation Account	40	—
Totals	\$920	\$920

^a Figures include principal and interest.

The Department of Finance indicates that the proposed allocation reflects a policy decision by the administration and it will propose trailer legislation to effectuate this policy change. In order that the Legislature can assess whether the proposed allocation is warranted, we recommend that the department and CTC report at budget hearings on the programmatic impacts of the proposed allocation on STIP and TCRP projects compared to the impacts that would result under Chapter 212.

STRATEGIC GROWTH PLAN

In addition to the various transportation funding proposals specific to the 2006-07 budget, the Governor is proposing a Strategic Growth Plan (SGP) that lays out a ten-year funding plan totaling \$223 billion to improve state infrastructure, including \$107 billion for transportation in particular. In this section, we discuss the key funding features of the transportation component of the plan.

Key Elements for Transportation

Ten Year Funding to Come From a Mix of Existing and New Sources, Including Bonds. The Governor proposes funding to include the following:

- \$47 billion in existing transportation funding sources such as state gas tax and weight fee revenues, the Proposition 42 transfer and federal funds.
- \$48 billion in new funding including private investments, future local sales tax revenues for transportation, and bonds backed by future state and federal transportation funds. Specifically, the Governor proposes \$14 billion in bonds to be backed by future state gas tax and weight fee revenues.
- \$12 billion in general obligation (GO) bonds, including \$6 billion each to be authorized by voters in 2006 and November 2008 elections.

Bond Funding Focuses on State Highway System. A significant element of the SGP for transportation is the proposed use of GO bonds for transportation. Figure 7 summarizes the proposed allocation of \$12 billion in GO bonds over ten years. As the figure shows, most of the GO bond money would be for improvements on the state highway system and the state intercity rail services.

Figure 7	
Proposed Allocation of \$12 Billion General Obligation Bonds	
<i>(In Millions)</i>	
	Amount
"Performance" improvement projects on state highways	\$5,600
Port mitigation/trade and goods movement matching grants	4,000
State Highway Operations and Preservation Program	1,500
Intercity rail improvements, bicycle, and pedestrian facilities	700
Intelligent transportation systems	200
Total	\$12,000

The bond funds would not be allocated according to the current STIP fund allocation process, where 25 percent of funding is used for interregional improvement and 75 percent for regional improvements.

Instead, the Governor proposes that most of the bond funds be allocated to projects proposed by the Business, Transportation and Housing Agency and Caltrans. The plan would allow for project changes only if specified conditions are met.

Significant Reliance on Future Revenue Bonds. The SGP also calls for the issuance of \$14 billion in revenue bonds backed by future state gas tax and weight fee revenues. Beginning in 2015 and continuing for 30 years, 25 percent of these revenues—up to \$1.025 billion per year—would be set aside to pay debt service on these bonds. As with the proposed GO bonds, allocation of these revenue bond funds would not be subject to the current statutory STIP allocation process. Instead, the bond funds would be allocated to projects proposed primarily by the Business, Transportation and Housing Agency and Caltrans. The plan would allow for project changes only if specified conditions are met.

Permanently Firewall Proposition 42 for Transportation. As part of the SGP, the Governor is proposing to amend the State Constitution to delete the authority to suspend the Proposition 42 transfer after 2006-07. This would ensure future transfer of gasoline sales tax revenues to transportation.

Other Provisions. The SGP also calls for:

- Authorizing public-private partnerships whereby the state enters into long-term lease agreements with the private sector for the latter to construct, operate, and maintain transportation facilities over an extended period of years. The SGP proposes to use \$4 billion in GO bond money to leverage about \$14 billion in private investments through these partnerships.
- Authorizing Caltrans and local transportation agencies to use design-build to deliver capital projects.

IMPLICATIONS OF STRATEGIC GROWTH PLAN ON LONG-TERM STATE TRANSPORTATION FUNDING

In general, the Governor's proposals to provide bond funds to transportation over the next ten years and to firewall Proposition 42 would provide the state transportation system with both increased investment and funding stability. These proposals, in conjunction with the passage of SAFETEA-LU and resolution of the state's role in financing the toll bridge seismic retrofit program, would significantly improve California's transportation funding picture relative to past years. Nonetheless, the Legislature should consider a number of issues in assessing the Governor's

proposals and their impact on the state's transportation program over the long term.

Bonds Provide One-Time Funding Increase

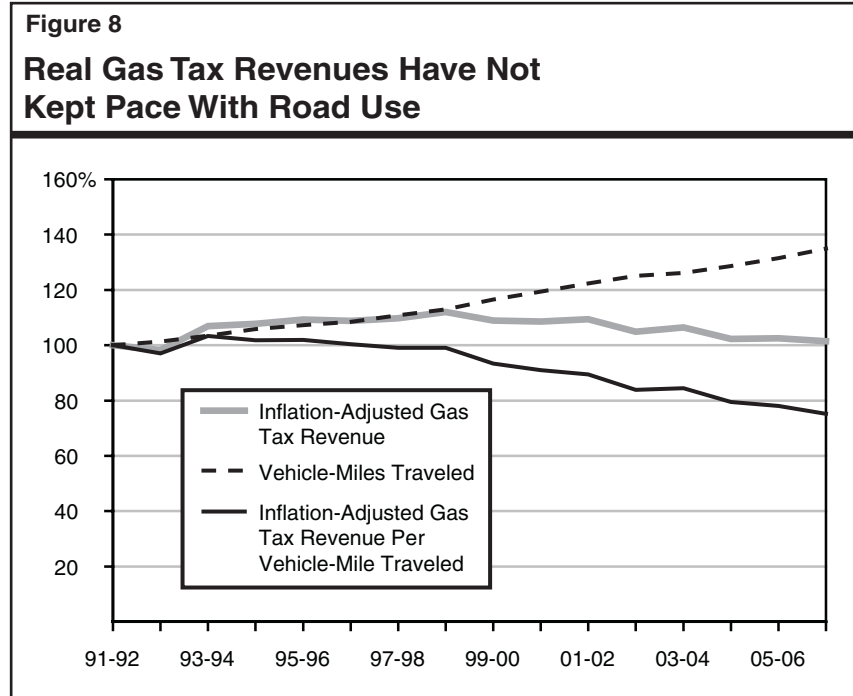
The California Transportation Commission has identified substantial unfunded transportation demands throughout the state, and most have not yet been addressed. The proposed general obligation bonds would provide a one-time infusion of funding to transportation. How effectively this additional funding would address the state's transportation priorities, however, depends on the types of projects funded.

Gas Tax Revenues Have Not Kept Pace With Increasing Travel. The number of miles traveled on California roads has steadily increased over the past 15 years. As Figure 8 indicates, vehicle-miles traveled on all California roads are projected to increase 35 percent between 1991-92 and 2006-07. However, gas excise tax revenues, a major source of transportation funding in the state, have not kept pace with this trend. Figure 8 shows that this tax roughly kept pace with miles traveled through much of the 1990s, as the tax was gradually increased in that period from 9 cents to 18 cents per gallon. From 1998-99 through 2006-07, however, inflation-adjusted state gas tax revenues are projected to decline 8 percent while vehicle-miles traveled increase by more than 16 percent. (Gas tax rates are not adjusted for inflation. As a result, inflation erodes the purchasing power of the revenues over time.)

As Funding Has Declined, Demands Remain High. In 1999, as required by SR 8 (Burton), CTC produced a ten-year assessment of the funding requirements of the state's transportation system. The resulting report identified over \$100 billion in *unfunded* transportation needs over the following decade. The TCRP and annual Proposition 42 funding would have addressed a portion of these demands, but to date they have not provided significant additional funding to do so. While the SR 8 study has not been updated since 1999, the annual redirections of transportation funding to other uses combined with the declining value of the gas excise tax suggest that the state still faces large, unfunded transportation demands, likely of the magnitude identified in the SR 8 report.

Bonds Would Provide Additional Funds to Address Demands; Efficacy Depends on Types of Projects Funded. Providing \$12 billion in GO bonds would substantially increase the state's level of investment in transportation infrastructure over the next ten years. Nonetheless, how effectively the one-time bond funds address the state's transportation priorities ultimately depends on how the money is targeted and the types of projects that are funded. These decisions have not yet been made. At

the time this analysis was prepared, the administration had proposed a “working list” of projects that it maintains are targeted to reduce congestion and improve throughput on the state highway system. These projects focus mainly on improvements to the interregional segments of the state highway system and the intercity rail system.



Administration Has Failed to Demonstrate Projects’ Congestion Benefits

The Strategic Growth Plan proposes a major infusion of state funds into a list of projects selected exclusively by the administration. So far, it has not provided the Legislature with basic information necessary to assess the merit of these proposals. Accordingly, we recommend that the Legislature not approve the Governor’s bond proposals until the administration provides the requested information.

