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2009-10 Budget Analysis Series

Transportation

February 3, 2009

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EXECUTIVE SUMMARY

The Governor's budget proposes $16.5 billion in expenditures (mostly from special funds) for transportation programs in 2009-10. This includes $13 billion for the Department of Transportation (Caltrans), $2 billion for the California Highway Patrol (CHP), $963 million for the Department of Motor Vehicles (DMV), and $125 million for the High-Speed Rail Authority.

Balancing the 2009-10 Budget

Eliminate Transit Assistance to Fund Home-to-School and Regional Center Transportation. The Governor proposes to use $541 million in Public Transportation Account (PTA) funds for home-to-school and regional center transportation in order to help address the General Fund shortfall. In order to provide sufficient funding to do so, the Governor proposes to reduce funding for State Transit Assistance (STA) by one-half ($153 million) in the current year and to statutorily eliminate the program in the budget year, thereby providing no funding beginning 2009-10. Given the state's fiscal condition, we recommend the Legislature approve the suspension of program funding in 2009-10, as well as reducing the current-year funding by $153 million. (Below, we discuss the opportunity for improving the program if the Legislature chooses to continue STA.)

Redirect Tribal Gambling Revenues for the General Fund. The Governor proposes to redirect $202 million in tribal gambling revenues to the General Fund in the current and budget years, instead of providing these revenues for transportation. We have made the same recommendation to the Legislature in the past. Accordingly, we recommend that the Governor's proposal be adopted.

Vehicle License Fee (VLF) Shift. The Governor proposes to redirect $451 million in vehicle license fee revenues from DMV to other public safety programs to provide relief to the General Fund—including $92 million in the current year, and $359 million in the budget year. To backfill DMV for the loss of those funds, the Governor proposes to increase vehicle registration fees by $12 from $56 to $68. We note that the opportunity for any current-year General Fund relief expires in early April.

Sweep Non-Article XIX Revenues in Motor Vehicle Account (MVA). As an additional budget solution, we recommend the Legislature transfer MVA revenues that are not subject to the restrictions of Article XIX of the State Constitution to the General Fund to help address the state's budget problems. Specifically, we recommend transferring $70 million to the General Fund in both 2008-09 and 2009-10.

Other Issues

Unstable Funding Negatively Affects Transportation Programs. We explain how a number of major funding sources for transportation are unstable, and the ramifications of this situation for transportation programs. We offer several recommendations to the Legislature to help stabilize funding for these purposes. The specific actions the Legislature can take include more clearly setting funding priorities, providing more funding from ongoing sources by raising the

per gallon tax on gasoline and diesel, and exploring new ways of funding transportation programs, such as charging a mileage-based fee to generate revenues for transportation.

Governor's Economic Stimulus Proposal May Have Limited Benefits. The Governor proposes to stimulate the economy by advancing state and local transportation capital projects. We find that the Governor's proposal may have limited benefits and recommend an alternative approach to accelerating projects through the issuance of revenue bonds backed by future state gasoline tax revenues.

Improving Implementation and Accountability of Proposition 1B. Programs funded with Proposition 1B bond funds are well under way, with about one-half of the $20 billion authorized by the bond measure already appropriated. We review the implementation and accountability of Proposition 1B and make various recommendations to improve these programs.

STA Elimination Should Be Considered on Policy Grounds. While concurring with the Governor's proposal not to fund STA in the budget year, we believe the Legislature should consider a number of policy issues beyond the immediate budgetary solution before eliminating the program, as proposed by the Governor. If the Legislature chooses to continue funding STA in the future, we recommend improvements be made to the current program, including changes in the way monies are allocated to transit operators.

Caltrans Planning Staff Overbudgeted. Caltrans spends $50 million each year preparing initial planning documents for transportation capital projects. Our review finds the department has a shelf of completed documents and that the ongoing workload does not justify the level of resources being provided to produce more of them. We recommend that staffing for these activities be reduced and that the department better track its workload in this area.

More Cost-Effective Approach Needed to Meet Air Quality Rules. The budget proposes to spend $63 million in 2009-10 to replace and retrofit vehicles to meet state air quality rules. Our review finds that, in total, Caltrans' compliance with state air quality requirements will cost substantially much more ($260 million over multiple years) than was estimated by the state Air Resources Board (ARB) when the regulations were developed. We recommend that the Legislature have ARB and Caltrans provide the necessary information at budget hearings to determine a more cost-effective approach to meeting air quality requirements.

High-Speed Rail Authority Needs More Oversight. Proposition 1A, passed by voters in November 2008, authorizes $9 billion for the High-Speed Rail Authority to develop and construct a high-speed train system in California. We evaluate the authority's budget request and recommend additional accountability measures for the use of these bond funds.

CHP. The budget requests $35 million to add 240 new officers. We recommend the Legislature reject half of these positions (120 new officers) as they are not fully justified. In addition, our review found the request to be overbudgeted. We recommend a total reduction of $22 million.

DMV. We recommend that the Legislature reject an administration request for funding to implement Real ID because it is premature. The state is not required to begin issuing Real ID compliant cards in 2009-10, and the intentions of the new federal administration regarding this unfunded mandate are yet unknown. We provide an update on the numerous information technology (IT) projects currently under way at DMV, and identify some of the challenges the department has faced in implementing the IT projects.

BACKGROUND

Transportation Relies Heavily on Dedicated Revenue Sources

Traditional State Fund Sources. State transportation programs have traditionally been funded on a pay-as-you go basis from taxes and user fees. Two special funds—the State Highway Account (SHA) and the PTA—have provided the majority of ongoing state funding for highways and local transit programs. The SHA is funded mainly by an 18 cent per gallon tax on gasoline and diesel fuel (referred to as the gas tax) and truck weight fees. Revenues to the PTA come from a portion of the state sales tax on diesel fuel and gasoline. Since 2003, state gasoline sales tax revenues that previously were used for General Fund programs are used under Proposition 42 for highway improvements, transit and rail, and local streets and roads.

Other transportation-related programs, including traffic enforcement programs administered by DMV and CHP, also rely on dedicated revenue sources for their support. Specifically, both departments are funded mainly from fees imposed on drivers and vehicles.

Bonds. Since 2006, the state has increasingly used bond funds for various transportation programs. In 2006, voters passed Proposition 1B to provide about $20 billion in bond funding over multiple years for a variety of transportation improvement purposes. In November 2008, Proposition 1A was passed to provide $9.95 billion to develop a high-speed rail system and to improve other passenger rail systems in the state.

Expenditure Proposal and Trends

Budget Proposal. The Governor's budget proposes $16.5 billion in expenditures for transportation programs in 2009-10. This amount includes about $13 billion in state and bond funds, and $3.6 billion in federal funds. The total amount proposed is a net decrease of $3 billion, or about 16 percent, below the estimated current-year expenditure level. The drop is mainly due to the Governor's proposal to significantly increase current-year expenditures on transportation capital improvements, in order to stimulate the economy. Specifically, as part of his economic stimulus package, the Governor is proposing to increase by about $1.7 billion the current-year funding from Proposition 1B bonds for state highways, transit capital improvements and local streets and road improvements.

For 2009-10, key proposals in the budget would:

- Transfer $1.7 billion in Proposition 42 gasoline sales tax to transportation. The amount reflects the revenue projected to result from the higher state sales tax rate proposed by the Governor.
- Provide $3.5 billion in bond money for various Proposition 1B programs.
- Use $769 million in GARVEE bonds backed by future federal funds to pay for three highway rehabilitation projects.
- Use $125 million in Proposition 1A (2008) bonds to develop a high-speed rail system.
- Provide no operating assistance to transit operators.
- Increase CHP traffic officers by 240 positions.

Overall Growth Trends. Figure 1 shows expenditures for state transportation programs from state, bond, and federal funds from 2002-03 through 2009-10. The figure shows that total state transportation expenditures were relatively stagnant up until 2004-05, but have grown steadily since. The increase is mainly due to the availability of bond funding.

As Figure 1 shows, bond expenditures increased beginning 2007-08. In fact, bond expenditures are estimated to increase to about $7 billion in the current year, accounting for 36 percent of all expenditures on state transportation programs. Figure 1 also shows that while bond expenditures have increased, expenditures from non-bond state funds have decreased, and will make up a smaller proportion of expenditures on state transportation programs. Specifically, non-bond funding will account for about 53 percent of all state transportation expenditures in 2009-10 compared to 71 percent in 2002-03. A main reason for the decrease in the past couple of years is the redirection of transportation funds to help the General Fund, as discussed later in this section.

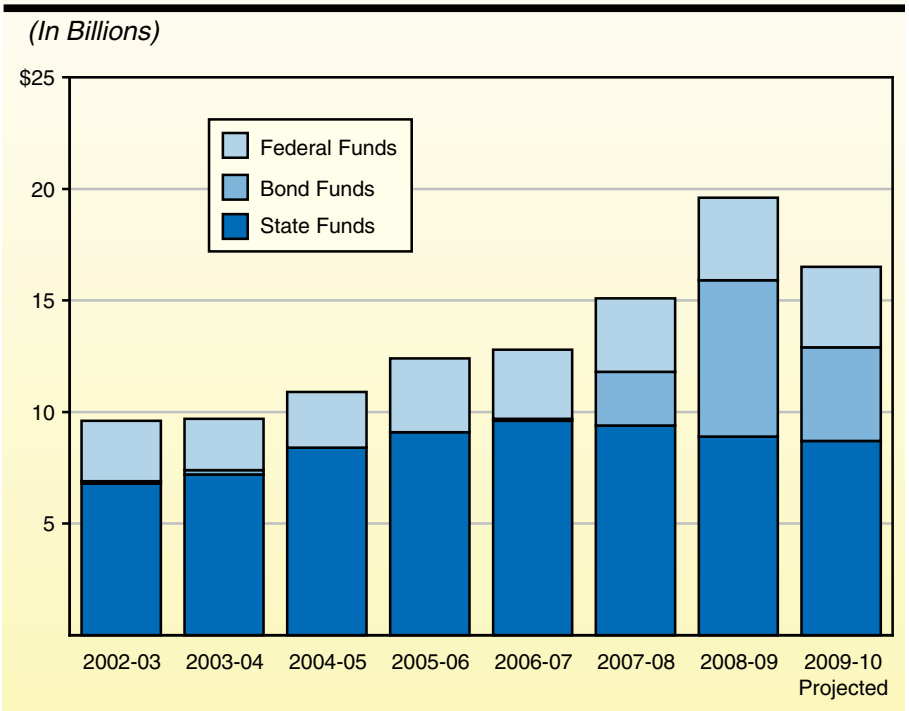
Spending by Major Programs

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 $13 billion in 2009-10 for Caltrans—about $1.3 billion, or 9 percent, less than estimated current-year expenditures. As Figure 2 shows, Caltrans expenditures from the General Fund are projected to increase—by $400 million (or about 30 percent)—while expenditures from all other funds are projected to decrease. The higher General Fund expenditures reflect the projected increase in Proposition 42 gasoline sales tax transfers to transportation, resulting from the increase in the state sales tax rate proposed by the Governor. The decrease in bond-funded expenditures in the budget year (mainly from Proposition 1B) reflects the Governor's proposal to increase current-year bond spending as an economic stimulus, as noted earlier.

Figure 1

Expenditures on State Transportation Programs



CHP and DMV. Spending for CHP is proposed at about $2 billion, which is 3 percent higher than the current-year estimated level. About 90 percent of all CHP expenditures would come from MVA, which generates its revenues primarily from driver license and vehicle registration fees. The increase includes first-year support for an additional 240 traffic officers.