Instead of allocating the proposed \$12 billion GO bond funds in accordance with the current STIP process, the SGP would infuse \$12 billion in GO bond funds into a list of projects proposed exclusively by the administration. (The Business, Transportation and Housing Agency and Caltrans will select the projects to receive bond funds. The Environmental

Protection Agency will provide input on a subset of these projects.) While many of the projects proposed for bond funding undoubtedly are of high priority, the administration has failed to provide essential information that is necessary to assess the merits of the projects, including information regarding the congestion benefits that would be realized through these investments. Specifically, we have asked the administration to provide the following information, but to date have received no response:

- The total cost of each project in the proposed list and the proportion of total project costs that would be funded through the bond funds. This would allow an assessment of how much, if any, additional funding would be needed to fully pay for the proposed projects.
- How well the proposed projects align with currently programmed STIP and TCRP projects, as well as high priority earmarks in SAFETEA-LU. The state has already programmed many projects in the STIP for the next five years, and it has also committed to funding 141 TCRP projects. Many of these projects do not yet have full funding. Thus, additional resources will be needed to complete them. Similarly, the federal act has earmarked a significant amount of federal dollars to provide partial funding to many projects statewide. To the extent the projects proposed for the bond funds result in providing full funding for projects that are of high statewide priority, the impact on mobility and congestion could be significant. Otherwise, the effect on congestion and mobility would be less noticeable.
- The estimated amount of congestion relief to be achieved by each proposed project and how the department estimated the congestion reduction effect. This information would allow a relative ranking of the proposed projects based on how well each project is expected to reduce congestion. The information would also facilitate a comparison of the proposed projects with other improvements that are not on the proposed list in terms of their relative impact on congestion reduction.
- The current state of development for each of these projects and the estimated project delivery date. This information would provide an indication as to when the bond funds would be used, as well as when projects can be expected to be completed. To the extent the proposed projects have been defined and scoped, delivery of the projects could be sooner than if the projects are not yet defined.

In order to assess whether the proposed bond funds would be used effectively, the Legislature needs to receive the above information. Without this information, it is impossible to determine how the proposed

projects rank in reducing congestion relative to other improvements, such as enhancements to commuter rail systems, as well as improvements on regional segments of state highways and principal arterials. Accordingly, we recommend that the Legislature not approve the Governor's bond proposals until the administration provides this information.

Revenue Bonds Would Negatively Impact Future Highway Maintenance and Rehabilitation

The proposal to use state gas tax and weight fee revenues to pay debt service on future revenue bonds would reduce the amount of funding available for highway maintenance and rehabilitation. Providing adequate funding for these activities would necessitate either an increase in the gas tax or weight fees in the future, or a redirection of Proposition 42 funds to these activities. We recommend that the Legislature reject this proposal absent additional revenues being provided to back these bonds.

Gas Tax Mostly Funds Highway Maintenance. Currently, state gas tax and weight fee revenues are used mostly for highway maintenance and to fund projects in the State Highway Operation and Protection Program (SHOPP), which include rehabilitation and safety improvement projects. (Projects that expand transportation capacity are generally funded with gas sales tax revenues, federal funds and other nonstate sources.) These revenues are the only source of state funding available for highway maintenance. This is because federal funds generally are not available for maintenance purposes, nor are Proposition 42 funds. While SHOPP projects can be funded with federal funds (when matched with state funds), Proposition 42 funding is not statutorily available for this purpose.

Modest Growth in Gas Tax Revenue. As noted above, growth in state gas tax revenue has not kept pace with inflation. This revenue stream grows with increases in the consumption of gasoline and diesel. In past years, the growth has been relatively modest, at around 2 percent a year. In the long run, as the consumption of alternative fuel increases, growth in the state gas tax revenue could be even slower. However, given an aging transportation system, highway maintenance and rehabilitation requirements will increase over time, and in all likelihood will outpace the revenue growth. For instance, Caltrans issued a five-year maintenance plan in January 2005 which showed that annual expenditures on the roadway, drainage, and bridge component of the highway system would have to more than double the current level (from \$147 million to \$397 million a year) in order to address the maintenance backlog for these facilities.

Governor's Proposal Squeezes Highway Maintenance and Rehabilitation. Beginning in 2015 and continuing for 30 years, the Governor's proposal would take "off the top" up to \$1.025 billion a year from state gas tax and weight fee revenues for debt service on the revenue bonds he proposes. Our review shows that given the relatively modest revenue stream and growth in maintenance and rehabilitation needs, this would leave inadequate state funds for these activities. Maintaining the current level of funding for highway maintenance and rehabilitation after 2015 while paying the debt service on the proposed revenue bonds would necessitate an increase in future state gas tax or weight fees. Alternatively, a portion of future Proposition 42 funding could be redirected to these purposes. This would require a change in the Proposition 42 formula which currently allocates funds to the STIP, PTA, as well as local streets and road improvements. (This would require a vote by the electorate to make Proposition 42 funds available for this purpose.) Absent these actions, the state would fall short of maintaining and preserving the current highway system.

Using Revenue Bonds for Transportation Has Merit; but Should Not Crowd Out Essential Functions. As we discuss in a later section, bonding provides an appropriate means to finance capital investment under certain circumstances. Using revenue bonds for transportation has merit particularly where the revenue used to back the bonds are generated from user fees such as gas tax and weight fees. This is because these fees provide users a clear signal of the costs of the facilities being funded. However, the use of the bonds should not crowd out other essential services that are funded by the same revenues. Accordingly, we recommend that the Legislature reject the Governor's proposal unless a new stream of user fee revenues is provided for the debt service payments of these bonds.

Proposal Improves Transportation Funding Stability; But Removes a Tool to Close the State's Budget Gap

Transportation funding has been highly uncertain for several reasons, including uncertain annual Proposition 42 commitments and repayment of prior year loans made from transportation. The Governor's proposal would improve the predictability of transportation funds by guaranteeing future Proposition 42 transfers. However, this removes a tool to close the state's budget gap.

Uncertain Funding Delays Projects, Causes Waste. Large transportation projects tend to be funded from multiple sources, making them particularly vulnerable to funding fluctuations. If expected funding does not materialize, a project may have to be cancelled or delayed. Funding

fluctuations in recent years have delayed and increased construction costs for many STIP and TCRP projects. (Please see our write-up on this issue in the *Analysis of the 2004-05 Budget Bill*, page A-33.)

In addition, some funding sources are contingent on other funding sources remaining in place. For example, much of the federal transportation funding provided in SAFETEA-LU requires additional funds from nonfederal sources to cover full project costs. If these additional funds do not materialize, federal funds are lost. Thus, a project's funding is only as stable as its least predictable source.

Funding for State Transportation Capital Projects Relies Heavily on Proposition 42 Money. State gas tax and weight fee revenues provide the largest source of ongoing state funding for transportation. However, these revenues are mostly dedicated to highway maintenance and rehabilitation. State funding for capital improvements that expand the capacity of the state's transportation system (such as adding traffic lanes, constructing new highways, and expanding rail services) relies mainly on the availability of Proposition 42 funds. The CTC estimates that for the 2006 STIP period (2006-07 through 2010-11), additional new projects can be programmed for funding only if Proposition 42 funds are forthcoming for the entire five-year period and past transportation loans are repaid in full. Without these funds, there would be no resources to fund additional projects, over and above the ones that have already been scheduled for funding through 2008-09 (in the 2004 STIP).

Guaranteeing Proposition 42 Transfers Improves Funding Predictability; Removes Budget Balancing Tool. Currently, the state can suspend partially or fully the Proposition 42 transfer when the Governor and the Legislature agree that making the transfer "will result in a significant negative fiscal impact on the range of functions of government funded by the General Fund." This provides the state with the flexibility to redirect Proposition 42 funding to other nontransportation priorities in times of tight fiscal conditions, such as the state has experienced in the past few years. However, this also creates uncertainty regarding the availability of Proposition 42 funds for transportation from year to year.

The Governor's proposal to eliminate the suspension authority would make Proposition 42 funding a certainty. This would allow for better long-term capital planning; allow projects to be programmed on a steady, even-flow basis from year to year; reduce project delays and costs; and lessen Caltrans staffing fluctuations. However, eliminating that suspension provision would also remove a tool the state could use as it continues to confront budgetary imbalance.

Analyst's Assessment of Governor's Proposals

The Governor's Strategic Growth Plan would provide an increase in funding for transportation and make ongoing state support for transportation more certain. However, the administration has not provided information to justify its proposed use of general obligation bond funds. Furthermore, its proposal to improve transportation funding stability would adversely impact the state's ability to address tight fiscal conditions.

Figure 9 summarizes our assessment of the Governor's proposals in his Strategic Growth Plan. As we discussed, these proposals have certain merits. Specifically, the SGP would provide a significant increase in one-time funding for transportation in the form of GO bonds. Additionally, the SGP would improve funding predictability by guaranteeing the Proposition 42 transfer of gasoline sales tax revenue to transportation.

Figure 9

Strategic Growth Plan

LAO Assessment of Transportation Proposal

- ✓ General obligation (GO) bond funds provide one-time infusion to transportation.
- ✓ Revenue bonds without new revenue source would crowd out ongoing highway maintenance and rehabilitation projects.
- ✓ Allocation of both GO and revenue bond funds stray from current State Transportation Improvement Program process.
- ✓ Administration has not provided basic information to assess the merits of the transportation projects that it has proposed to be funded with GO bonds.
- ✓ Firewalling Proposition 42 provides long-term transportation funding stability, but removes a state budget balancing tool.

However, the Governor's proposals also raise fiscal and policy concerns. The projects funded by SGP bond funds would be selected outside of the STIP process. This means that regional transportation planning agencies would have little influence over which projects get funded. Projects would be selected primarily by the Business, Transportation and Housing Agency and Caltrans, based on criteria to be determined by the

administration. In addition, the Governor proposes \$14 billion in revenue bonds to be issued in 2015 that would be backed by existing gas tax and weight fee revenues. Absent an increase in the gas tax or weight fee revenues, this bond could crowd out highway maintenance and rehabilitation. Lastly, while the Governor's firewall of Proposition 42 revenues would make transportation funding more stable, it would reduce the flexibility of the state in the event of tight fiscal conditions.

LEGISLATURE SHOULD ASSESS FUNDING REQUIREMENTS; ENHANCE FUNDING STABILITY

In assessing the Governor's proposal, the Legislature should consider two primary issues. First, should additional funding be provided to transportation? Second, how should transportation funding be stabilized while providing the state with maximum fiscal flexibility?