For DMV, the budget proposes expenditures of $963 million—essentially the same as the current-year level. Traditionally, support for DMV comes from MVA and vehicle license fee revenues. Vehicle license fees are an in-lieu property tax, which DMV collects for local governments. In past years, these revenues typically paid for a significant portion of the department's support (from 35 percent to 40 percent). For 2009-10, the

Figure 2

Transportation Budget Summary—Selected Funding Sources

(Dollars in Millions)

	Actual 2007-08	Estimated 2008-09	Proposed 2009-10	Change From 2008-09	
				Amount	Percent
Department of Transportation					
General Fund	$1,416.3	$1,351.0	$1,751.7	$400.7	29.7%
Other state funds	3,948.4	3,010.1	2,590.7	-419.4	-13.9
Federal funds	3,265.4	3,662.0	3,578.5	-83.5	-2.3
Bond funds	1,003.3	4,773.1	3,746.5	-1,026.6	-21.5
Other	1,704.6	1,467.7	1,288.4	-179.3	-12.2
Totals	**$11,338.0**	**$14,263.9**	**$12,955.8**	**-$1,308.1**	**-9.2%**
California Highway Patrol					
Motor Vehicle Account	$1,652.8	$1,743.8	$1,802.9	$59.1	3.4%
State Highway Account	57.7	61.6	60.4	-1.2	-1.9
Other	110.8	140.5	140.6	0.1	0.1
Totals	**$1,821.3**	**$1,945.9**	**$2,003.9**	**$58.0**	**3.0%**
Department of Motor Vehicles					
Motor Vehicle Account	$480.6	$619.3	$887.2	$267.9	43.3%
Vehicle License Fee Account	358.5	267.7	—	-267.7	-100.0
State Highway Account	49.7	51.5	52.5	1.0	1.9
Other	20.2	21.8	23.3	1.5	6.9
Totals	**$909.0**	**$960.3**	**$963.0**	**$2.7**	**0.3%**
State Transit Assistance					
Public Transportation Account	$306.4	$153.2	—	-$153.2	-100.0%
Bond funds	530.3	1,219.7	350.0	-869.7	-71.3
Totals	**$836.7**	**$1,372.9**	**$350.0**	**-$1,022.9**	**-74.5%**
High-Speed Rail Authority					
Public Transportation Account	$1.7	$5.6	—	-$5.6	-100.0%
Bond funds	15.6	37.3	$125.2	87.9	235.7
Other	3.6	3.5	—	-3.5	-100.0
Totals	**$20.9**	**$46.4**	**$125.2**	**$78.8**	**169.8%**

budget proposes no vehicle license fee revenues for DMV support in order to free up funds for local public safety programs. Instead, the budget proposes to support DMV almost entirely with MVA funds. To generate sufficient funding in the MVA to cover the funding shift, the budget proposes to increase vehicle registration fees by $12 per vehicle. In addition, the budget proposes to increase driver license and identification card fees by $3 each in order to fund the production of a new license/card with enhanced security features.

Transit Assistance. The state provides funding assistance to transit systems for both operations and capital improvements. Current law allocates a portion of the annual PTA revenues to transit operators under the STA program, mainly for operations. In recent years, program funding has been limited and PTA funds were used instead for home-to-school transportation and regional center transportation, which previously had been paid from the General Fund. For instance, the current-year budget, as passed in September 2008, kept STA at the 2007-08 level of $306 million. However, due to deepening state fiscal problems, the Governor's budget now proposes to eliminate STA funding for the remainder of the current year, thereby reducing the current-year funding level to $153 million. For 2009-10, the budget proposes no STA funding.

Proposition 1B provides $3.6 billion in bond funds for transit capital improvements. As part of his economic stimulus package, the Governor is proposing to increase the current-year appropriation from Proposition 1B bonds by $800 million (from $350 million to $1.15 billion). For 2009-10, the budget proposes $350 million for transit capital improvements.

High-Speed Rail Authority. In November 2008, voters passed Proposition 1A, which authorizes $9 billion in general obligation bonds for the development and construction of a high-speed rail system. (Proposition 1A also authorizes another $950 million for capital improvements of other passenger rail systems in the state.) Under law, up to 10 percent of the bond funds may be used for noncapital costs, including planning, design, and engineering of the system. For 2009-10, the budget proposes $125 million in Proposition 1A funds to continue a number of contracts to plan and develop the system and to fund the authority's administrative expenses.

Recent Use of Transportation Funds to Help General Fund

Due to the state's difficult fiscal condition in the past several years, funding that has traditionally been dedicated to transportation has been loaned to the General Fund or redirected to pay for programs that previously were funded from the General Fund.

Loans and Repayments. Since 2001-02, various amounts of transportation funds have been loaned to the General Fund. Figure 3 shows the amount of loans outstanding, and the amount of repayments due to transportation. As Figure 3 shows, three substantial loans require repayment.

First, $1.4 billion was loaned from the Traffic Congestion Relief Fund (TCRF) to the General Fund in 2001-02 and 2002-03. (The TCRF provides funding for 141 transportation projects statewide.) About $1.2 billion of the loan was to be repaid from bonds backed by tribal gambling revenues. However, because these bonds have not been issued, repayment has been made in annual installments with tribal gambling revenues of about $101 million a year. The Governor's budget proposes to defer both the current- and budget-year repayments, and retain a combined $202 million for General Fund uses.

Figure 3

Transportation Loans and Repayments[a]

(In Millions)

	To General Fund[b] From:			
Year	**TCRF[c]**	**Proposition 42**	**SHA**	**Other**
Total Amount Borrowed	**$1,383**	**$2,079**	**$200**	**$31**
Balance through 2008-09	749[d]	587	200	31
2009-10	-100[d]	-83	—	—
2010-11	-100	-83	-200	-31
Beyond 2010-11	-549	-421	—	—

a Amounts do not include interest.

b Positive numbers are amounts payable to the General Fund, negative numbers are amounts payable from the General Fund.

c Funds shown from the General Fund as payment to the TCRF come from tribal gambling revenues.

d As part of his 2009-10 budget, the Governor proposes to delay the payment of tribal gambling revenues in 2008-09 and 2009-10.

SHA = State Highway Account; TCRF = Traffic Congestion Relief Fund.

Second, over $2 billion in Proposition 42 funds was loaned in 2003-04 and 2004-05 combined. As of the end of the current year, $587 million is still outstanding. Under the Constitution, the General Fund is required to repay the loan with interest by June 30, 2016, at a specified minimum rate each year. In accordance with the requirement, the Governor's budget proposes a General Fund repayment of $83 million in 2009-10.

Third, to help the General Fund in the current year, $231 million was loaned to the General Fund from SHA and other transportation accounts. The *2008-09 Budget Act* requires this amount to be repaid with interest by June 30, 2011.

Redirections and Broadened Use of Transportation Funds. In addition to the loans of transportation funds discussed above, the use of certain transportation revenues has been broadened to include purposes that had previously been paid from the General Fund to help address the state's fiscal problems. In particular, in 2007-08 and 2008-09, a portion of so-called "spillover" gasoline sales tax revenue was used to reimburse the General Fund for transportation-related expenses, such as bond debt service. Additionally, PTA revenues were used to fund home-to-school transportation as well as regional center transportation. In the current year, these uses total about $1.4 billion. For 2009-10, the budget proposes a total of $541 million for these uses, including $403 million for home-to-school transportation and $138 million for regional center transportation.

BALANCING THE 2009-10 BUDGET

Using Transportation Funds To Help the General Fund

The Governor's budget includes several proposals to use transportation funds to help the state address a significant General Fund deficit. In total, as Figure 4 (see next page) shows, the budget proposes to provide an additional $193 million in General Fund help in the current year. This amount is over and above the $1.6 billion in assistance to the General Fund already provided as part of the 2008-09 budget enacted last September. For 2009-10, the budget propos-

es to provide about $1 billion in additional help to the General Fund. In this section, we briefly describe the Governor's proposals and offer our recommendations for achieving additional General Fund relief.

Eliminate STA to Provide $541 Million for Home-to-School and Regional Center Transportation. As discussed earlier, the PTA has funded home-to-school and regional center transportation in the past couple of years. These activities have traditionally been General Fund expenditures. In 2008-09, PTA funds, together with spillover revenue (in the Mass Transportation Fund [MTF]), will provide a total of almost $1.4 billion to pay for home-to-school and regional center transportation and to repay the General Fund for transportation debt service payments. In the budget year, the Governor proposes to fund regional center transportation at the current level ($138 million) and provide $403 million for home-to-school expenditures from the PTA and MTF.

The PTA also funds the STA program, which provides operating assistance to transit operators. For 2008-09, STA is funded at $306 million. However, because spillover revenue is expected to be substantially lower than projected in the current year and minimal in the budget year, the administration proposes to statutorily eliminate the STA program beginning in 2008-09, in order to sustain the planned level of General Fund relief. This would reduce STA disbursements by $153 million (assuming half-year savings) in the current year and provide no transit operator assistance in future years.

Given the state's fiscal condition, the continued use of PTA funds for home-to-school and regional center transportation is reasonable. *We recommend the Legislature suspend STA funding for the current and budget years.* (Later in this report, we discuss the proposal to eliminate the program on an ongoing basis. Please see the "State Transit Assistance" section of this report.)

Redirect $202 Million in Tribal Gambling Revenue to General Fund. As shown in Figure 4, the Governor proposes to redirect about $202 million in tribal gambling revenues to the General Fund in 2008-09 and 2009-10 combined. These revenues, amounting to $100.8 million per year, are dedicated in statute to repay outstanding transportation loans. Absent the Governor's proposal, the revenues would fund highway rehabilitation projects under the State Highway Operation and Protection Program (SHOPP) and transportation projects in the Traf-

Figure 4

Governor's Proposals to Use Transportation Funds to Help the General Fund

(In Millions)

Proposal	2008-09 Estimated	Governor's Budget Proposals		
		2008-09[a]	2009-10	Total New Proposals
Shift vehicle license fees to public safety	—	$92.0	$360.0	$452.0
Fund home-to-school transportation	$622.8	—	402.7	402.7
Redirect tribal gambling payments	—	100.8	100.8	201.6
Fund regional center transportation	138.3	—	138.3	138.3
Debt service/Proposition 42 repayment	621.3	—	—	—
Borrow transportation funds	231.0	—	—	—
Totals	**$1,613.4**	**$192.8**	**$1,001.8**	**$1,194.6**

[a] As part of his 2009-10 budget, the Governor proposes additional uses of transportation funds to provide General Fund relief in 2008-09.

fic Congestion Relief Program (TCRP). To ensure that projects are not affected, the budget proposes that the redirection occur only if the state receives federal economic stimulus funding for transportation.

Given the severity of the state's fiscal problem, the Governor's proposal is reasonable, and we recommend that it be adopted. In fact, we had previously proposed the same budget-balancing option to the Legislature.

Shift $452 Million in Vehicle License Fee Revenue to Public Safety Programs. The DMV collects vehicle license fees for the counties. Historically, the department has retained a portion of the fee revenues to cover its administrative costs. The *2008-09 Budget Act* appropriates $359 million of vehicle license fees revenues to support DMV operations—a figure that represents about 37 percent of the department's total operating budget. The Governor's 2009-10 budget proposes to shift this funding to local public safety programs that would otherwise be funded by the General Fund. Specifically, the Governor's proposal would shift $92 million in the current year and $359 million in the budget year. To backfill the hole in DMV's budget created by the shift of vehicle license fees monies, the Governor proposes to increase the vehicle registration fee by $12, raising it from $56 to $68.

The Governor's proposal assumes that the vehicle registration fee increase would be effective in April 2009. At this point, however, we do not think it is reasonable to assume that effective date. This is because it takes DMV about 90 days from enactment of legislation to implement a fee increase. Given the lag time required to implement a fee increase, the opportunity for any current-year General Fund relief from the proposed shift of VLF monies expires by early April 2009.

In our recent report *2009-10 Budget Analysis Series*, titled *Criminal Justice Realignment*, we discuss the concept of expanding upon the Governor's shift of vehicle license fees revenues to realign criminal justice programs to local government.

LAO Alternative Proposals

In addition to these administration proposals to achieve General Fund savings, we offer two additional recommendations for the Legislature to consider to help address the state's severe fiscal problems.

Sweep Non-Article XIX Funds in MVA. The MVA supports the activities of the CHP, DMV, and ARB. The MVA derives its revenues from a variety of sources, but mostly from vehicle registration and driver license fees. The budget estimates that, in 2008-09, MVA revenues will total about $2.4 billion.

Under Article XIX of the State Constitution, any revenues from fees and taxes on vehicles or their use—such as driver license and vehicle registration fees—can only be used for vehicle-related programs. However, other MVA revenues, such as those from various miscellaneous services provided by DMV to the public or businesses, are not subject to the constitutional restriction. As such, these revenues can be used for general purposes.

The budget estimates that non-Article XIX revenues would be $117 million in 2008-09 and $119 million on 2009-10. Based on our projection of MVA revenues and expenditures, we estimate that $70 million can be transferred to the General Fund each year for 2008-09 and 2009-10 without having an adverse impact on programs funded from MVA. Accordingly, *we*

recommend transferring $70 million to the General Fund for each of the two years.

Suspend Local Airport Grants. Revenues generated by the state's excise tax on aircraft and jet fuel fund various state grant programs available to general aviation airports in the state. Annually, roughly $4 million is allocated through these grant programs to local airports. The largest program funded with this money is the Annual Credit Grant, which provides $10,000 annually to each of 149 general aviation airports for either capital projects or operating expenses. The other grant programs provide funding for specific capital projects or land acquisition. These funds are usually used as a small match (typically 2.5 percent of project costs) for federal funds.

Many of the airports that receive state grants have multimillion dollar budgets, and have the option of increasing fees to users of airport facilities to provide any necessary federal matching funds in the near term. Airports that cannot raise fees might be able to delay their projects for a year. Thus, we do not think suspending the grant programs for one year would have significant adverse impacts on local airports. Accordingly, *we recommend suspending the airport grant program for the budget year and using the $4 million for General Fund relief.*

OTHER ISSUES

Unstable Funding Adversely Impacts Transportation Programs

The state has several programs to fund capital improvements to state and local transportation systems. Figure 5 summarizes these programs and their respective state funding sources. In order to effectively plan, develop, and construct transportation projects, funding for these programs should be predictable over time. Currently, funding for the state's transportation programs is not predictable from year to year. This creates difficulties in the state's ability to plan and deliver capital improvements. In the following analysis, we review the outlook for funding and the effect that funding instability has on the state's transportation programs.

We note that, in the previous section of this report, we have recommended that the Legislature take various steps to use transportation funds to help address the state's General Fund deficit. While we continue to recommend such actions given the state's massive deficit, it is nonetheless important for the Legislature to understand the negative effects on the stability of California's transportation finance system. We discuss these and other aspects of these problems in this analysis.

Stable and Predictable Funding Assists With Multiyear Projects

As Figure 5 shows, two ongoing programs—the State Transportation Improvement Program (STIP) and SHOPP—are supported from special funds with monies collected mainly from taxes on fuels. These programs are multiyear plans to fund the various phases of work (such as environmental review, design, and construction) required to build transportation capital improvements. Both programs are updated once every two years, so that each program continually schedules funding for projects for several years into the future, based on funding that is projected to be available under existing law.

The state also has two major programs—Proposition 1B and the TCRP—that provide one-time funding for transportation projects. While these are one-time programs, like STIP and SHOPP they provide funding for projects over multiple years.

Multiyear Nature of Projects Requires Predictable Funding. The multiyear approach to funding transportation improvements is necessary because of the length of time it takes to build capital projects. Simple capital improvements generally take a couple of years to complete from the time initial plans are prepared, through project development, to the end of construction. Complex projects take longer, sometimes many years, to complete.

A lack of predictable funding from year to year complicates planning for project workload and the setting of priorities. For instance, it would not make sense to fund the first phase of a project in a particular year if the funding required to complete the project will not be available in subsequent years. Without predictable funding, future funding to complete the project cannot be assured at the time the decision is made to fund the start of the project. This could lead to poor decisions about which projects to fund and when to fund them. Having predictable levels of funding from year to year can avoid unnecessary complications in determining project workload and the setting of priorities.

Predictable Funding Needed Because Projects Funded From Many Sources. In addition, most transportation projects are funded from multiple sources, including state, bond, local, and federal funds. Each source generally has different requirements or limitations on how funds can be spent. If expected funding from one source does not materialize, a project could be delayed while it awaits replacement funding. Therefore, predictable and stable funding from each source helps to avoid unnecessary project delays that can often make projects more costly.

Frequent Changes Create Instability and Inefficiencies, Delay Projects

Since 2001-02, transportation funds have been used to help balance the state's budget.

Figure 5

The State's Transportation Programs and How They Are Funded

State Transportation Improvement Program (STIP) is the state's ongoing five-year program of projects to enhance and expand the capacity of the highways and transit systems. The STIP is funded mainly from a portion of Proposition 42 gasoline sales tax revenues deposited in the Transportation Investment Fund and from funds in the Public Transportation Account.

State Highway Operation and Protection Program (SHOPP) is the state's ongoing four-year program of projects to repair and rehabilitate the state's highways and to improve the system's safety. The SHOPP is funded from the State Highway Account, which receives funding from the state's 18 cents per gallon gas tax and from truck weight fees.

Proposition 1B approved by voters in 2006 provides one-time funding from general obligation bonds for various specific transportation programs, mainly to expand the capacity of the state's highways and transit systems.

Traffic Congestion Relief Program (TCRP) is a statutorily created one-time program to fund 141 specific highway and transit projects. The TCRP was funded from the state's General Fund and a portion of the state's gasoline sales tax revenues. Due to state budget problems, much of the funding was loaned back to the General Fund before it could be used on projects.

Because the decisions to do so are made annually, depending upon the state's overall budget requirements, it is difficult to predict from year to year (1) how much transportation money will be redirected to help the General Fund and (2) the funding source from which the money would be redirected. As a result, it is not possible to determine which programs and projects would be affected until after budgetary decisions are made. The resulting instability and unpredictability of funding delays project progress, complicates efforts to plan for future projects, and creates inefficiencies in the department.

Transportation Loans Increase Instability and Will Delay Projects. In the current year, $231 million was loaned from SHA and other accounts to help balance the state's budget. These funds are required to be repaid by June 30, 2011. This means that some projects that rely on SHA money, mainly highway repair projects, will not progress in 2008-09 as originally scheduled in the SHOPP. Instead, these projects will be pushed out to later years.

For 2008-09 and 2009-10, the Governor's budget proposes to redirect a total of $202 million of tribal gambling revenues to the General Fund. These funds are supposed to repay past SHA loans (about $114 million) and loans from TCRF ($86 million) which funds TCRP projects. The redirection of these funds would affect a mix of SHA-funded projects and TCRP projects. Under the Governor's proposal, the redirection would occur only if the state receives federal stimulus money for transportation. However, there is no assurance that the federal money would be available for the same set of projects. Depending on the conditions imposed on the use of the federal funds, the department may have to delay one set of projects and work to deliver other projects instead.

Funding Fluctuations Create Other Inefficiencies in Caltrans. As mentioned earlier, most transportation projects rely on multiple sources to be fully funded. For instance, many projects that receive Proposition 1B funds also receive STIP funding from Proposition 42 revenues or from SHA. Some of these projects also receive TCRF funding. Caltrans staff must monitor and keep account of the availability of money from each source when they work to deliver the projects. When funding is held up due to budgetary or other decisions, staff resources are expended to determine which projects would be affected and how to minimize the impact on the projects. Staff resources are also spent to seek alternatives to provide backfill funding. This additional staff work could be reduced and inefficiencies minimized if funding for projects in the various programs are more predictable from year to year.

Proposed Sales Tax Increase Would Increase Funding

Higher Sales Tax Rate Would Provide More Proposition 42 Funding. To help balance the state's budget, the Governor proposes to temporarily increase the state's sales tax rate by 1-1/2 cents for three years. At this higher rate, the sales tax on gasoline would generate about $1.7 billion in Proposition 42 gasoline revenue for transportation in 2009-10. This amount is about $400 million more than estimated in the current year. Proposition 42 revenues are allocated as follows: 40 percent to cities and counties for local streets and roads, 40 percent to the state for the STIP, and 20 percent to the PTA for mass transportation purposes.

Budget Display Incorrect; Caltrans Plans to Spend State's Share. The Governor's January budget documents suggest that the full amount of the STIP's share of Proposition 42 funds would not be spent in the budget year. The budget documents indicate that a portion ($160 million) would be held as a balance in the Transportation Investment Fund. Given the lack of transportation funding available from other sources, we questioned Caltrans as to why these funds should be held as reserve. The department has since indicated that the budget display is in error, and that Caltrans does intend to spend the STIP share of Proposition 42 funds in the budget year.

Uncertainty of Higher Revenue Complicates Project Delivery. The Governor's proposal assumes that the higher sales tax rate would be effective March 1, 2009. The prospect of having additional Proposition 42 money for STIP projects means that the department would need to reassess which additional projects it can fund in the budget year and be prepared to move the projects forward. However, if the proposal is not adopted, then the department would have to reverse course and make further delivery adjustments.

Additionally, the proposal has a particularly significant impact on the PTA, which receives 20 percent of total Proposition 42 revenues. If the sales tax increase is rejected, there would not be sufficient funds to pay all the expenses proposed from the account, as we discuss later.

Unavailable Bond Funds Disrupt Project Progress

Proposition 1B, passed by voters, provides $20 billion in bonds to fund transportation improvements. Although the bond measure is a one-time program, it was expected to provide a degree of predictability in funding for a number of years. Currently, the Proposition 1B programs are well under way with about one-half of the funds appropriated in 2007-08 and 2008-09 combined. However, using bonds to fund projects has recently become problematic, as the state's cash problems, together with a tight credit market, have held up the issuance of bonds.

Pooled Money Investment Account (PMIA) Provides Short-Term Financing for Projects. Current law allows cash from the PMIA—the state's short-term savings account—to pay expenses incurred on bond-funded projects before bonds are sold. This process (known as "AB 55 loans") provides short-term financing for projects that are to be funded from bonds, including projects in the Proposition 1B programs.

Bond Funds Unavailable Due to Cash Problems. In view of the state's overall cash condition and the inability to sell bonds, the Pooled Money Investment Board (PMIB) voted on December 17, 2008, to suspend disbursements from the PMIA for bond projects. As a result of the board's action, money is not currently available to pay for work to continue on most Proposition 1B projects. Consequently, Caltrans is holding back on awarding new contracts to build projects and may have to stop construction on some projects. (Please see "Improving Proposition 1B Implementation and Accountability" later in this report.)

Maintenance and Rehabilitation Funding Continues to Shrink

A key component of the state's transportation programs is the rehabilitation and repair of the state's highway system. Major repairs and rehabilitation, as well as safety improvements to the system, are accomplished under the SHOPP. Routine repairs and maintenance of the system are carried out by the department under the Maintenance

program. State funding for highway maintenance and rehabilitation comes from the SHA.

Maintenance Costs Continue to Increase, Leaving Less for Rehabilitation. In recent years, the cost of maintaining the state's highways has increased. Spending more to pay these increasing costs leaves less funding for major rehabilitation and repair work. As a result, a substantial number of repair projects planned by Caltrans have not been funded. In addition, as the highways age, the amount of major rehabilitation needed has increased.

Gas Tax Revenues Are Declining, Recommend Rate Increase. As noted earlier, revenue from the 18 cents excise tax on gasoline and diesel—commonly referred to as the "gas tax"—and from truck weight fees fund the SHA. Currently, these sources do not provide sufficient funding for highway maintenance and rehabilitation. In addition, revenues from the gas tax have declined in recent years. While in the past gasoline consumption has increased at a stable rate of between 1 percent and 2 percent, it has declined every year since 2005. In the future, increasing fuel efficiency and a switch to alternatively powered vehicles could continue to put downward pressure on the consumption of gasoline and therefore on gas tax revenues. If the declining trend continues, an increasing amount of highway repair and reconstruction work would not be funded.

In previous analyses, we have identified substantial requirements, in the tens of billions of dollars, to repair the state's highways over the next ten years. To provide an ongoing, stable source of funding for highway repairs we have recommended the Legislature increase the gas tax by 10 cents per gallon, and index it in order to keep pace with future inflation. (Please see our *Analysis of the 2008-09 Budget Bill,* page A-34). In light of the growing disparity between revenues and needed maintenance and rehabilitation work, *we continue to recommend a gas tax rate increase as a way to provide more ongoing funding for maintenance and rehabilitation.*

Explore Mileage-Based Fees. In the long term, we think the Legislature should evaluate new ways of funding the maintenance, rehabilitation, and improvements to the transportation system that are becoming available due to advancements in technology. One method, in particular, would be to charge fees to drivers based on the number of miles traveled. The state of Oregon has conducted a pilot program to test such a mileage-based fee system. While this could prove to be an effective new way of funding transportation programs, it would require a significant amount of research to determine if a mileage-based fee system is feasible for California, and if so, how such a system would best be implemented. *Accordingly, we recommend the Legislature begin exploring how a mileage-based fee system could potentially be implemented in California.* We are continuing to collect information about this issue.

PTA Expenditure Priorities Unclear

Recent Broadened Use of PTA Has Resulted in Project Delays. Traditionally, PTA funds the state's intercity rail service and the STA program, provides support for Caltrans' mass transportation program, and funds transit capital improvement projects that are programmed in the STIP. In the past several years, the use of PTA funds was broadened to include home-to-school and regional center transportation in order to help the General Fund. To free up PTA money for these latter uses, transit capital projects have been delayed.

According to the California Transportation Commission (CTC) staff, about $520 million in projects programmed for funding from 2007-08 through 2009-10 have been delayed or deprogrammed. Many of these projects would instead be funded with Proposition 1B funds to the extent they are still high in priority for transit operators.