Long-Range Funding Requirement Should Be Assessed

The state does not currently have an up-to-date assessment of its transportation needs. Therefore we recommend that the Legislature direct the California Transportation Commission, working with Caltrans and regional agencies, to (1) estimate the amount needed to complete currently programmed projects in the state's transportation programs and federal-earmarked projects which are high in state priority, and (2) provide an updated assessment of what the state's needs are beyond what projects have already been programmed. We further recommend that project selection for bond funding not occur until this study is complete.

Transportation Demands Exceed Recent Funding Levels. As noted earlier, CTC identified in 1999 roughly \$100 billion in unfunded statewide transportation demands over a ten-year period. Despite the enactment of TCRP and Proposition 42, there has not been a significant increase in transportation funding since 2000, due mainly to the redirection of transportation funds to other uses. As a result, numerous projects designated in the TCRP and programmed in the STIP and SHOPP await funding. For the 2006 STIP period, funding for new projects would be available only if Proposition 42 funds are available annually over the next five years and all past loans are repaid. In addition, the reauthorization of the federal transportation program included over 500 earmarks to projects in California; however, the vast majority of these earmarks do not cover full project costs. If the state chooses to maximize its use of the earmarked federal funds, it may have to provide part of the funding necessary to cover full

project costs. All of these demands suggest that additional funding for transportation is warranted.

To determine how much funding the state should provide, we recommend that the Legislature direct CTC, working with Caltrans and the regional agencies to do the following:

- Estimate (1) the total costs of all programmed STIP and TCRP projects, as well as the earmarked projects in SAFETEA-LU, and (2) the unfunded portion of the costs associated with these projects. This together with an identification of the priorities of SAFETEA-LU earmarked projects (as we have recommended in the report on the federal act) would provide a rough estimate of how much funding in total would be needed to complete programmed STIP and TCRP projects.
- Provide a current assessment of what the state's needs are beyond what have already been scheduled for funding. The updated assessment should also identify the areas (such as goods movement and trade corridors) where the state may need additional investment. This assessment should be based on long-range transportation plans that have been prepared for various regions as well as Caltrans' long-range plan for interregional transportation.

The above information would allow the Legislature to determine what the state's priorities should be and the total funding that the state should provide over the next decade to meet these priorities. We recommend that the Legislature not allow any GO bond funds to be programmed until such a study is available. This recommendation would not, in any way, delay voter consideration of bond funds for transportation, it would merely ensure that the bond funds be targeted and programmed to meet the highest identified needs.

How Should Stable Funding Be Provided?

We recommend that the state rely on user fees to provide ongoing funding for transportation. To provide the state with the greatest fiscal flexibility while ensuring a stable source of ongoing transportation funding, we continue to recommend that Proposition 42 be repealed and the state gas tax be increased correspondingly and indexed for inflation. Other user fees such as tolls should also be considered. The state should also encourage private and local investments.

User Fees Should Be the Basis of Transportation Funding. Transportation spending has traditionally been funded from user fees. The primary transportation user fee in California is the state's 18 cent per gallon excise tax on gasoline and diesel fuel. The tax is charged to drivers only, in rough

proportion to the amount of driving they do. Thus, it approximates a fee charged for the provision of roads used by the driver. User fees provide a clear signal to road users of the cost of the service they receive, and users can respond to this signal and adjust their driving patterns accordingly. In this regard, direct tolls for road use are even closer to a user fee for driving than the gas tax.

As we indicated in past analyses (please see *2004-05 Analysis*, page A-36), we think the state gas tax should be relied upon to generate the bulk of state transportation funding. This is because in addition to being roughly a user fee, the tax has other qualities that make it a preferred source for transportation funding. These include:

- ***Simple to Collect.*** Collection of the gas tax is relatively efficient. Drivers are not inconvenienced, as they pay the tax whenever they stop for fuel. Collection at the state level is simple as well, as the state collects the tax directly from fuel distributors, which are few in number.
- ***Economically Efficient.*** Gas taxes can also result in greater economic efficiency by encouraging a lower level of fuel consumption. Gas usage results in “external” costs (such as pollution and congestion), and an excise tax results in a higher price that reflects these additional social costs. This in turn can have the effect of decreasing gasoline consumption to a more acceptable level.
- ***Constitutional Restriction Provides Predictability of Funding Availability.*** Article XIX of the State Constitution restricts the use of the state gas tax (and weight fee) revenues to specified transportation purposes only. Thus, it provides a predictable stream of funding for the purposes of long-term capital planning.

Recommend Repeal of Proposition 42 and Increase in State Gas Tax. The Governor’s proposal to firewall Proposition 42 would increase the long-term stability of state transportation funding, but would reduce the state’s overall fiscal flexibility. For more than 25 years, beginning in 1973, sales tax collections on gasoline were a General Fund revenue used to support general government purposes—principally education, health, and social services. In 2000, during good economic times, the Legislature directed this revenue source to instead meet transportation priorities for a limited period of time (through 2007-08). This change was made permanent by the voters in 2002 with the provision that funds could remain in the General Fund under specified conditions.

As discussed in “Part I” of our companion volume, the *2006-07 Budget: Perspectives and Issues* the state continues to face multibillion dollar shortfalls between spending and revenues under the Governor’s proposed

policies throughout the forecast period. In order for the state to get and keep its fiscal house in order, we believe the Legislature needs all budget tools at its disposal, we therefore recommend, as we have in prior analyses, the repeal of Proposition 42 and raising the state gas tax correspondingly to generate an equivalent amount of funds for transportation. An increase of about 8 cents per gallon would generate the amount of Proposition 42 funding projected for 2006-07. We further recommend that the tax be indexed to inflation to prevent erosion of the revenue over time relative to road use.

Pay-As-You-Go or Bonding. The state has, for the most part, funded transportation infrastructure improvements through annual appropriations of taxes and fees using a pay-as-you-go approach. This approach limits annual expenditures to available resources generated each year and provides for a relatively steady level of capital improvements from year to year.

However, if the state wants to increase transportation investments significantly for a specific period of time, bonding provides a means to generate upfront the large amount of funds necessary for the capital improvements. Bonding for capital improvements is also appropriate because these improvements and facilities typically provide services over many years, thus different generations of taxpayers will benefit from the facilities. There are two major types of bonds that usually apply to transportation projects:

- ***General Obligation Bonds.*** The \$12 billion included in the Governor's proposals for transportation are GO bonds. These bonds are supported by the General Fund. While they add new resources to transportation, the cost of debt service is borne by all taxpayers and not exclusively by those who use transportation facilities and services.
- ***Revenue Bonds.*** The Governor's proposed \$14 billion revenue bonds would fall into this category. These bonds are backed by a dedicated stream of revenue. For transportation, the revenue generally comes from user fees such as the gas tax and weight fees. However, as discussed earlier, the Governor's proposed revenue bonds would crowd out future funding for ongoing highway maintenance and rehabilitation. Providing adequate funding for these essential expenditures would necessitate future gas tax and weight fee increases.

Other Nonstate Funding of Transportation Should Be Encouraged. The state could provide incentives for other entities, including local governments and the private sector to invest in transportation.

- **Local Funding.** Many counties already have local sales tax measures with revenues dedicated to fund transportation. Because the benefits of transportation investments are felt most at the local level, the state may want to encourage more local investment in the transportation system. The state could provide matching grants to further induce the use of local funds particularly for high priority transportation improvements. An example of such an approach is the State-Local Transportation Partnership Program created in 1989 which provided matching funds for certain locally funded transportation projects.
- **Private Investment.** Public-private partnerships provide a means to generate private investment in the construction of transportation facilities. These partnerships often take the form of a state or local government entering into a lease arrangement with a private entity to design, construct, maintain, and operate a facility for an extended period of time. The federal act, SAFETEA-LU, includes provisions to encourage private sector investments in transportation. The Governor's SGP includes a proposal to authorize the state to enter into such lease agreements with local entities or the private sector for up to 99 years.

Current state law does not authorize Caltrans to engage in additional public-private partnerships. As a result, Caltrans' experience with these partnerships is limited to two pilot projects authorized under Chapter 107, Statutes of 1989 (AB 680, Baker). Nonetheless, there may be merit to allowing Caltrans to engage in public-private partnerships, as it could attract much needed investment in the state's transportation infrastructure. It should be noted, that private investment may work well in specific types of projects, such as truck lanes and toll facilities, but has limited potential for widespread use as many state projects might not generate an adequate return on investment to entice the private sector.

CONCLUSION

The funding outlook for transportation looks brighter in 2006-07 than in prior years. The Governor's 2006-07 budget proposals, as well as his Strategic Growth Plan, add to this outlook by increasing the investment in the state's transportation system and proposing to make funding more reliable by guaranteeing the Proposition 42 transfer. However, as we have discussed, the Governor's proposed methods for providing these funds raise a number of fiscal and policy concerns. Specifically, the Governor's plan would allocate state funds in a way that is not consistent with the

current STIP process. Additionally, to date, the administration had failed to provide the Legislature with adequate information to assess the merit of these proposals.

Given that both the Legislature and the Governor have expressed a common interest in improving California's transportation infrastructure, we have presented a list of issues for the Legislature to consider when developing a strategic infrastructure investment plan. First, we recommend that the state reassess its transportation funding requirement. While this task was performed in the late 1990s, transportation demands such as goods movement and trade corridors might have moved up in state priority since then. Secondly, there are a number of ways that the Legislature could fund transportation infrastructure improvements. While we continue to recommend that the Legislature ask voters to repeal Proposition 42 and replace the funding with a gasoline excise tax that is indexed to inflation, we recognize that infrastructure can be financed through a number of other methods. In addition to GO and revenue bonding, we have highlighted the possible roles of local government and the private sector in funding transportation infrastructure.