Absent Sales Tax Increase, Home-to-School Transportation Funding Will Be Reduced. The Governor's budget projects PTA revenues of $752 million in 2009-10, assuming the proposed sales tax rate increase becomes effective. Given the state's fiscal problems, the budget proposes to use $541 million for home-to-school and regional center transportation. The remaining funds would go to pay for intercity rail service, Caltrans' support, and pay about $78 million in outstanding obligations on transit capital projects. (These are payments for STIP transit projects for which PTA funding was allocated in previous years.) In order to leave a small reserve ($9 million) in the account at the end of 2009-10, the budget proposes no funding for STA in the budget year and to eliminate program funding for the second half of the current year. (Please see further discussion in the "State Transit Assistance" section of this report.)

The small balance in the PTA creates significant risk for the programs it funds because revenues could come in lower than expected. If, for instance, the Governor's proposed sales tax increase is not adopted, PTA revenues would be lower in the budget year and the account would probably have a funding shortfall of about $70 million. The Department of Finance (DOF) indicates that, should this occur, the administration will provide less PTA for home-to-school transportation to make up the difference.

In order to avoid a shortfall in the fund, *we recommend that the Legislature reduce the home-to-school transportation funding from PTA by $79 million if the Governor's sales tax rate increase proposal is not adopted. Additionally, we recommend that the Legislature adopt budget bill language under Item 6110-111-0046 stating that if resources in the PTA fall short of projections, PTA appropriation for home-to-school transportation will be reduced correspondingly.*

Future Federal Funding for Transportation Is Uncertain

The state receives about $3 billion in federal transportation funds a year. However, the future level of federal funding is uncertain at this time.

Potential Federal Economic Stimulus Funding for Transportation. It appears that substantial amounts of one-time funding, potentially in the billions of dollars, may come to the state as part of a federal economic stimulus package in early 2009. Many details of the federal package are not yet available for review by the Legislature. Depending on the level of assistance provided, and the restrictions on its use, federal stimulus funding could potentially pay for state projects that have been delayed due to insufficient funding. However, it is likely that the one-time funding must be expended within a relatively short period of time. In order to meet that requirement, Caltrans would have to again readjust its project delivery priorities. So that Caltrans will have sufficient time to adjust its workload, *we recommend that the Legislature provide direction to the department on the use of federal funds.* Specifically, we think the Legislature should have Caltrans (1) identify and expedite SHOPP projects that are almost ready for construction, and (2) identify delayed Proposition 1B projects that would likely be able to use federal funds.

Ongoing Federal Funding Uncertain. The current federal act that authorizes funding for transportation programs over multiple years will expire at the end of September 2009. Given past congressional delays in enacting new transportation authorization acts, it could potentially be some time before a new federal act is approved. As a consequence, the proposed funding level and policy approach of the federal transportation program may not be known for a while.

In addition, due to lower-than-projected tax revenues, the federal highway trust fund, which funds federal transportation programs, ran out of funds in 2008. Congress subsequently provided $8 billion to allow funding for transportation programs to continue. Even with the infusion of funds, it is possible the account could run out of money again before the end of 2009, at about the same time the federal act expires. It is unclear what Congress and the new administration would do in such a situation. The uncertainty regarding the availability of federal funds makes it even more complicated for the state to plan and deliver the state's transportation programs.

Issues for Legislative Consideration

As we noted previously, a number of different factors are contributing to a lack of stability and predictability in the funding for transportation programs. Some of the factors, such as large variations in the availability of federal funding for transportation programs, are not within the state's control. The Legislature has only limited options in the short term for other factors, such as the redirection of state transportation funding to benefit the General Fund, due to the state's severe budget problems.

Neveretheless, we have identified in this analysis some actions the Legislature can take to provide greater predictability in the funding for transportation programs. For instance, *we recommend that the Legislature set clear budget-year priorities for programs funded from the PTA. We also recommend increasing the state's gas tax to provide additional funding for highway maintenance and rehabilitation.* In the longer term, the Legislature should consider additional strategies to provide more stable and predictable funding for transportation programs. One option, as noted previously, would be to explore the possible use of mileage-based fees.

The key strategy, we believe, is for the Legislature to think comprehensively about how the different pieces of the transportation funding puzzle can be fit together to provide a stable set of resources for the programs and projects it considers to be its highest priority. In the end, we believe this approach would lead to a more efficient, and cost-effective, use of each transportation dollar.

Governor's Transportation Economic Stimulus Proposal

As part of his budget plan, the Governor proposes an economic stimulus package that includes a number of proposals relating to transportation. In the following analysis, we review these proposals and recommend an alternative to accelerate transportation projects to stimulate the economy.

The Governor's Proposal

The Governor's economic stimulus package as it relates to transportation includes the following proposals:

- Exempting certain highway projects from environmental review.

- Authorizing the use of design-build procurement.
- Authorizing public-private partnerships for transportation projects.
- Making additional bond funds available for local transportation.

Exempt Several Large Highway Projects From Environmental Review. The administration proposes to exempt a number of large highway projects from the state's environmental review (California Environmental Quality Act, or CEQA) process. Since the initial stimulus proposal was made in November 2008, Caltrans has modified the list of projects to be advanced to include eight projects with estimated total construction costs of about $713 million, including $311 million funded from Proposition 1B bonds and $402 million funded from GARVEE bonds that are backed by future federal funds. Instead of being subject to the CEQA process, these projects would only need to obtain necessary permits to move forward. The proposal also includes streamlining certain state and local permitting processes, mainly by shortening the time period within which permits would be granted.

Authorize Design-Build. The Governor proposes to set up a demonstration program to allow the construction of up to ten transportation projects using the design-build procurement method. Projects would be sponsored and the contract awarded by either Caltrans or a local transportation entity, and the types of projects may include highway, bridge, tunnel, or public transit capital improvements. The design-build authority would expire January 1, 2016. The Governor is also proposing to broaden the authority for local entities to use design-build for non-transportation projects.

Authorize Additional Public-Private Partnerships. The Governor proposes to allow Caltrans and other state agencies to enter into public-private partnerships for certain projects. Partnerships could be agreements whereby a private partner assists the public sponsor to define a feasible project and negotiates reasonable terms to implement the project. Alternatively, partnerships could involve a private entity assuming the responsibility for delivering, improving, operating, or maintaining eligible facilities in exchange for payment. For transportation projects, such payments could be made from revenue generated by tolls or other road user fees.

Make Local Transportation Funds Available. The Governor proposes to increase by $800 million the amount of Proposition 1B bond funds available in the current year for local transit capital improvements. This would bring total current-year funding to $1.15 billion for these purposes. The Governor also proposes to make an additional $700 million available for local streets and roads, thereby increasing the current-year funding for these uses to $950 million.

Below, we discuss various issues and concerns we have with the Governor's proposals.

Bond Funds May Not Be Available to Advance Projects

The Governor's economic stimulus proposal relies heavily on the expenditure of additional Proposition 1B funds in 2008-09. However, simply appropriating the funds does not mean they would be available for expenditure on projects in a timely manner. As we noted in our earlier analysis of the state of transportation funding, due to the state's current cash problems, short-term loans from PMIA are not currently available to pay for project expenses before bonds are

sold. Additionally, the state has not been able to sell bonds due to the tight credit market. Without the ability to sell bonds or borrow from the PMIA, the state would not be able to spend more on Proposition 1B projects under the Governor's proposal, and the objective to stimulate the economy would not be achieved. Even when the state's cash (and budget) problems are resolved and access to the bond market is restored, we think there still are several additional factors that would limit the benefits of the proposal, as described below.

Highway Projects May Only Advance by Couple of Months

The Governor initially proposed to advance $822 million in highway projects as part of his economic stimulus package in November 2008. Our review of the proposal at that time found that exempting projects from the CEQA process would likely only advance projects by a couple of months. Since November, Caltrans has modified slightly the list of projects proposed for acceleration. Instead of 11 projects, the list now includes 8.

Projects Require More Than CEQA Exemptions to Be Expedited. Our review of the updated request to expedite eight projects finds that CEQA exemptions and streamlined permitting alone are not likely to advance most of these projects by more than a couple of months. For instance, most of the projects would also require expediting federal environmental permits or exempting the state from project development work required to get necessary federal permits, such as studying the impact of a project on an endangered species. It is unknown at this time whether and when the state would get the necessary federal waivers and permits. If all these requests were granted on an expedited basis, Caltrans indicates that it could advance some projects by a couple of years.

Caltrans Can Advance Some Projects With Existing Authority. In addition, our review shows that Caltrans intends to redesign some projects so that certain segments of the projects may proceed to construction early while the design and development of the remainder of the project is completed in the customary time frame. It appears that, by splitting these projects up into smaller components, Caltrans could accelerate some projects without the requested CEQA exemptions and state permitting changes.

Design-Build and Public-Private Partnerships Not Needed to Advance Projects

Design-Build Has Merit, but Not Needed to Advance Projects. Design-build procurement would allow Caltrans to contract with the same private business to perform both the design and construction of a given project. This differs from the traditional procurement method in which the state contracts with private businesses only for the construction of projects after they have been fully designed. As noted earlier, the Governor's proposal would allow Caltrans or local transportation agencies to use this procurement method for up to ten transportation projects.

We think a pilot program on the use of design-build procurement for transportation projects has merit, and we have recommended that the Legislature enact legislation to do so in the past. (Please see *LAO Recommended Legislation,* December 2008, page 54). Discussions with the department, however, indicate that design-build authority would not be used for any of the highway projects being proposed for acceleration.

While a design-build pilot program has merit, it is not a necessary element to implementation of the Governor's economic stimulus proposal.

Public-Private Partnerships Also Not Needed to Advance Projects. Similarly, Caltrans indicates that it does not plan to use the proposed public-private partnership authority to speed up any of the projects designated for acceleration. Additionally, it could take a significant amount of time for the state to identify appropriate projects, request proposals from the private sector to form partnerships, and negotiate the terms of the agreements to set up the partnerships. Consequently, it is not likely that the Governor's proposal to authorize public-private partnerships for transportation projects would result in economic stimulus in the near term. Nonetheless, because private-public partnerships provide a tool for attracting private investment and financing of state infrastructure, we think that the Legislature should evaluate the proposal to determine whether, and under what circumstances, this tool may be used to the state's benefit.

Stimulus Effect of Local Road Funding Would Be Delayed

One component of the Governor's proposal is to appropriate an additional $700 million from Proposition 1B to cities and counties for streets and road improvements in the current year. Because many street and road projects are relatively limited in scope (involving activities such as resurfacing and repaving), the additional funds could provide relatively immediate economic stimulus to localities—at least, to the extent cities and counties have projects ready for construction.

However, to deal with the state's cash crisis, the Governor is also proposing to defer about $900 million in regularly scheduled payments to cities and counties until October 2009. These payments involve fuel (excise and sales) tax revenues that the state provides to cities and counties on a regular basis. Thus, the full stimulus impact of accelerating $700 million for local streets and roads would be delayed.

Transit Funds Have Limited Economic Stimulus Benefit

The current-year budget provided $350 million in Proposition 1B funds for local transit capital improvements. The Governor is requesting an additional $800 million in the current year for the same purpose. (Separate from this stimulus proposal, the budget requests $350 million for these purposes for 2009-10.)

Our review, however, indicates that not all of the $800 million could be encumbered by recipients (mainly transit operators) in 2008-09. Specifically, in an initial survey conducted by Caltrans, transit operators indicated that they only have about $676 million in projects that are ready to go. In addition, other factors could limit the benefits of this proposal, as discussed below.

Economic Stimulus Benefits to California May Be Limited. Our review of the survey data shows that about one-half of the proposed funding would be used for projects other than the construction of facilities, which may have limited economic stimulus benefit for California. For instance, new bus procurement comprises 28 percent of the requested stimulus funding. According to Caltrans, there is only one bus manufacturer in the state. Depending on the manufacturer's production capacity, some or most of the funds would likely go to out-of-state manufacturers. In that event, spending millions of dollars all at one time to procure new buses would provide little economic stimulus to California directly. In ad-

dition, bus procurement typically takes a couple of years. Any stimulus to the economy (such as increased employment of drivers or maintenance workers) resulting from the added transit capacity supplied by new buses would be delayed until the new rolling stock is delivered.

Other potential projects include expenditures on Global Positioning System (GPS) systems, marketing, radios, and computer software. Because it is unknown how much spending for these items would remain in California, the amount these projects would benefit the state's economy is also unclear.

Some Transit Capital Allocation Not Used for Highest-Priority Projects. As discussed in the "Improving Proposition 1B Implementation and Accountability" section of this report, the uneven and uncertain disbursal of bond funds for transit capital improvement may result in funds being used for projects that are not the highest priority. This is because not knowing how much and when funding would be available makes it difficult for transit operators to effectively plan for the best use of the funds. Injecting additional funds midyear may only further complicate their planning efforts.

Since the budget already proposes to make $350 million available for 2009-10, *we recommend delaying the $800 million to the budget year and instead providing the combined amount ($1.15 billion) in 2009-10.* This would facilitate better planning opportunities for local operators and encourage higher priority use of the funds.

LAO Alternative

In a report we issued in December 2008, entitled *Advancing Transportation Projects to Stimulate the Economy: An Alternative Approach*, we reported our findings and recommendations in regard to the Governor's proposed economic stimulus package for transportation. In the report, we highlighted the potential challenges to success for the Governor's proposal and offered an alternative approach for the Legislature to provide economic stimulus to the state using available transportation funding.

Specifically, we recommend the use of revenue bonds backed by future state gas tax revenues to accelerate 122 highway rehabilitation projects. These projects would be ready for construction in 2008-09, 2009-10, and 2010-11 but are not scheduled for construction until later years due to limited funding.

Federal Stimulus Could Fund Highway Rehabilitation. In addition, if the state were to receive federal economic stimulus funds for transportation projects, we think funding highway rehabilitation projects such as those we identified in our report would have the greatest economic benefit to the state. *Accordingly, we recommend that the Legislature target any federal economic stimulus funds that California receives for transportation to highway repair projects to the extent possible.*

Improving Proposition 1B Implementation and Accountability

Proposition 1B, approved by voters in November 2006, authorizes the state to sell $20 billion in general obligation bonds for transportation projects through specific programs intended to relieve congestion, facilitate goods movement, improve air quality, and enhance the safety and security of the state's transportation system. (For a more detailed description of the Proposition 1B programs, please see our *Analysis of the 2008-09 Budget Bill,* page A-40.) These bonds provide a major one-time infusion of state funds into the

transportation system that are to be spent over multiple years.

Figure 6 shows the various Proposition 1B programs and the amount of funding allocated to each. As the figure shows, about $9.3 billion of the Proposition 1B funds have been appropriated in 2007-08 and 2008-09 combined. As part of his economic stimulus package, the Governor is requesting further Proposition 1B appropriations totaling $1.7 billion in the current year for highway projects, transit capital, and local streets and roads. For 2009-10, the Governor requests an additional $3.5 billion for Proposition 1B programs. Below, we discuss the challenges and risks the programs face, and make recommendations to improve the implementation and accountability of the Proposition 1B programs.

Cash Problems Cause Stoppage of Projects

Money from PMIA is used to provide short-term funding to pay expenses on projects incurred before bonds are sold, including those for Proposition 1B bond projects. These expenses include mainly construction costs. As noted earlier in this report, on December 17, 2008, PMIB voted to suspend disbursements from PMIA for projects funded from Proposition 1B due to the state's difficult cash situation. (The board did later allow some past obligations to be paid.)

As a result of the board's action, money is not currently available to pay for work to continue on most Proposition 1B projects. Figure 7 shows that there are 196 projects totaling about

Figure 6

Appropriations of Proposition 1B Funds

(In Millions)

Program	Authorized Amount	Appropriated 2007-08	Appropriated 2008-09	Proposed 2009-10	Balance
Corridor Mobility	$4,500	$733.5	$1,717.4[b]	$1,351.3	$697.7
Trade Corridors	2,000	0.1	468.9[b]	489.8	1,041.2
Local Transit	3,600	600.0	1,150.0[b]	350.0	1,500.0
State Transportation Improvement Program	2,000	908.4	995.9	57.0	38.7
Local Streets and Roads	2,000	1,037.0	950.1[b]	0.1	12.8
SHOPP[a]	750	402.8	214.2	78.0	55.0
State and Local Partnership Program	1,000	0.1	200.6	200.6	598.7
Grade Separations	250	123.1	62.0	0.7	64.3
State Route 99	1,000	14.3	108.5[b]	431.5	445.7
Local Seismic	125	13.6	21.1	31.2	59.1
Intercity Rail	400	188.1	72.4	126.4	13.2
School Bus Retrofit	200	193.0	—	3.0	4.0
Air Quality	1,000	250.0	250.1	250.1	249.7
Transit Security	1,000	101.5	101.5	101.5	695.6
Port Security	100	41.4	58.1	—	0.5
Total Appropriations	**$19,925**	**$4,606.9**	**$6,370.8**	**$3,471.3**	**$5,476.1**

[a] Includes $500 million for State Highway Operation and Protection (SHOPP) augmentation and $250 million for traffic light synchronization.

[b] Includes Governor's January proposal to appropriate an additional $162 million for corridor mobility, $52 million for trade corridors, $800 million for local transit, $700 million for local streets and roads, and $5 million for State Route 99 in 2008-09.

$4 billion that may be delayed. Depending on how long funding remains unavailable, projects would likely be delayed for at least several months and potentially up to a couple of years.

Projects Already Under Construction May Be Stopped. As Figure 7 shows, 98 Proposition 1B projects are currently under construction, with contracts already awarded. These projects have estimated total construction costs of $1.8 billion, including $1.5 billion from Proposition 1B. In view of the state's cash situation, DOF has indicated it will order Caltrans to suspend work on most if not all of these projects by early February. It is unclear, at the time this analysis was prepared, how many of the 98 projects have actually been stopped.

A stoppage of work not only causes delays, but can result in substantial additional costs to the state. As summarized in Figure 8, Caltrans estimates that it would cost about $150 million just to shut down these projects. There would be additional costs to restart these projects in the future when funding is again available. These restart costs are estimated by Caltrans to be about $200 million.

Projects Planned for Award in 2008-09 Are Delayed. In addition to stopping projects that are under construction, Caltrans has also stopped awarding any new contracts to construct Proposition 1B projects. From January 2009 through June 2009, Caltrans and local project sponsors had planned to award contracts for 98 projects with total construction costs of $2.1 billion (including $1.7 billion from Proposition 1B). These projects are now delayed until bonds can be issued or until the board allows new loans from the PMIA.

Disbursements for Local Programs Also Held Up. In addition, Proposition 1B provides grants to local transportation agencies for transit capital and street and road improvements. The disbursement of these funds has also been stopped due to the state's cash problem. Specifically, as much as $420 million for local transit capital improvements and about $290 million for local streets and roads may not be disbursed

Figure 7

Proposition 1B Projects at Risk in 2008-09

(Dollars in Billions)

	Number of Projects	Proposition 1B Funding	Total Project Cost
Already awarded construction contracts	98	$1.5	$1.8
Projects planned for award in 2008-09	98	1.7	2.1
Total Projects at Risk	**196**	**$3.2**	**$3.9**

Figure 8

Stopping Construction of Projects Has Substantial Costs

Cost to Secure Construction Sites When Work Is Stopped

- "Button up" costs include installing barriers to prevent traffic accidents, covering trenches, and preventing runoff. These activities are necessary to make highway construction sites safe for travel by the public.
- Caltrans cost estimate: About $150 million to stop work on projects under construction.

Future Cost to Restart Projects

- Project restart costs include rebidding terminated contracts, paying penalties on suspended contracts, and redeploying equipment back to construction sites.
- Caltrans cost estimate: About $200 million but unclear how costs would be paid.

to local entities in the second half of 2008-09 because of the current situation.

Delay of Bond Projects Has Many Negative Impacts. Delaying funding for projects currently in construction would cause a costly suspension of projects. The lengthened time to complete projects also delays the benefits (such as reduced traffic congestion) that are to be realized from improved transportation facilities. There are negative impacts to the state's economy as well. Because project construction is done by the private sector, delaying projects negatively affects the employment of construction workers. In addition, due to the current economic climate, the state now faces a substantially more competitive bidding environment than in recent years, and is able to bid projects at prices that are significantly lower than estimated. By delaying projects, the state may miss an opportunity to save on the cost of construction by building projects while prices are low.

Other Risks Threaten Project Delivery

The CTC is the administrative agency for a number of Proposition 1B programs. These include three predominantly highway-related programs for which CTC selected projects on a competitive basis: (1) the Corridor Mobility Improvement Account (CMIA) program, (2) the Trade Corridor Improvement Fund (TCIF) program, and (3) the State Route 99 improvement program. (The commission also administers other Proposition 1B programs that provide funding for non-highway purposes or are allocated by formulas.) Projects in these programs were selected based on criteria that include meeting set construction deadlines. Additionally, it is expected that the projects would be fully funded from a combination of sources, including a specific, fixed amount from Proposition 1B bonds.

In addition to the immediate risks to projects relating to the actions of PMIB, there are other risks to the delivery of projects in these three programs. We discuss these other risks below.

Less Local Money Available to Pay for Cost Increases. Because the amount of Proposition 1B funding allocated for each project is fixed, any increased costs must be paid from another source, most likely from local funds. Currently, 19 counties have adopted local sales tax measures to fund transportation improvements, including local contributions toward Proposition 1B projects. However, due to the downturn in the economy, potentially less revenue is available from these local sales taxes to cover any project cost increases. Discussions with local transportation agencies indicate that, in general, local sales tax revenues have declined by about 5 percent to 20 percent in the past one to two years. Additionally, many local agencies issue bonds against future sales tax revenues in order to raise money upfront to pay project costs. However, because of tight credit markets, these agencies may have difficulty issuing such bonds in the near future.

Some Projects Are Already Overbudget. Proposition 1B requires that CMIA projects begin construction no later than December 2012 in order to receive bond funds. Because of this requirement, a substantial amount of project development work (environmental review, design, acquisition of rights-of-way) has already been completed for most of the projects selected for CMIA. It is during these project development activities that cost increases are often discovered. For instance, the environmental review could reveal that additional costly mitigation measures would be required. Given that most CMIA

projects are already well into this development phase, it is not likely that these projects will have significant cost increases.

Nevertheless, our review found that as of November 1, 2008 about 20 percent (or 11 out of 54) of CMIA projects had known cost increases of at least either $5 million or 5 percent above the original cost estimate. While cost increases of $5 million or more may not be substantial when compared to the total cost of kinds of large projects that are typical in the CMIA program, any cost overrun can be problematic, because it would still require that additional monies be provided (from non-bond sources) to fully fund the projects.

At this time, it is too early to determine the extent to which projects in the TCIF and State Route 99 programs will incur costs that are higher than planned. Most TCIF and state Route 99 projects still require a substantial amount of project development work. Thus, there is a greater risk that the costs for these projects could escalate significantly before they are ready for construction.

CTC Should Report on Risks and Lagging Projects. In order to monitor the progress of the bond program, *we recommend that the Legislature enact legislation that requires CTC to include the following additional types of information in its annual report to the Legislature:*

- The overall status of the Proposition 1B programs.
- Risks to project delivery.
- Evaluations of projects that are more than six months behind schedule and/or more than 20 percent over cost.
- Recommendations to improve project delivery and program effectiveness.

This information would provide the Legislature with an annual, aggregate look at the progress of all Proposition 1B programs and identify the key risks and threats to program progress as well as means to mitigate them.

Intercity Rail Procurement Progress Slow

Intercity rail ridership has experienced substantial growth in recent years. The state's three intercity rail services had an average ridership increase of 12 percent in 2007-08. The Capitol Corridor service in particular has recorded nearly 50 percent ridership growth since 2003-04. In order to meet the growing demand, service capacity has to increase by procuring additional cars and locomotives (rolling stock). The department's most recent State Rail Plan projects a $290 million need for additional rolling stock and maintenance facilities over the next ten years.

Proposition 1B provides $400 million for intercity rail improvements, including at least $125 million for rail car and locomotive procurement. The Legislature appropriated $187 million of these funds in 2007-08 and an additional $71 million in 2008-09 for Caltrans to procure rail rolling stock and improve track and other rail facilities.

Caltrans Slow to Use Funds. Caltrans is spending the funds at a much slower rate than was anticipated when they were appropriated. To date, only $64 million (out of the total $258 million) has been encumbered for various track improvement projects, and Caltrans does not expect to encumber any more funds for these projects in the current fiscal year. The department did not use any of the funding provided to it in 2007-08. This is because statutory lan-

guage required an audit of intercity rail ridership before the funds could be encumbered for rolling stock, but the audit was not completed in time for the money to be spent.