DEPARTMENTAL ISSUES

Transportation

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 travel modes and Administration encompasses management of the department.

The budget proposes total expenditures of \$12 billion by Caltrans in 2006-07. This is \$899 million, or 7 percent, less than estimated current-year expenditures. This decrease is explained in large part by unusually high estimated capital outlay expenditures in the current year, which assume that the Bay Bridge self-anchored suspension contract will be awarded before July 2006. The department's proposed staffing level of 21,863 personnel in 2006-07 is similar to the current year. About \$3.7 billion (32 percent) of Caltrans' total support will come from the State Highway Account, \$3.5 billion (31 percent) from federal funds, and \$2.3 billion (20 percent) from the Proposition 42 transfer and early repayment of a previous suspension. The remaining support will be funded from reimbursements, as well as from the Traffic Congestion Relief Fund and various smaller transportation accounts.

Insurance Pilot Includes Too Many Projects, Estimated Savings Uncertain

Caltrans requests \$1.4 million to contract with an insurance broker to procure coverage for contractors on 82 construction projects over three years. The department anticipates that this would result in substantial savings in construction costs. The requested amount only reflects the cost of program administration and does not include other related costs, such as insurance premiums, which we estimate would be at least \$100 million over the pilot's three-year period.

Due to the state's very limited experience with the proposed type of insurance arrangement, we think that the pilot should be scaled down to involve fewer projects. Accordingly, we recommend the adoption of budget bill language to limit the scope of the pilot project.

Construction Contractors Must Provide Insurance Coverage. Currently, contractors and subcontractors bidding on construction contracts of transportation projects must have insurance for exposures such as liability and workers' compensation. The cost of insurance is included in the cost of a contractor's bid, and eventually becomes part of the cost of the contract that Caltrans pays. The department estimates that currently about 4 percent of the cost of construction for a project is attributable to insurance costs.

Department Proposes Pilot to Reduce Construction Costs. The department requests \$1.4 million in the budget year to begin implementing an Owner Controlled Insurance Program (OCIP) pilot over three years. This pilot would purchase a single insurance policy to cover all contractors that work on 82 capital outlay projects anticipated to begin construction over the next three years. The requested amount would cover the budget-year cost of retaining a consultant (most likely an insurance broker) to acquire the insurance policy. The proposal, however, does not account for other costs, including the insurance premium, which we estimate would be at least \$100 million to insure all 82 projects. According to Caltrans, the insurance premium would be paid from each project's construction budget.

The department used two criteria to select the 82 projects to be included in the pilot: (1) the project is planned to begin construction over the next three years and (2) estimated project construction costs are in excess of \$25 million each. In total, the projects proposed to be included in the OCIP would have a combined value of \$5.5 billion.

Department's Estimates for Cost Savings Predicated on a Number of Factors. By covering insurance costs through an OCIP, rather than each contractor carrying its own individual insurance policy, Caltrans estimates that it can save between \$40 million and \$65 million over the three-year

period. The department estimates these savings based on several factors. First, Caltrans assumes it could negotiate lower insurance premiums than individual contractors because the department (1) would be buying in bulk, (2) could enforce stricter safety standards, and (3) could assume a high deductible. In addition, Caltrans estimates that it would receive a rebate on the policy if it can achieve a favorable loss record for all the work covered by the policy. Currently, contractors who buy the insurance receive a rebate when they maintain a low loss record, that is, when claims for loss are low.

Savings Estimates Problematic. Our review shows that the cost savings that could be realized through an OCIP are much more uncertain than Caltrans indicates. Specifically, while the department may be able to negotiate a lower insurance premium than individual contractors would pay collectively on these projects, the pilot includes annual administration costs (\$1.4 million in 2006-07) that Caltrans previously has not faced. Furthermore, in order to achieve a lower premium, Caltrans must directly, or indirectly through a contracted insurance administrator, enforce safety standards and provide contractors with training on safe work practices. Again, this is a cost that the state has never had to assume.

In addition, Caltrans' assumption that the state would accept a high deductible means that in the event of a claim, the state would have to pay some level of cost before the insurance would pick up the tab. Currently, Caltrans does not have to pay any costs when a contractor files an insurance claim.

Furthermore, the department estimates that 35 percent of the savings (\$15 million to \$20 million) will be from rebates awarded by the insurance company for projects that maintain a favorable loss record. We think this estimate may be too high. This is because when the state procures the insurance instead of the contractors, incentives for the contractors to maintain a favorable loss record are reduced. If contractors no longer face higher premiums for accidents and do not reap the benefits for a loss-free job, they would have less incentive to maintain the best possible safety record.

Proposed Pilot Too Large. To date, the state has used OCIPs for the construction of five state buildings. While OCIPs have been implemented by other states and local entities for transportation projects, we have reservations about the size of Caltrans' proposed pilot. With the exception of Boston's "Big Dig" project, the department's proposed OCIP pilot would be the largest OCIP ever attempted. We believe that the department could still learn from a pilot program with a smaller number of projects, while at the same time reducing the state's fiscal exposure.

Recommend Limiting Number of Projects in Pilot. Accordingly, we recommend the following budget bill language limiting funds in support of the OCIP pilot in 2006-07 to administration of no more than 15 projects:

Up to \$1.4 million appropriated in this item is available for support of Caltrans' Owner Controlled Insurance Program to administer insurance coverage for contractors on up to 15 projects.

Department Should Report on Success of Insurance Pilot

We think that a limited-scale pilot of Caltrans' proposed owner controlled insurance program (OCIP) is reasonable. In order to assess the program's success, we recommend that the Legislature adopt supplemental report language directing the department to report on the net costs or savings realized through the OCIP, the types of projects included in the pilot, and the amount it paid for insurance-related costs.

Recommend Supplemental Report on OCIP Pilot Experience. Before the state makes a long-term commitment to insuring contractors, we believe that further investigation is warranted to better identify the costs and benefits of implementing an OCIP. 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 the program should continue:

By April 1 of 2007, 2008, and 2009, respectively, Caltrans shall report to the Joint Legislative Budget Committee and the policy committees on transportation on the following concerning the Owner Controlled Insurance Program (OCIP):

- (1) The type and value of projects included in the pilot.
- (2) The amount that Caltrans would have paid contractors for insurance coverage in the absence of an OCIP, as identified in contractors' bid statements.
- (3) The amount the department paid in insurance premiums, deductibles, program administration, and any other OCIP-related costs incurred during the pilot.
- (4) The estimated net cost or benefit of implementing the pilot.
- (5) An assessment of the projects that were best suited for inclusion in an OCIP and the projects that were least well suited, in terms of cost effectiveness.

Governor's Plan Would Further Reduce Investment in Highway Maintenance

For 2006-07, the budget provides \$882 million for highway maintenance. This level of funding is almost identical to estimated current-year expenditures and does not address growing maintenance needs. Furthermore, the Governor's Strategic Growth Plan would further erode funding for highway maintenance in the future.

We recommend the department report at budget hearings on how it plans to maintain the state highway system without further adding to the deferred maintenance backlog.

Funding in 2006-07 Does Not Address Growing Maintenance Needs. In January 2005, Caltrans published a five-year maintenance plan which showed that maintenance expenditures on roadways, drainage, and bridges in the state highway system would have to increase by \$105 million each year to stop growth in the maintenance backlog. Furthermore, to address a long list of deferred maintenance projects within five years, annual expenditures for roadway, drainage, and bridge maintenance would have to increase by \$250 million annually. In 2006-07, funding for all aspects of highway maintenance will only increase by \$8 million over estimated current-year expenditures, to a total of \$882 million. This means that the list of deferred maintenance work on roadway, drainage and bridges will grow during the budget year.

Governor's Plan Would Lead to Future Disinvestment in Highway Maintenance. The Governor's Strategic Growth Plan proposes to divert a quarter of excise tax and weight fee revenues to debt service on revenue bonds to support non-maintenance and non-rehabilitation activities for 30 years beginning in 2015. As these revenues represent the primary funding source for highway maintenance and rehabilitation, the Governor's plan would result in the state falling further behind in the maintenance and rehabilitation of the highway system. As we indicated in our write-up on Funding for Transportation Programs (in the Crosscutting Issues section), we recommend that the Governor's revenue bond proposal (for 2012) not be adopted unless a new, dedicated stream of revenue is provided for debt service on these bonds, so that maintenance and rehabilitation expenditures would not be crowded out.

Recommendation. Accordingly, we recommend the department report at budget hearings on how it plans to maintain the state highway system without further adding to the deferred maintenance backlog.

Governor's Budget Omits Pavement Maintenance Provision

The current-year budget act includes language dedicating a specific amount of the department's major maintenance contracts to highway pavement preservation. The budget includes \$81 million for these projects in 2006-07. In order to ensure that these funds are expended for highway pavement preservation, we recommend the adoption of similar language in the 2006-07 Budget Bill.

Major Highway Maintenance Contracts Are Cost Effective. Currently, Caltrans contracts out many major pavement preservation projects. Both the department and the Federal Highway Administration estimate that this investment is very cost effective, as every one dollar spent on preventative pavement maintenance can save up to six dollars in future rehabilitation costs. Our review shows that in past years, for various reasons, Caltrans has redirected funding for these activities to other programs. To prevent this from occurring in the current year, the Budget Act included language limiting the use of funds provided for highway pavement preservation to that purpose.

Recommend Reinserting Budget Bill Language. For 2006-07, the budget proposes \$882 million for highway maintenance, including \$81 million for pavement preservation. We think that limiting the use of this amount to pavement preservation would prevent the funding from being redirected. Accordingly, we recommend similar budget bill language be adopted, as follows:

Of the funds appropriated in this item, \$81 million is for major maintenance contracts for the preservation of highway pavement and shall not be used to supplant any other funding that would have been used for major pavement maintenance.