Required Report Not Yet Submitted. Because of concerns over the fact that none of the funds appropriated for rail car procurement were spent in 2007-08, the Legislature added language to the 2008-09 budget that requires Caltrans to report to the Legislature by January 1, 2009 on the activities the department has undertaken to spend the money for rolling stock procurement. At the time this analysis was prepared, the report had not been submitted, and the department had yet to procure any rail cars or locomotives.

Caltrans Should Report Procurement Status at Budget Hearings. *We recommend that the Legislature direct the department to explain at budget hearings why it has not submitted the required report.* The department should also report on why it has not made any progress in procuring rail equipment.

Budget-Year Request for Track and Facility Improvements Warranted. The 2009-10 budget requests an additional $125 million for various intercity rail projects. These projects include mainly track and station improvements on all these corridors. Our review shows the requested projects to be reasonable.

Year-by-Year Transit Formula Hinders Project Planning and Skews Priorities

Proposition 1B provides $3.6 billion for transit capital improvements, including the construction and expansion of rail and bus systems and the acquisition of equipment. The Legislature appropriated $600 million of these funds in 2007-08 and $350 million in 2008-09. As of the beginning of 2009, somewhat over one-half of these funds had been provided to transit operators and regional transportation agencies. (As part of his economic stimulus package, the Governor is proposing to increase the current-year funding for this purpose by $800 million.)

Funding Uncertainty Hinders Project Planning. So far, the amount of funding appropriated for these projects has varied greatly from year to year. Also, the appropriated amounts have been allocated without a predictable, ongoing formula. Due to uncertainty about how much funding will be available each year, and over how funds will be allocated from year to year, planning efforts by project sponsors (mainly transit operators) are being hampered. Large projects are difficult to plan and fund without some knowledge of how future bond funding will be distributed annually, and how much funding a sponsor could reasonably expect over several years. Additionally, some small transit operators are having trouble effectively using their small annual allocations. This is because they are unable to carry the funds appropriated over multiple years to accumulate enough money to complete projects.

These challenges are leading sponsors to fund projects that may not be their highest priority just so that the project will fit the available funding. Eligibility guidelines require each project to be in a region's long-range plan, which should include all high-priority or important future projects. However, our review showed that many of the project applications for bond funding indicated that the recipients recently amended their plans to include these projects. This means that many projects were not sufficiently high in priority to be included in the sponsors' initial plans. Our review also found that over $100 million, or nearly 20 percent, of the disbursed bond funds have been spent on peripheral needs such as bus

stop and station improvements and upgrading farebox equipment. In the case of some small operators, funds were spent for bus benches, bus LED signs, brochure holders, and bus stop signage rather than projects that would directly increase the capacity of transit systems.

Legislature Should Establish an Ongoing Allocation Process... As we proposed in our *Analysis of the 2008-09 Budget Bill* (see page A-54), *we continue to recommend that the Legislature establish a formula that directs the allocation of the remaining funds such that the percentage of the total that each agency will receive over time is defined.* Doing so would allow transit agencies to better estimate their share of funding. This, in turn, would enable better project selection and use of the bond funds for high-priority projects.

... And Allow for "Banking" of Funds. *We also recommend that the Legislature enact legislation that allows recipients to either (1) bank their allocations over multiple years so that they can accumulate funds for large high-priority projects, or (2) fund projects in advance of future bond funding, with a commitment that future allocations would be made available as reimbursements for the project's cost.* This would allow fund recipients to use bond money more effectively to pay for large projects that are a high priority.

Improve Accountability for Proposition 1B Programs

After passage of Proposition 1B in 2006, the Legislature and the administration decided to require a greater level of accountability for the use of bond funds than other transportation programs in general. To achieve ongoing accountability over the course of the bond programs, the administration proposed to develop and maintain a "bond accountability" internet web site to report the progress and status of each bond project.

The Legislature agreed to the approach, but also adopted legislation requiring periodic reports on the Proposition 1B programs. Specifically, Chapter 181, Statutes of 2007 (SB 88, Committee on Budget and Fiscal Review), requires each Proposition 1B administrative agency to collect reports from bond fund recipients and to submit those reports to DOF every six months. The purpose of these reports is to ensure that projects are proceeding on schedule and within their estimated cost. As the administrative entity for many of the Proposition 1B programs, CTC is subject to this reporting requirement.

CTC Failed to Provide Statutorily Required Reports. Despite the statutory requirement, CTC has decided not to submit the semiannual reports for any of the Proposition 1B programs it oversees. Rather, on September 25, 2008, CTC notified DOF that it would not submit a report on the status of the Proposition 1B projects. The commission asserted that the information provided on the bond accountability web site developed by the administration fulfills its reporting requirements. (As we discuss below, our review found problems with the information posted on the web site.) In any event, CTC's failure to submit the required reports leaves a gap in Proposition 1B accountability, because CTC is the only entity charged with oversight of these bond programs.

Furthermore, discussions with CTC staff in October 2008 indicate that the commission has no role in ensuring that information reported on the administration's web site is accurate or helpful. For instance, CTC is not responsible for entering or even reviewing information on the web site. When asked about problems and changes to

the web site (as described below), the commission staff was unaware of either.

Bond Accountability Web Site Not Very Helpful. Our review finds that certain information that is essential to understanding the progress and status of Proposition 1B projects is missing from the bond web site. This missing information about projects, as shown in Figure 9, mainly includes planned and actual dates for the beginning and completion of various phases of a project (also known as project milestones) as well as cost information.

Our review shows that while the web site does provide some information on the projects for several programs (namely CMIA, State Route 99, SHOPP Augmentation, and Local Bridge Seismic programs), it is difficult, and in some cases impossible, to determine basic information about the status of projects. For instance, for many projects it is unclear when the milestones are being completed and if the project is generally proceeding on schedule. In addition, for other Proposition 1B programs—specifically TCIF, STIP Augmentation, Traffic Light Synchronization, and Grade Separation programs—only a listing of the projects and their original schedule and costs are available. For these programs, the web site does not provide any of the information needed to perform ongoing oversight, such as to determine if projects are within cost estimates, on schedule, or if the project has even been started.

Overall Project Status Indicators Were Misleading…and Now Are Missing. In order to provide an easy way to determine if bond projects are on schedule and within cost, the administration had previously proposed to include status indicators for each project on the web site. The status indicators would show a green checkmark for projects that were on schedule, a yellow diamond for projects with potential risks, and a red "X" for projects with known cost or schedule changes. As of July 2008, the indicators showed that all projects were on schedule and within cost, despite the fact that at that time some projects had known increases in cost and delays in schedule.

After discussions with Caltrans about the seemingly inaccurate information, the project status indicators were removed from the web site. While removing inaccurate information

Figure 9

Key Project Information Needed for Accountability

- ✓ ***Project Milestones.*** The development of projects occurs in phases that generally include environmental review, design, rights-of-way acquisition, and construction. The beginning and completion of these phases are called milestones. The achievement of project milestones are used to measure the progress of a project's development. Information should include:
  - Planned start date and completion date of each phase.
  - Actual or estimated start and completion of each phase.
  - An indicator to show when each phase has been completed.
- ✓ ***Project Costs.*** Information on the original cost estimate and any changes throughout the various phases of a project.
- ✓ ***Date When Information Was Last Updated.*** Information reported about projects should be clearly dated.
- ✓ ***Overall Status of the Project.*** Because projects can be impacted by factors that are not necessarily measured by the milestones, an overall assessment of whether the projects are on schedule and within cost is needed to facilitate oversight of the projects.

from the web site was appropriate, completely removing the status indicator feature means that the web site no longer provides a short-hand summary on the status of the bond projects.

CTC Should Report at Budget Hearings. As noted above, CTC has failed to provide the required Proposition 1B reports. In addition, the commission is contributing to a lack of accountability for the use of Proposition 1B funds by not reviewing information on the administration's web site to ensure its accuracy. Accordingly, *we recommend that the Legislature direct CTC to report at budget hearings on why the commission has disregarded the statutory requirement to submit semiannual reports on the status of the bond programs.* Given that the web site has proven to be a poor accountability tool, *we recommend that the Legislature enact legislation requiring CTC to provide additional information on the Proposition 1B programs in its annual report to the Legislature, as we recommended earlier.* Doing so would improve accountability and oversight of the bond programs.

State Transit Assistance

The state provides assistance to regional and local transit systems in two ways. First, the state funds transit capital improvements, such as equipment purchase, track, and facility construction. The PTA has provided over $1 billion to these types of transit and rail projects over the past five years, and since 2007, Proposition 1B has provided an additional $1.2 billion for these purposes. Second, the state provides financial support for transit operations through STA program. Funding comes from PTA and is allocated to local recipients (mainly transit operators) based on a statutory formula. Before 2001, STA funding ranged mostly from $40 million to $70 million a year. Since the passage of Proposition 42 in 2002, however, funding for STA has been significantly higher. The current-year funding of the STA program is at $306 million.

Governor Proposes to Eliminate STA Funding

Traditionally, PTA monies were used to fund the state intercity rail service, transit capital projects programmed in STIP, and Caltrans mass transportation and planning activities. As we noted earlier (see the "Background" section of this report), PTA uses have been broadened in recent years specifically to fund home-to-school transportation and regional center transportation in order to help address the state's General Fund shortfall. Falling fuel prices have led to an unanticipated decrease in the fuel tax revenues deposited into the PTA. In response to this problem, the Governor's budget proposes to reduce the current-year funding for STA by one-half, or $153 million, in order to ensure adequate funding for home-to-school and regional center transportation in 2008-09, as planned. Additionally, the Governor proposes to eliminate the STA program statutorily, thereby providing no further funding for this program as of 2009-10.

Approve the Governor's Budget Proposal

PTA Will Have Shortfall in Current Year Absent Corrective Action. As noted above, due to falling gasoline prices, PTA resources will be less than projected in the current year. After funding home-to-school and regional center transportation, maintaining the intercity rail program, and paying outstanding transit capital obligations, the account will not have sufficient resources to fund the STA program at the planned level

of $306 million. To avoid a significant shortfall in the account, the Legislature faces having to prioritize the use of PTA funds. Given the state's fiscal condition, we concur with the Governor's proposal to reduce STA by $153 million—the equivalent of half of the original full-year appropriation—in order to achieve the planned level of General Fund relief in the current year. *Accordingly, we recommend that the Legislature adopt the Governor's proposal.*

PTA Resources Will Continue to Be Limited in the Budget Year. The PTA's resources in the budget year are projected to be about $750 million. This amount, however, assumes that (1) the current-year proposed STA reduction is adopted and (2) the Governor's proposal to increase the state sales tax is effective in 2009-10. The budget proposes to provide $541 million for home-to-school and regional center transportation combined in 2009-10, as relief to the General Fund. Doing so and supporting all its other existing purposes—paying for state intercity rail service, as well as obligations on transit capital projects—would essentially deplete all projected PTA resources in 2009-10. Thus, there would be no resources left to fund STA in the budget year. Based on the lack of available funding and state budgetary concerns, *we recommend that the Legislature provide no funding for STA in 2009-10.* (See additional discussion about the PTA fund condition in "Unstable Funding Adversely Impacts Transportation Programs" in this report.)

Program Elimination Should Be Considered on Policy Grounds

In assessing the Governor's proposal to change state law to permanently eliminate the STA program, the Legislature should consider a number of policy issues beyond the immediate budgetary solution of using PTA to help address the current General Fund problem. For example, the Legislature should assess the state's role in funding local transit and the goals and objectives of any state assistance. We discuss these issues below.

State's Role in Funding Transit. Public transit exists primarily to serve local communities. In large metropolitan areas, integrated transit systems now provide an alternative to road and highway use within entire regions. As such, these services are primarily a local and regional responsibility.

However, the state has had a longstanding policy of assisting public transportation services and encouraging regional transportation coordination. The first step in this direction was the Legislature's enactment of the Transportation Development Act (TDA) in 1971. The law provides funding equal to ¼ cent of the general sales tax that is collected statewide to counties for transit assistance purposes. In 2007-08 (the most recent year of data from the State Controller's Office [SCO]), local transit received about $1.4 billion in TDA funds mainly for operating expenses. Since 1980, the STA program has provided supplemental state funding to the TDA monies to help support transit operations from a portion of the gasoline sales tax revenue.

As noted earlier, the state also provides substantial funding to transit operators to make capital improvements. Most recently, Proposition 1B allocated $3.6 billion in bond funds for these purposes. Given the substantial amount of state capital funds and TDA funds that transit operators receive, the Legislature should consider what other goals and objectives it may want to achieve with the additional assistance provided under STA. For instance, should STA be used to create

incentives for operators to provide specific types of transit service or to achieve specific service goals? Alternatively, should any additional state role in transit be limited to just capital assistance?