Estimated Capital Outlay Expenditures Likely to Increase

Delays in the Bay Bridge project and in the repayment of tribal gaming bonds to the Traffic Congestion Relief Fund will move capital outlay expenditures from the current year to the budget year. Accordingly, we withhold recommendation on \$4.8 billion requested for capital outlay projects as these expenditure levels will likely be revised during the May Revision when more accurate information on the Bay Bridge and tribal gaming bonds become available.

Withhold Recommendation on Capital Outlay Expenditures. The budget proposes \$4.8 billion to fund capital outlay projects, a 20 percent decrease from estimated current-year expenditures. However, estimated expenditures for 2005-06 include \$1.9 billion related to the award of a Bay Bridge contract and various projects to be funded from tribal gam-

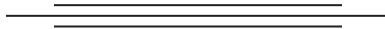
ing bond revenue. Neither of these expenditures is certain to occur in the current year. As of January 2006, the bidding period on the Bay Bridge construction contract was extended by almost two months. Given this new timeframe, it is possible that Caltrans will not award a contract until 2006-07. In addition, another lawsuit has been filed delaying the issuance of tribal gaming bonds. For a third year in a row, it is likely that the tribal gaming bond revenues will be pushed back.

Given these potential delays, the 2006-07 capital outlay expenditure level will likely be significantly higher than assumed in the January budget. Accordingly, we withhold recommendation until updated information is available in the spring.

Capital Outlay Support Request Will Be Revised

We withhold recommendation on the \$1.6 billion requested for capital outlay support staff because staffing needs will be revised during the May Revision when more accurate information on workload for the various state transportation programs becomes available.

Withhold Recommendation on Capital Outlay Support. The budget proposes \$1.6 billion to fund capital outlay support, a 7 percent decrease from estimated current-year expenditures. However, the department typically provides new estimates in the spring as a part of the May Revision. By that time, the department will have more accurate estimates regarding the amount of project development work that will be performed during 2006-07. Pending receipt of new workload estimates, we withhold recommendation on the department's capital outlay support request.



HIGH-SPEED RAIL AUTHORITY (2665)

The California High-Speed Rail Authority (HSRA) is responsible for planning and constructing an intercity high-speed rail system that is fully integrated with the state's existing mass transportation network. 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 HSRA has an executive director and three staff positions.

The authority was due to expire December 31, 2003. Chapter 696, Statutes of 2002 (SB 796, Costa), repealed the expiration date, making HSRA permanent. To provide for development and construction of the rail system, Chapter 71, Statutes of 2004 (SB 1169, Murray), authorized the sale of \$9.95 billion in general obligation bonds, \$9 billion of which would be for planning and construction of a high-speed rail segment between San Francisco and Los Angeles. Currently, the bond measure is scheduled to be placed on the November 2006 ballot.

Governor Proposes to Indefinitely Postpone High-Speed Rail Bond

As part of his Strategic Growth Plan, the Governor proposes to indefinitely postpone submitting a high-speed rail bond measure to the voters. The budget, however, provides support for the California High-Speed Rail Authority through 2006-07 irrespective of whether the rail project will continue. We recommend budget bill language limiting the availability of the support funds only to high-speed rail-related activities in 2006-07 and directing the unexpended funds to be reverted if the bond measure is permanently postponed.

The HSRA Created for a Single Purpose. The authority was created for the sole purpose of implementing an intercity high-speed rail system as an alternative to air and auto travel. For almost a decade, HSRA has planned and performed environmental studies for the development of such

a system. Since the authority's inception, it has expended about \$18 million for environmental studies and planning activities.

Governor's Proposals Would Halt High-Speed Rail Activities. As part of his Strategic Growth Plan, the Governor proposes to indefinitely postpone submitting the high-speed rail bond measure to the voters. This would essentially terminate the project. The budget, however, requests \$1.3 million to support HSRA, but does not include funding for the authority to continue environmental or other work related to the development of a rail system. Discussions with the authority indicate that if the project is to proceed, about \$1 billion would be needed in the next couple of years to move forward with the next phase of project development, which includes acquiring critical rights-of-way and completing more detailed project environmental impact reports. If the project is to be terminated, continued HSRA funding is not justified.

Recommend Making Funding for Authority Contingent on Bond Measure. Accordingly, we recommend budget bill language stating that the budget appropriation for HSRA in 2006-07 ceases if legislation is subsequently enacted that indefinitely postpones a bond measure to fund a high-speed rail system. The following language is consistent with that recommendation:

The appropriation in this item is available for support of the High-Speed Rail Authority to work exclusively on a high-speed rail system. Any unexpended portion of this appropriation shall revert upon enactment of legislation that postpones indefinitely the placement of a high-speed rail bond on the ballot.

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 10,700 positions. The department is comprised of uniformed (sworn) and nonuniformed (nonsworn) personnel, with uniformed personnel accounting for approximately 7,300 positions, or 67 percent, of total staff.

The budget proposes nearly \$1.6 billion in support for CHP in 2006-07, about \$124 million (8.5 percent) above estimated current-year expenditures. The increase is primarily related to first-year funding (\$57 million) of a multiyear radio system upgrade as well as staffing augmentations for patrol services and wireless 911 call handling (\$40 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 2006-07, MVA funds would comprise nearly 90 percent of CHP's support costs.

Enhanced Radio System Proposed to Improve Communications

The California Highway Patrol (CHP) proposes to begin in 2006-07 a five-year, \$491 million project to modernize its radio system. We concur that CHP's radio system needs improving, however, it is not

clear to what extent the proposed solution supports the state's goal for interoperability among public safety agencies. We recommend that the Director of the Office of Emergency Services, in his role as chair of the Public Safety Radio Strategic Planning Committee, report to the Legislature at budget hearings on how CHP's proposal supports the state's goal.

Background. Immediate and reliable access to information is fundamental to public safety agencies' ability to protect life and property. For CHP officers in the field, the radio system is the primary, and sometimes only, link to information and resources during both routine and emergency operations. To be effective, the system must allow officers to communicate without disruption from interference, lack of coverage, congestion, or equipment failure (collectively referred to as "operability"). In addition, the system must have the ability to communicate with other public safety agencies as needed (known as "interoperability").

The CHP's radio system consists of both mobile and fixed assets. The mobile component includes, for example, mobile and portable radios. The fixed component includes base stations (radio transmitters/receivers).

The CHP uses its radio system for department operations about 90 percent of the time. Roughly 10 percent of the system's use is to provide interoperability with other public safety agencies. The existing radio system was designed in the early 1960s and operates primarily in low band frequencies, which accommodate a wider geographic area than high band frequencies. According to a performance review conducted by the Department of Finance in 2002, most of the CHP's radio equipment is more than ten years old—beyond its useful life expectancy.

Existing Radio System Is Obsolete and Fails to Meet Department's Needs. The CHP maintains that its public safety radio equipment is obsolete and the fixed infrastructure is failing. Based on our review, we concur with the department's assessment. Documented problems include aging equipment, rising costs for maintenance and repair, and lack of functionality deemed critical by the department. For instance, officers are unable to communicate at a sufficient distance from their enforcement vehicles (the current 400 to 500 foot reach is too limiting), to broadcast over a wide area without assistance from a communications center, or to access different frequencies as needed for operability and interoperability. The department also notes deficiencies in its fixed equipment that limit dispatch capabilities.

The CHP is also experiencing problems with frequency congestion (too many users in the same frequency bands) and insufficient coverage (inability to use certain frequencies in some operational areas). To address these issues, CHP seeks a flexible system that allows officers access

to multiple frequencies using the same mobile radio unit. Such a system would improve operability, particularly with respect to coverage issues. However, congestion problems are likely to continue among all public safety radio users unless additional frequencies are made available by the Federal Communications Commission.

Previous Efforts to Implement a Statewide, Integrated System Failed. In 1994, CHP—along with nine other public safety agencies and the Department of General Services—initiated a process to build a statewide, integrated public safety radio system. After several years of planning, that effort culminated in a proposal to replace the entire state public safety radio infrastructure. Under the proposal—commonly known as the PRISM project—all state agencies would have operated in selected high frequency bands using the same type of equipment, thus facilitating direct interoperability. Plans called for a phased build-out beginning in 2001-02. However, the project did not proceed because of its high price tag (\$3.5 billion over 15 years) and the state's fiscal constraints. The CHP subsequently withdrew its participation in the project due, in part, to the projected costs to the MVA and the long implementation timeline.

Budget Proposes to Replace Radios and Selected Infrastructure. The Governor's budget proposes to modernize CHP's public safety radio system over a five-year period beginning in 2006-07. The proposal entails significant investments in new fixed and mobile equipment. Specifically, it would replace all mobile and portable radios, selected fixed radio equipment such as base stations and receivers, and upgrade other communications infrastructure. Under this proposal, CHP would continue to use its existing low frequency bands, but would possess the capability of switching to channels tuned to selected higher frequency bands as needed to achieve operability and interoperability. The success of this solution depends on the acquisition of additional low band radio frequencies and the negotiation of agreements between agencies on procedural guidelines that govern the linking and integration of systems. The proposal would mean that data (as opposed to voice) communications would continue to rely on in-vehicle computers, which are currently deployed in about 30 percent of patrol vehicles.

Five-Year Proposal Would Cost \$491 Million. The total cost of the project is estimated at \$491 million. The budget requests \$57 million for 2006-07, the first year of project implementation. The projected lifespan of the purchased equipment is approximately ten years. Thus, once the initial commitment and associated investments are made, the direction is set for at least the next decade.

Proposal Justified, but Alignment With State Direction Unclear. Our review shows that improving CHP's radio communications system

is warranted. This is because the system is obsolete and fails to meet the department's operational needs. While the proposed solution would satisfy CHP's operational needs, it is unclear to what extent it achieves interoperability. Instead of a single, integrated statewide system, the proposed solution would result in the state having a number of communications systems among various public safety agencies for the next decade or longer. Thus, the key issue facing the state is how best to address the state's interoperability needs while ensuring that CHP's operational needs are met in a timely way.

Recommend PSRSPC Report at Budget Hearings. Chapter 1091, Statutes of 2002 (AB 2018, Nakano),—the Public Safety Communications Act—assigned the Public Safety Radio Strategic Planning Committee (PSRSPC) primary responsibility for developing and implementing a statewide radio system that facilitates interoperability among all of the state's public safety departments, as well as assessing the need for new or upgraded equipment and establishing a program for equipment purchase. Given the PSRSPC's statutory mandate to develop a public safety radio system that facilitates statewide interoperability as well as the scope and long-term nature of this project, we recommend that the Director of the Office of Emergency Services, who currently serves as chair of the PSRSPC, report at budget hearings on: (1) the extent to which the proposed project supports the state's interoperability goals—without compromising CHP's operational needs and (2) whether CHP's proposal would hinder or complicate future development of other systems.

Justification for Additional Wireless 911 Staffing Inadequate

We withhold recommendation on the department's request for 173 positions to augment its wireless 911 call-center staff, pending receipt of a revised proposal that takes into consideration a variety of factors that affect staffing requirements. Any request to further augment staffing in 2007-08 should be submitted as a separate proposal next year after the department has assessed the impact of new technology as well as any staffing increases made in 2006-07.

Current Call-Center Staffing. The CHP is required by state law to answer all wireless 911 calls that are not otherwise routed to local public safety answering points. The department's 25 communications centers answer most wireless 911 calls placed in the state. Currently, these centers are staffed by 325 call-takers who perform a variety of functions, including answering wireless 911 calls, dispatching emergency services, and advising the public and other agencies of incident details or CHP services. The CHP indicates that wireless 911 calls represent more than 80 percent of the telephone workload handled by its communications centers statewide. Be-

cause staffing has stayed relatively unchanged, the growth in call volumes in recent years has contributed to delays in call response. According to an audit conducted by the Bureau of State Audits (BSA) in 2004, of the nine CHP communications centers that tracked wait times, six had wait times that exceeded the state's ten-second performance benchmark. Average wait times ranged from a low of 4.7 seconds in Orange County to a high of 49.2 seconds in Los Angeles.

Proposal Doubles Staffing Level Over Two Years. The department proposes to more than double the size of its call-taking staff over two years, from 325 to 654. Specifically, the proposal requests hiring authority for 173 positions in 2006-07. However, because these positions would be phased in at the rate of 12 to 14 per month, the request includes partial-year funding of \$6.4 million in 2006-07 and full-year funding of \$10.5 million in 2007-08. The remaining 156 positions and \$9 million would be added in 2007-08, bringing the ongoing cost of the two-year staffing augmentation to roughly \$19 million annually.

The CHP estimated its additional staffing requirements using an approach that treats small communications centers differently from the larger ones. At the department's nine small centers, the proposed staffing level reflects a decision to separate call-taking and radio dispatch duties into two stations. Based on this configuration, staffing at each small center would increase to a minimum of six positions to ensure 24/7 coverage of the call-taking station.

At the 16 medium to large centers—where call volume is a more critical factor—the proposed staffing level is based on a standard formula used for 911 call centers. The formula takes into account total monthly call volume, average telephone talk time, and a fixed allocation for call wrap-up to cover administrative duties such as logging the call.

Staffing Formula Fails to Account for All Relevant Factors and Relies Too Heavily on Estimates of Call Volume. The volume-driven formula used by CHP for its medium to large centers was designed to estimate staffing requirements for a typical 911 call center, with an emphasis on ensuring adequate peak hour coverage. While CHP applied the formula to a typical hour (based on a 30-day average), this approach does not take into consideration variations in workload and, therefore, may not accurately reflect total staffing needs. Moreover, the formula does not account for other factors that influence staffing requirements—such as call wait times and abandoned call rates—which vary by center. A second shortcoming in the staffing proposal relates to the underlying data used to make the calculations. The CHP lacks reliable data that are comparable across centers, therefore it was necessary to estimate call volumes and talk

times in some cases. For example, data from only seven centers were used to project staffing needs for the 16 medium to large centers.

Another issue that complicates long-term staffing projections is the recent deployment of new technology. For example, some of the larger centers have implemented call-screening technology that weeds out unintentional calls. In addition, eight centers are in various stages of implementing enhanced wireless 911—a technology that provides the call-taker automatically with caller identification information (for example, cell phone number and location). This technology has the potential to reduce the time associated with each call. This technology also enables the selective routing of calls to local answering points, which may have the effect of reducing the number of calls handled by CHP. The department reports its initial experience has been that, after an initial drop in call volume, calls diverted due to call-screening and local rerouting were replaced by other calls. However, it is too soon to assess the long-term impacts of these technological enhancements.

Staffing Increase Warranted, but Little Basis for Accurately Projecting Needs. Our review shows that a staffing augmentation is warranted, given the growth in wireless phone usage as well as the high volume of calls handled per CHP dispatcher relative to local 911 call centers as noted in the BSA audit. However, a formula-driven approach—such as the one used by CHP in developing its staffing proposal—implies access to reliable data, as well as appropriate adjustments for other center-dependent variables that influence staffing needs. Both are lacking in the current proposal. The CHP has indicated that automated call-accounting data became available for all centers beginning November 2005. By the May Revision, the department will possess comparable statistics for all communications centers over a sufficient period to make more accurate projections.

Withhold Recommendation Pending Refined Proposal for May Revision. While we do not disagree that there is a need for some additional staffing, reliable data are not available to justify the specific number requested. Therefore, we withhold recommendation on the proposal to increase staff by 173 positions in 2006-07, and instead recommend that the department resubmit its proposal in time to be included in the May Revision. The resubmittal should incorporate several months of automated call-accounting data for all medium to large centers. It should also take into consideration other center-dependent variables that influence staffing needs, particularly call wait times. Any request to further augment staffing in 2007-08 should be submitted as a separate proposal next year after the department has assessed the impact of new technology as well as any staffing increases made in 2006-07.

Costs of Additional Staffing for Road Patrol Overestimated

For 2006-07, the department requests \$34 million to hire an additional 240 road patrol officers, as well as 70 supervisory and nonuniform staff to support the officers. While the staffing augmentation is warranted, the requested funding is too high, as it does not adjust for the lower pay level the officers will receive while training at the academy. Accordingly, we recommend a reduction of \$3.2 million due to overbudgeting. (Reduce Item 2720-001-0044 by \$3.2 million.)

Uniformed personnel account for approximately 7,300 positions at CHP. Uniformed staff perform a variety of duties, including road patrol, vehicle theft investigation, and security services. Roughly two-thirds of CHP's overall uniformed staff is assigned to patrol duties on roadways throughout the state. For 2006-07, the department requests \$33.7 million to provide partial-year funding for 240 additional road patrol officers and full-year funding for 70 supervisory and nonuniformed staff. This staffing augmentation seeks to increase the number of hours that CHP officers spend on proactive road patrol. In order to address the state's population growth and the resultant increase in vehicle travel, the department indicates that it plans to request similar staffing augmentations in the future.

Staffing Augmentation Warranted. In our January 2005 report, *Enhancing Road Patrol Service Through Efficiencies*, we discussed the importance of CHP officers performing proactive road patrol services in order to reduce incidences of accident-causing behavior. In addition, we recommended ways to increase the time that existing CHP uniformed staff devote to proactive road patrol activities. These recommendations included reducing reporting requirements for noninjury accidents and shifting uniformed staff currently performing administrative work to road patrol duties. The department reports that it is examining ways to streamline incident reporting and that it has shifted 150 uniformed staff from administrative work to patrol duties in the current year.

The department states, however, that increasing the efficient use of its existing uniformed staff alone is insufficient to address growth in population and vehicle use. This is particularly true for some of CHP's divisions where there have been large increases in vehicle registrations and highway travel. In addition, vehicle collisions in other divisions have far outpaced officer hiring between 2000 and 2004. The CHP expects that increased road patrol and traffic enforcement will reduce the incidence of accidents on state highways. Thus, an increase in staffing directed at providing additional road patrol services, particularly for specific divisions, is warranted.

Proposal Overbudgeted. Despite the merits of this proposal, the funding level requested is too high. Specifically, the department requests

\$11.4 million in partial-year funding for officer salaries. However, this amount does not reflect the lower pay level that the new officers will receive while they are in training at the academy. According to CHP, all new uniformed staff must undergo six months of training in the academy prior to becoming an officer. Cadet class sizes in the academy are limited, thus the new officers will be phased in over 2006-07 at 60 new cadets per quarter. Our review shows that the new uniformed staff hires will receive cadet pay during much of 2006-07. Furthermore, 60 of the new hires will not reach officer pay status until 2007-08, when they complete the academy. The department's request for \$11.4 million in officer salaries does not take into account the period when each new hire receives cadet pay.

Funding for New Officers' Salaries Should Be Reduced to Reflect Time in the Academy. We recommend \$3.2 million be deleted from this proposal to account for the time that the new officers will spend in the academy and receive cadet pay.

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 for 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 \$818 million for support of DMV in 2006-07. This represents an increase of \$47 million, or 6 percent, above the estimated current-year expenditures. About one-half of the increase is for various cost adjustments to the department's vehicle registration and driver licensing programs. Another \$18 million in additional expenditures is requested to implement a vehicle registration suspension program, to replace the department's fee payment system, and to relocate several field offices. The budget proposes a staffing level of 8,267 personnel for 2006-07, which is essentially identical to the current year.