STA Accounts for Small Portion of Overall Transit Operations. Currently, transit operations total in excess of $6 billion statewide a year. About 70 percent of all transit operating revenues comes from local sources, including passenger fares and local (mainly sales) taxes. The TDA funds account for about 16 percent of annual transit revenues, while federal funds account for about 10 percent. The remaining funding—about 3 percent per year—comes from STA. The relative small portion of overall transit operations supported by STA raises the question of how significant a contribution the program provides to overall transit services in the state.

STA Funding More Important to Small Operators. Of the roughly 260 entities statewide eligible to receive STA funding, 150 operators received funding between 2001-02 and 2005-06, according to data reported to the SCO. For the 25 largest recipients (among them the Los Angeles County Metropolitan Transportation Authority, Bay Area Rapid Transit, and Santa Clara Valley Transportation Authority), which received the bulk (over 90 percent) of the total annual STA allocation, program funding constituted on average about 3 percent of operating revenues. However, STA was a significant resource for the 25 smallest recipients, comprising between 17 percent and 31 percent of their annual operating revenues. Most of the small operators each received amounts in the tens of thousands of dollars annually. Many of these recipients are specialized service operators located in rural areas such as Humboldt and Imperial Counties, providing mainly paratransit-type service.

Summary. The specific service-level benefits realized by the state's current role in funding transit operations through STA are unclear at this time. Compared to TDA funding, the STA program contributes a relatively small amount to statewide transit operations. Most of STA is allocated to the state's largest operators and comprises a small percentage of their overall revenue, although it is a larger part of funding for many smaller operators, particularly rural and specialized service providers. The impact of the program on the overall public transportation system, however, cannot be determined. This is both because of the relatively small size of the program overall and the general-purpose nature of the funding assistance. If the Legislature chooses to continue the STA program, we recommend that the Legislature improve the program by adopting a more rational funding formula and tying the distribution of funds to recipient performance so as to better target the use of state funding. We discuss the advantages of these changes in state policy below.

Create a More Rational Funding Formula

Current Funding Formula Results in Unpredictable Allocations. The PTA receives its revenues from sales taxes on gasoline and diesel. (Currently, state gasoline sales tax receipts are split into three separate allocations of funding—spillover, Proposition 111, and Proposition 42. Depending on the price of gasoline and the state's economic conditions, the amount of spillover varies from year to year.)

Prior to 2007-08, STA was statutorily allocated 50 percent of all PTA revenues each year, regardless of the revenue source. Beginning in 2008-09, the funding formula was revised such that the shares of PTA revenues that the program

receives differ depending on the source of the revenues. Specifically, STA now receives:

- Two-thirds of all spillover gasoline sales tax revenue deposited into the PTA.
- Seventy-five percent of all Proposition 42 gasoline sales tax revenues transferred into the PTA.
- One-half of all Proposition 111 gasoline sales tax revenue and diesel sales tax revenues deposited into the PTA.

As Figure 10 shows, the current formula can provide different STA funding levels from the same amount of gasoline sales tax revenue depending on the amount of overall revenue that is counted as spillover revenue. Essentially, the higher the spillover amount, the higher the formula-determined STA funding level.

We see no logical basis for funding the program differently depending on whether a certain increment of gasoline sales tax revenue is determined to be spillover. Because of the volatility of spillover revenue from year to year, STA funding levels have and will continue to fluctuate under the current formula.

Given the unpredictable nature of STA funding, transit operators may be reluctant to plan for receipt of these funds in their budgets. As such, it is likely that STA is not always being used in the most effective manner.

Predictable Formula Would Enable Better Planning. A predictable funding formula would allow recipients to better plan how to use the funds. *If the Legislature decides to continue the STA program and provide transit assistance on a formula basis, we recommend that the Legislature enact a more predictable funding formula.* A new funding formula could be structured in one of two ways. The Legislature could choose a specific funding level, based on some average of the previous years' funding amounts, and provide that amount each year. This would provide funding certainty to transit operators. Another option is to set STA funding each year as a percentage of total PTA revenues, similar to the way funding was calculated prior to 2007-08. In this way, STA funding would not be allocated differently for each particular revenue source and be somewhat more predictable than it is currently.

Figure 10

STA Funding Varies Depending on Spillover Revenues

(In Millions)

	Scenario A		Scenario B	
Component	**Gasoline Sales Tax**	**STA Amount**	**Gasoline Sales Tax**	**STA Amount**
Spillover[a]	$1,000	$330	—	—
Proposition 42[b]	1,435	215	$2,435	$365
Proposition 111	65	32	65	32
Totals	**$2,500**	**$577**	**$2,500**	**$397**

[a] Figure shows total spillover revenues. Of this amount, 50 percent is deposited into the Public Transportation Account (PTA).

[b] Figure shows all Proposition 42 gasoline sales tax revenues. Of this amount, 20 percent is transferred into the PTA.

STA = State Transit Assistance.

Include Performance Measures in Distribution Formula

If the Legislature chooses to continue the STA program in the future, we further recommend that performance measures be used in the distribution of funding to

transit operators. The current formula for distribution of STA funding does not effectively consider the performance of transit operators. One-half of STA funds is now allocated based on population and one-half based on operating revenues. To be eligible for funding, an operator must meet a minimum farebox recovery ratio, generally 20 percent. We find that this eligibility measure is artificially low and does little to encourage performance improvement.

If the Legislature decides to continue the STA program, we recommend that the Legislature adjust the way funding is distributed to tie the amount that an operator receives to specific, measurable outcomes of performance. For instance, the Legislature could choose to reward operators that are increasing the cost-effectiveness of their operations. Many measures currently used by operators to track their own performance could be instituted to determine the amount of STA awarded to each recipient.

Integrating these performance measures into the distribution of funds would reward well-operated systems and encourage others to improve their operations. For example, to promote cost-effectiveness, recipients with an improving (declining) ratio of annual operating costs per passenger mile, or annual subsidy per passenger mile, could be eligible for a larger percentage of funding than they would otherwise receive under the present formula. Transit operators that were improving their efficiency would be able to expand their systems and the state's funds would better benefit statewide transit operations.

Conclusion

Due to the state's budget problem, we recommend that the Legislature suspend STA for the remainder of the current year and for the budget year, but consider the policy implications before statutorily eliminating the program. If the Legislature decides not to eliminate STA, we recommend two statutory changes to the current program. First, in order to enable local operators to reliably budget for state assistance, we recommend enactment of a more predictable annual funding calculation. Second, we recommend the adoption of performance criteria for the distribution of funds in order to drive desired behavior among recipients. These changes would enable the Legislature to then better determine the impact of the program on the state's overall public transportation system.

Caltrans—Improving Resource Allocation for Project Planning

Caltrans' transportation planning program is responsible for a range of activities including the preparation of initial plans for individual projects, also called "project initiation documents" (PIDs). Caltrans proposes to allocate $51 million (SHA) and 433 personnel-years (PYs) for the preparation of PIDs in the budget year. This compares to $49 million and 433 PYs provided for the department's PID activities in 2008-09. In this section, we examine Caltrans' PID activities and make recommendations to improve the allocation of resources for this program activity.

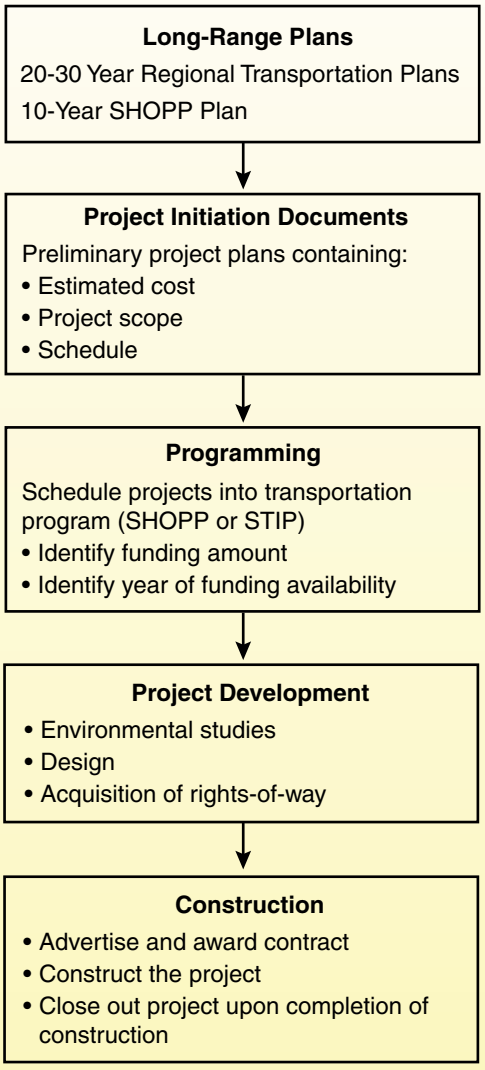
How Caltrans Plans Highway Capital Projects

Project Ideas Come From Long-Range Plans. Figure 11 shows the steps the state takes to plan, develop, and build highway capital projects. As shown in the figure, long-range transportation plans forecast travel demand over a period of many years and identify alternatives, including various capital improvement projects that would

meet the projected travel demand. These plans are fiscally unconstrained, meaning that the potential capital projects are identified in the plans without regard to funding availability. Current law requires Caltrans to plan for long-term rehabilitation, major repairs, and reconstruction of the state's highways in the Ten-Year State Highway Operation and Protection Plan. Long-range plans for highway expansion, development of transit systems, and local street and road improvements, called Regional Transportation Plans (RTPs), are developed by regional transportation planning agencies. The RTPs typically cover a period of 20 to 30 years.

Figure 11

How Caltrans Builds Capital Projects



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

PIDs Provide Details About Individual Projects. Project ideas are identified in the long-range plans. Before potential projects can be developed and constructed, however, detailed project planning work must first be completed. Initial project plans, called PIDs, contain specific information, including the identification of the transportation problem that is to be addressed, an evaluation of potential alternatives to address the problem, and the justification and description of the preferred solution. Each PID also includes the estimated cost, scope, and schedule of the project—information needed to decide if, how, and when to fund the project.

PIDs Required Before Projects Can Be Programmed for Funding. The CTC requires that a PID be completed before a project can be adopted into one of the state's transportation programs, and state funding scheduled for the various phases of a project (such as environmental review, design and construction). The state has two main ongoing transportation programs, SHOPP and STIP. The SHOPP is a four-year program of projects that rehabilitate the highway system, or improve the system's safety. The STIP is a five-year program for expanding the capacity of state highways. Both SHOPP and STIP are updated in two-year cycles.

Projects that are to be programmed in an upcoming cycle must have PIDs prepared and completed before the cycle begins. Thus, as Figure 12 (see next page) shows, PIDs are typically prepared during the two-year period between programming cycles. For example, PIDs for

projects that are to be programmed into the 2010 SHOPP would ordinarily be prepared during 2008-09 and 2009-10. The amount of work and length of time needed to complete a PID depends upon the complexity of the project. A PID for a relatively simple project such as a SHOPP pavement project typically takes a few months, while a PID for a more complex project, such as a STIP project to significantly expand a highway, may take a few years to prepare. In dollar terms, the cost to produce a single PID can range from tens of thousands of dollars up to a few million dollars.

After a PID is completed it is put on the "PID shelf" until funding becomes available in the next programming cycle. (Caltrans defines the PID shelf as planning documents that have been completed for projects that have not been programmed.) However, when there are more PIDs completed than can be funded, some PIDs could remain on the shelf for a number of years.