About \$439 million (54 percent) of the department's total support will come from the Motor Vehicle Account and \$317 million (39 percent) from the Motor Vehicle Licensing Fee Account. The remaining support will be funded primarily from the State Highway Account and reimbursements.

Registration Suspension Program Will Not Be in Place on Time

It is highly unlikely that the Department of Motor Vehicles (DMV) will meet the October 1, 2006 deadline to implement a program to suspend registration of uninsured vehicles, given DMV's outdated computer system and a late start on program development. To reduce

additional delay, we recommend approving the department's proposal for \$9.3 million to contract with a private vendor to implement this program. We further recommend that DMV report at budget hearings on the estimated costs of taking over duties for the registration suspension program from the vendor in 2009-10.

Chapter 920, Statutes of 2004 (SB 1500, Speier), requires (1) insurance companies to electronically report all private passenger automobile liability insurance policies to DMV and (2) DMV to establish a vehicle registration suspension program for vehicle owners who fail to provide evidence of financial responsibility within 30 days of registering their vehicles. The law also requires DMV to start suspending registration of uninsured vehicles beginning January 1, 2006. However, subsequent legislation, Chapter 76, Statutes of 2005 (SB 62, Committee on Budget and Fiscal Review), allows the department to delay program implementation until October 1, 2006. As of January 2006, the requirement for insurance companies to electronically report policy status to DMV had largely been met. The department, however, was only in the early stages of developing a suspension program.

Implementing a registration suspension program entails tracking the insurance status of over 25 million vehicles annually, mailing an estimated 5.5 million letters notifying vehicle owners of inadequate insurance records, assessing fees for late registrations, and suspending registration for vehicle owners who do not provide proof of insurance within 45 days of notification. Preparing to meet these requirements necessitates a series of actions by the department. Specifically, DMV must procure new database and telecommunications infrastructure. In addition, it must design, develop, and test software that tracks vehicle registration status, generates notices of suspension, and issues appropriate fees for late registration. Furthermore, DMV must hire and train additional personnel to staff call centers to accommodate increased call volumes resulting from the suspension program.

Indecisiveness Over Implementation Plan Led to Delay. The department's indecision over how to implement the registration suspension program has caused significant delays in bringing the program online. Specifically, DMV has vacillated between two methods to implement the program: an in-house strategy utilizing DMV staff and a contract-out solution relying on a private vendor.

In February 2005, DMV proposed a vendor-based approach which foresaw the program being implemented by July 1, 2006. For various reasons, however, the department reversed its approach in May 2005 and committed to an in-house method using DMV staff to implement the program. This solution was approved by the Legislature and the 2005-06 budget appropriated \$4 million to DMV for nine additional staff to begin

work on the program and update the department's telecommunications infrastructure. In July 2005, the department advised the Legislature that it was reversing its approach yet *again*. Deciding that the in-house method would not be able to meet the October 1, 2006 program start date required by statute, DMV adopted its current method of first using a private vendor to establish the program and then taking over the program's administration using DMV staff in 2009-10.

Vacillation between methods in February through July 2005 has led to delays in completing program development milestones. Discussions with the department indicate that as of January 2006, the project is two months behind schedule in selecting a vendor to implement the suspension program. Vendor selection will not occur until late April, leaving only five months for a vendor to design, develop, and test the system, in addition to ensuring that it is sufficiently staffed to handle call volumes resulting from the new suspension program. Given the amount of work required of the vendor once a contract is awarded, it is highly unlikely that the program will be implemented by October 1, 2006.

Budget-Year Proposal Warranted. For 2006-07, DMV requests \$9.3 million, which includes authority for one position and \$9 million for contract services. Our review shows that contracting with a vendor would likely be the fastest way to get the program online. Even with this approach, however, DMV is unlikely to meet the statutory deadline. Given the Legislature's intent that the registration suspension program be implemented as soon as possible, we recommend approval of the department's budget-year proposal to contract with a vendor to implement the program.

Vendor-Based Solution Likely to Have Additional Costs. The department estimates the cost of establishing the registration suspension program by a private vendor would be \$42 million through 2008-09. Our review shows that the estimate does not take into account costs that DMV would incur when preparing to assume full program administration responsibilities in 2009-10 as currently planned. Depending on how the vendor's contract is specified, these costs could include procurement of equipment and hiring and training DMV staff to administer the program in-house. By contracting out the set up and initial administration of the suspension program, DMV delays rather than avoids many of these costs. We estimate these costs to be at least a few million dollars.

Recommend Department Report on Costs of Program Takeover. The eventual takeover of the program's administration will result in significant costs that were not included in the department's proposal. Accordingly, we recommend that the department report at budget hearings on its plan for resuming full administration of the suspension program. Specifically, DMV should present to the Legislature timelines and estimated start-up costs associated with taking over the program from the vendor in 2009-10.

Real ID Act of 2005 Will Significantly Increase DMV Costs

Requirements under the federal Real ID Act, which will become effective in mid-2008, underscore the necessity for the Department of Motor Vehicles (DMV) to successfully update its aging computer and database infrastructure, as well as hire staff to handle additional workload. We recommend that DMV report at budget hearings on anticipated workload requirements to implement the act, how the department plans to meet these requirements, and the potential costs related to the act's implementation.

The federal Real ID Act of 2005 requires that beginning in May 2008 persons who live or work in the United States possess a federally approved ID card in order to participate in a range of federally regulated activities, including air travel, collection of Social Security payments, and receipt of federal services. The law requires that state-issued driver licenses and ID cards meet minimum federal regulations, including verification of applicants' identity and legal status, as well as implementation of antifraud security features. Under the Real ID Act, federal agencies are prohibited from accepting state-issued driver licenses and ID cards unless these documents are determined by the U.S. Secretary of Homeland Security to meet the minimum standards.

The act permits states to issue driver licenses and ID cards that are not in compliance with the federal requirements, such as driver licenses that are issued to motorists who are not legal U.S. residents. However, these documents must have a "unique design or color indicator" so that federal agencies and law enforcement can identify them as unacceptable for federal purposes.

The Secretary of Homeland Security is responsible for developing detailed regulations to implement the law's provisions. These regulations will likely not be issued until late 2006. States have until May 2008 to comply with the new requirements.

Impact on DMV Operations Will Be Significant. The department reports that there are currently 24 million driver licenses and ID cards issued in the state. Each year, DMV processes approximately eight million driver licenses through renewals and new license applications. Given this volume, the department has identified several components of the Real ID Act that will have significant impacts on its operations. Together, these provisions will result in significant costs to improve DMV's aging computer and database infrastructure, and to provide additional staffing to respond to increased workload. The impact of the provisions on the department's costs are summarized in Figure 1 and are discussed in detail below.

Figure 1**Potential Impact of Real ID Act of 2005 on DMV Costs****Maintain Electronic Copies of Identity Source Documents**

- Significant computing and database infrastructure updates and purchases.

Verify the Authenticity of Identity Source Documents

- Significant staffing augmentation necessary.

Verify an Applicant's Current Address

- Possibly significant mailing costs or computer update costs, depending on how DMV implements the requirement.

Increase Storage Capacity for Name and Address Records

- Driver license database modification.

Communicate With Other States to Verify Driver License Status

- Improvements to computing and database infrastructure.
- Additional staffing to communicate (by phone or e-mail) with states that are not ready to provide electronic verification.

Issue Driver Licenses and ID Cards for No More Than Eight Years

- Staffing augmentation may be necessary.

Annually Reissue New Licenses and ID Cards for Temporary Residents

- Significant staffing augmentation may be necessary.

Redesign Driver Licenses and ID Cards

- Potential increase in card production costs, at least initially, due to potentially smaller pool of eligible vendors.

Maintaining Electronic Copies of Identity Source Documents. The department does not currently have the capability to electronically scan and retain copies of identity source documents, such as birth certificates and immigration documents presented by driver license and ID card applicants. The federal act requires that the state scan and maintain retrievable electronic copies of these documents for at least ten years. This means that scanning devices will have to be purchased for each of DMV's 168 field offices and that the department will have to update its computing and database infrastructure in order to capture, store, and retrieve these copies.

Verifying the Authenticity of Identity Source Documents. The act requires *all* identity source documents be verified for their authenticity. There are a multitude of state and local agencies that issue birth documents throughout the country. Currently, there is no national database

that centralizes this information. As a consequence, DMV staff will have to manually verify (likely by phone or e-mail) over one million source documents annually that are submitted with original driver license and ID card applications. This additional workload would likely require a significant augmentation in staff. (This workload could be considerably larger if the federal act requires DMV to verify identity source documents of existing license and ID cardholders, as discussed later in this piece.)

Verifying an Applicant's Current Address. At present, DMV only checks that an applicant's stated address exists within the U.S. Postal Service database, not that an applicant actually resides at that address. The department has a few options for verifying an applicant's address in accordance with federal law. One option would be to delay issuing licenses and ID cards until an applicant returns a signed address verification form received through certified mail sent to their residential address. This option would add cost and delay to the driver license and ID card issuing process. Another option, which the department is considering, would be to electronically verify applicants' addresses using a credit bureau database or like resource. This option would allow DMV to issue driver licenses and ID cards to applicants at the field office. However, it would require modifying field office computers to connect with a credit bureau or address verification service, in addition to paying for access to such a resource.

Increasing Storage Capacity for Name and Address Records. The DMV anticipates that states would likely be required to adopt a federal standard in storing the name and address records of driver license and ID cardholders. The department's driver license database would need to be modified to accommodate longer name and address records.

Communicating With Other States to Verify Driver License Status. Under the act, no state can issue a license to a driver previously licensed in another state until it verifies that the previous license has been cancelled by the issuing state. However, there is currently no national database that would facilitate such immediate confirmation. If this requirement is to be met electronically, it would require DMV and other states to update their respective computing infrastructure to enable this type of connectivity. As this approach depends on the readiness of other states, it is doubtful that it will be met electronically by 2009. Thus, a significant staffing augmentation will likely be necessary to accommodate this new licensing requirement by manually (likely by phone or e-mail) contacting other states.

Issuing Driver Licenses and ID Cards for No More Than Eight Years. The act limits the term of a license or ID 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. Similarly, California ID cards is-

sued to senior citizens are valid for ten years. These long periods between in-person renewals help keep down field office workload.

If the federal program requires that all driver license renewals occur in a field office, DMV estimates that there will be at least 1.3 million additional office visits per year resulting from more frequent in-person renewals. By reducing the term of ID cards for seniors by two years, these volumes would also increase accordingly. These additional office visits will add to DMV's workload and necessitate an increase in staffing.

Annually Reissuing New Licenses and ID Cards for Temporary Residents. Current state law requires that DMV limit the term of initial driver licenses or ID cards for temporary legal residents to their term of stay for the first five years. (These residents include foreign students and individuals on work visas.) After a temporary legal resident has been a licensed driver for five years, however, state law allows these applicants to renew their licenses using the standard five-year renewal cycle. The Real ID Act would require DMV to issue temporary legal resident licenses and ID cards in most cases for a term of no more than one year, renewable annually. Given the large number of temporary legal residents in the state, this would pose significant workload on DMV's driver license and ID card issuing program.

Redesigning Driver Licenses and ID Cards. The state currently contracts with a vendor for the production of driver licenses and ID cards. The department's current contract expires in June 2006, but may be extended for up to two years. Depending on how different the federal act's license and ID card requirements are from the state's current design and security standards, there could be higher card production costs (at least initially). In addition, these requirements could potentially limit the number of vendors able to produce driver licenses and ID cards for the state in the initial phase of the act's full implementation.

Key Issue Yet to Be Resolved. According to DMV, one key issue has yet to be resolved with the Department of Homeland Security. Specifically, it has not yet been determined whether persons who hold a valid state driver license or ID card at the time the act becomes effective (in 2008) would be allowed to retain those documents until they expire, or whether *all* licenses and ID cards would be considered null and void at that point. The latter would result in DMV having to issue new licenses and ID cards to the entire driving and ID card holding population (about 24 million). This would necessitate a significant one-time increase in support costs to handle the large workload. To the extent the final regulations allow for a phasing-in of the federally approved driver license and ID cards, the impact on DMV's licensing workload would be significantly less. Thus, the method through which the act is implemented will have a significant impact on the department's operations.

Recommend Department Report on Status of Federal Regulations and Costs. The regulations for the Real ID Act will likely not be adopted until late 2006. The DMV has been working with the U.S. Department of Homeland Security to stay informed on the development of these requirements. Given the short timeline to the act's full implementation, DMV should begin taking steps to meet those requirements it knows will be included in the final regulations and which necessitate changes in current state practices. However, the Governor's budget does not include funding for any activities to implement the act.

The department reports that it is currently in the stage of assessing the improvements needed in its field operations and computing infrastructure to meet the federal act's requirements. It is likely that DMV will submit spring finance letters to start work on these projects in the budget year.

Accordingly, we recommend that DMV report at budget hearings on how it plans to meet these federal requirements and, to the extent possible, provide the Legislature with estimates of the associated costs. Specifically, the department should report on actions it is taking in the current year and actions it plans to take in 2006-07. In addition, the department should provide an estimate of costs it anticipates in future years to satisfy the requirements of the Real ID Act.

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Crosscutting Issues

Funding for Transportation Programs

- A-17 ■ **Bay Bridge Funding Settled: Demand on State Funds Certain.** Legislation adopted in 2005 provides certainty that any excess costs for the toll bridge seismic retrofit program would not create an additional burden to future state transportation funding.
- A-19 ■ **New Federal Transportation Act Provides Funding Through 2009.** The new federal act will provide \$23.4 billion to California through 2009, and presents opportunities for financing transportation through nontraditional sources and expediting project delivery. There are a number of issues for the Legislature to consider and areas where further legislative actions are warranted to facilitate implementation of the act.
- A-24 ■ **Budget Proposals Boost Short-Term Funding.** If fully realized, the increase in transportation funding proposed for 2006-07 would enable many projects to begin to “catch up” on prior-year delays. The funding increase, however, would not provide for any additional transportation projects beyond what has been scheduled for delivery.
- A-26 ■ **Allocation of Proposed Loan Repayment Does Not Align With Statute.** The Governor proposes to allocate \$920 million of loan repayment in a way different from what is required under current law. Recommend that Caltrans and the California Transportation Commission report at budget hearings on the programmatic impacts of the proposed allocation on projects

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in state transportation programs, and how they compare to the impacts under current law.

- A-30 ■ **Bonds Provide One-Time Funding Increase.** The proposed general obligation bonds would provide a one-time infusion of funding to transportation. Nonetheless, how effectively this additional funding would address the state's transportation priorities depends on the types of projects funded and when they can be delivered.
- A-31 ■ **Administration Has Failed to Demonstrate Projects' Congestion Benefits.** Recommend the Legislature not approve the Governor's bond proposals until the administration provides requested information.
- A-33 ■ **Revenue Bonds Would Negatively Impact Future Highway Maintenance and Rehabilitation.** Recommend that the Legislature reject the Governor's revenue bond proposal absent additional revenues being provided to back the bonds.
- A-34 ■ **Proposal Improves Transportation Funding Stability; but Removes a Tool to Close the State's Budget Gap.** The Governor's proposal to eliminate the Proposition 42 suspension authority would improve the predictability of transportation funds. However, this reduces the state's overall flexibility to deal with tight fiscal conditions.
- A-36 ■ **Analyst's Assessment of Governor's Proposals.** The Governor's proposals in the Strategic Growth Plan have certain merits. However, the proposals also raise fiscal and policy concerns.
- A-37 ■ **Long-Range Funding Requirement Should Be Assessed.** Recommend that the Legislature direct the California Transportation Commission, working with Caltrans and regional agencies, to (1) estimate the amount needed to complete currently programmed projects in state transportation programs and the high-priority federal-earmarked projects, and (2) provide an updated assessment of what the state's needs are beyond what have already been programmed. Further recommend that project selection for bond funds not occur until this study has been completed.

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- A-38 ■ **How Should Stable Funding Be Provided?** Recommend that the state rely on user fees to provide ongoing funding for transportation. Further recommend that Proposition 42 be repealed and the state gas tax be increased correspondingly and indexed for inflation to provide ongoing funding.

Department of Transportation

- A-44 ■ **Insurance Pilot Includes Too Many Projects, Estimated Savings Uncertain.** Recommend budget bill language limiting funds in support of the program to administration of no more than 15 projects.
- A-46 ■ **Department Should Report on Success of Insurance Pilot.** Recommend adoption of supplemental report language directing the department to report on the net costs or savings realized through the insurance pilot, the types of projects included in the pilot, and the amount it paid for insurance-related costs.
- A-47 ■ **Governor's Plan Would Further Reduce Investment in Highway Maintenance.** Recommend the department report at budget hearings on how it plans to maintain the state highway system without further adding to the deferred maintenance backlog.
- A-48 ■ **Governor's Budget Omits Pavement Maintenance Provision.** Recommend budget bill language to limit specified amount to pavement preservation contracts.
- A-48 ■ **Estimated Capital Outlay Expenditures Likely to Increase.** Withhold recommendation on \$4.8 billion requested for capital outlay projects as the expenditure level will likely be revised during the May Revision when more accurate information on the Bay Bridge and tribal gaming bonds become available.
- A-49 ■ **Capital Outlay Support Request Will Be Revised.** We withhold recommendation on the \$1.6 billion requested for capital outlay support staff because staffing needs will be revised during the May Revision when more accurate information on workload for the various state transportation programs becomes available.

Analysis**Page****High-Speed Rail Authority**

- A-50 ■ **High-Speed Rail Bond Could Be Indefinitely Postponed.** Recommend budget bill language limiting the availability of support funds for the California High-Speed Rail Authority only to high-speed rail-related activities in 2006-07 and directing unexpended funds to be reverted if the high-speed rail measure is indefinitely postponed.

California Highway Patrol

- A-52 ■ **Enhanced Radio System Proposed to Improve Communications.** Recommend the Director of the Office of Emergency Services, in his role as chair of the Public Safety Radio Strategic Planning Committee, report at budget hearings on how the proposal satisfies state interoperability goals.
- A-55 ■ **Justification for Wireless 911 Staffing Inadequate.** Withhold recommendation on the department's request to augment wireless 911 staffing levels in 2006-07. Recommend the department resubmit a refined proposal in time for the May Revision.
- A-58 ■ **Costs of Additional Staffing for Road Patrol Overestimated. Reduce Item 2720-001-0044 by \$3.2 million.** Recommend reduction of \$3.2 million due to overbudgeting for officer salaries.

Department of Motor Vehicles

- A-60 ■ **Registration Suspension Program Will Not Be in Place on Time.** Recommend approval of \$9.3 million to contract with a private vendor to implement the program. Further recommend that the department report at budget hearings on the estimated costs of taking over the program from the vendor in 2009-10.
- A-63 ■ **Real ID Act of 2005 Will Significantly Impact Department of Motor Vehicles Costs.** Recommend the department report at budget hearings on anticipated requirements of the act, how it plans to meet these requirements, and the associated costs.