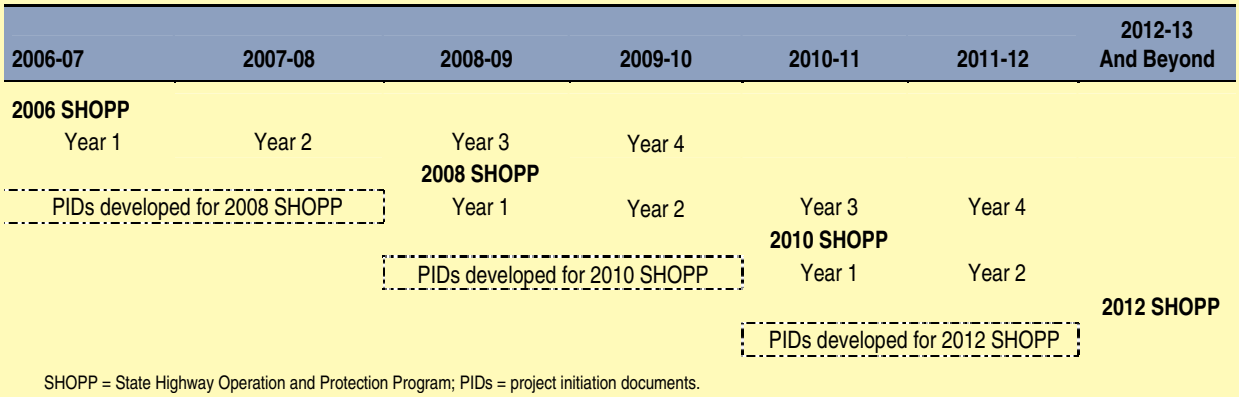
Most PIDs Are Prepared by Caltrans Staff. All PIDs for potential SHOPP projects, and many PIDs for potential STIP highway projects, are prepared by Caltrans staff who are mainly engineers and transportation planners working in district offices throughout the state. (Some PIDs for STIP projects are prepared by regional agencies.) Figure 13 shows the number of PYs and funding expended on the preparation of PIDs from 2002-03 to 2007-08. As the figure shows, staffing (in PYs) for PID activities has declined somewhat since 2002-03, while total expenditures to support those staff have increased slightly in that time. However, since 2006-07, staffing has been stable at about 430 PYs. In total, from 2002-03 to 2007-08, the department spent about $265 million preparing PIDs.

PIDs Completed for Many Projects That Cannot Be Funded

Having Some PIDs on the Shelf Is Warranted. At the time PIDs are prepared, it is not possible for Caltrans to know exactly how much funding would be available to program new projects for development. Because of this uncertainty, it is reasonable for Caltrans to have some PIDs on the shelf at any given time. In addition, if new funding unexpectedly becomes available, as could happen with federal economic stimulus funding for transportation projects, having some PIDs already completed could allow projects to

Figure 12

SHOPP Programming Cycles and PIDs



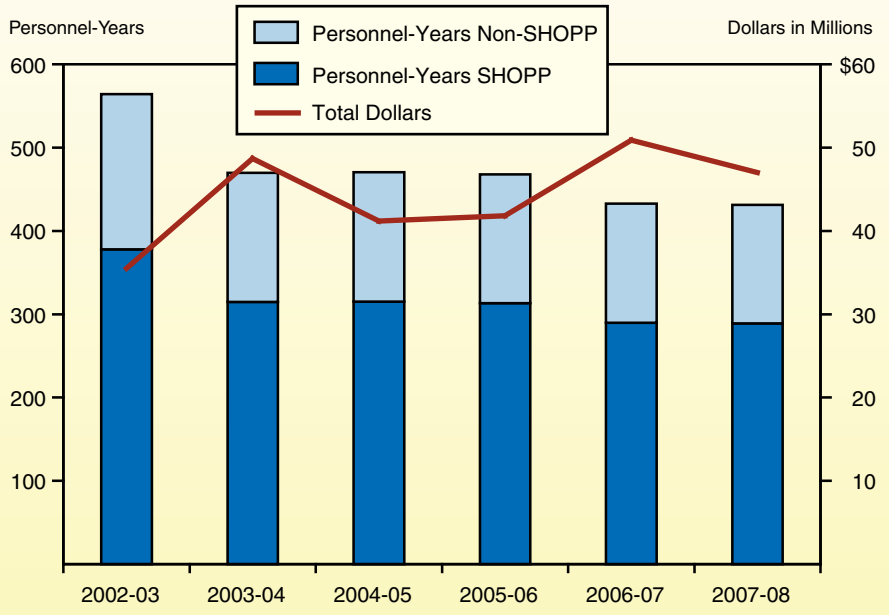
SHOPP = State Highway Operation and Protection Program; PIDs = project initiation documents.

start more quickly than would otherwise be possible. However, this benefit would be limited because projects on the PID shelf still require project development (such as environmental review, engineering, design, and acquisition of rights-of-way). Consequently, only a few projects with completed PIDs would likely be able to start construction quickly enough to qualify for federal stimulus funding.

Many More SHOPP PIDs Prepared Than Needed. Our review shows, however, that the amount of new PIDs produced for each SHOPP cycle far exceeds the funding available to develop and construct new projects. Figure 14 compares the dollar value of projects for which SHOPP PIDs have been completed to the dollar value of new projects actually programmed in the recent three SHOPP cycles and for the Proposition 1B program. As the figure shows, funding available

Figure 13

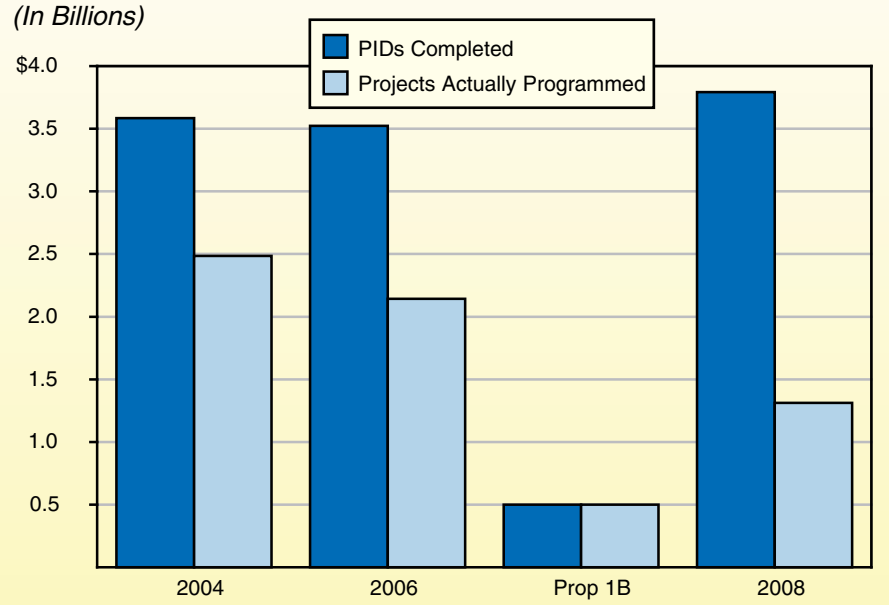
Resources for the Preparation of Project Initiation Documents



SHOPP = State Highway Operation and Protection Program.

Figure 14

Completed SHOPP PIDs Exceeded Actual Programming Capacity



SHOPP = State Highway Operation and Protection Program;
PIDs = project initiation documents.

to add new projects to SHOPP has declined in recent programming cycles; however, Caltrans' production of PIDs during this time has increased.

Caltrans Has a Large Shelf of PIDs for Unfunded SHOPP Projects… The over-production of SHOPP PIDs has led to a large number of PIDs sitting on the shelf. As of July 2008, Caltrans had 485 completed PIDs for unfunded SHOPP projects. The amount of funding needed to develop and construct all these projects is estimated to be $4.7 billion. By comparison, when the SHOPP was updated in 2008, only 196 new projects with a combined development and construction cost of $1.3 billion were actually funded. At this rate, it would take at least three programming cycles (more than six years), to program the entire shelf of SHOPP PIDs, assuming that no additional PIDs were completed. Having a $4.7 billion shelf of projects is excessive, in our view, because it is unlikely that there will be sufficient funding for a number of these projects.

…And a Large Shelf of PIDs for Unfunded STIP Projects. As of June 2008, there were 84 STIP projects for which Caltrans had completed PIDs. (This does not include additional PIDs completed by private consultants and paid for by regional transportation agencies). Caltrans estimates that it would take about $16.7 billion to develop and construct these 84 projects. By comparison, the STIP is currently being funded at the rate of about $700 million worth of highway projects each year. At this rate it would take more than 23 years before sufficient funding would be available to program all of the STIP projects with completed PIDs, assuming that no additional PIDs were completed. While some of these projects may ultimately be funded with local funds rather than with state funds, we believe having $16.7 billion worth of shelf projects is excessive given the state's transportation funding outlook.

Having Such a Large Shelf of PIDs Is Inefficient. Once a PID is completed most of the information is typically current and therefore useable for about two years. After that time, additional work is often required to update the document before a project can be programmed for funding. Some information in PIDs, cost estimates in particular, become outdated even more quickly. Cost estimates typically need to be updated after about six months. For instance, if a project is not programmed for development within a couple of years, the initial estimates would likely be no longer useable due to inflation or other changes in market conditions.

Other factors could make the information in a PID out of date as well. For example, a PID may identify a certain preferred alignment for a project; however, over time, the property needed for that alignment may not be available due to development. When a substantial amount of information in a PID is outdated, Caltrans must dedicate additional resources to revise or redo the document. Additionally, to the extent some PIDs will never be developed or constructed into projects due to funding constraints, the resources being spent on their preparation are wasted.

Recommendation: Reduce Staffing For Project Planning in 2009-10

Continued Staffing at Current Level Not Justified. In light of the large shelf of PIDs that currently exists, the department's request for 433 PYs and $51 million to prepare PIDs in 2009-10 is not justified. The requested level of resources is essentially the same as Caltrans has received for the past three years, which has

led to an over-production of PIDs, as discussed earlier. Furthermore, Caltrans is not able to justify the requested staffing level on a workload basis. Specifically, it cannot identify projects that are high in priority for future funding but for which a PID is not completed. Absent such workload justification, continuing to staff PID preparation at the current level would only result in a larger shelf of PIDs mainly for projects that would not proceed for many years.

Some Resources Needed in 2009-10 to Prepare Essential PIDs. Despite having many completed PIDs on the shelf, our analysis indicates that the department will nonetheless need some staff to prepare PIDs in 2009-10. This is because the department typically has workload related to unexpected events, such as emergencies and safety hazards. Additionally, staff would be needed to continue and complete work on PIDs for projects for which funding has been committed in 2009-10 from non-state sources, such as local sales tax revenues.

Staffing for PID Work in 2009-10 Should Be Reduced Substantially. Given the large shelf of PIDs, we recommend that the Legislature substantially reduce the funding and staffing allocated to PID activities for 2009-10. Because the department is not able to provide PID workload information, we cannot identify a precise level of staffing that should be provided; however, we estimate that roughly one-fourth of the current staffing (about 100 PYs) would be sufficient to cover any unexpected workload and complete outstanding PIDs in 2009-10. *Accordingly, we recommend that the department's request be reduced by 330 PYs and $40 million from SHA*. Because the staff (mainly engineers and planners) that prepare PIDs could easily be shifted to perform other work within the department, reducing PID staffing would not require laying off any workers. Instead, we think this reduction could be achieved by shifting them to vacant positions among Caltrans' approximately 9,000 other engineering and planning staff.

Recommendation: Base Staffing on Workload Beginning in 2010-11

Staffing Does Not Align With Workload Needs. In order to manage its PID workload well, Caltrans should regularly assess how many PIDs it needs to be preparing at any given time to facilitate the programming of projects. This assessment should also include monitoring of the status and completion of documents after work on them is started. However, the department is unable to demonstrate that it has such workload information. Absent this information, Caltrans is unable to estimate the staffing needs for the preparation of PIDs. Instead, as discussed above, Caltrans has allocated a steady level of staffing for PID preparation in recent years, even though more PIDs were prepared statewide than were actually needed.

Our review also found that, at the district level, the allocation of staffing for PID work does not match up with each district's actual PID workload. Rather, staff are allocated to the districts based on a formula of past staffing expenditures on PID work and highway lane miles in each district. As districts' workload varies from year to year, this method results in too many staff being provided to some districts and not enough to others. For instance, some projects with committed local funding could be held up because a district does not have adequate staff to prepare PIDs. In other districts, Caltrans staff could

be preparing PIDs for projects that may not be funded for many years.

Staffing for PID Activities Should Be Based on Workload. Based upon our analysis, we believe that Caltrans should substantiate its PID staffing request each year by identifying the volume and types of projects for which PID work needs to continue or be initiated. This approach would (1) better match staffing with program needs at both the statewide and district level, and (2) facilitate legislative oversight of the department's PID activities, thereby improving accountability.

The approach we propose would also be consistent with the way the department currently budgets for capital outlay support—that is, the staff needed to do environmental review, design, engineering, and oversight of the construction of projects. Accordingly, *we recommend the Legislature adopt budget bill language directing the department to determine its ongoing staffing for PID activities based on workload, beginning in 2010-11.*

Recommendation: Improve Management of PID Activities

Significant Gaps in Determining and Managing PID Work. In addition to the lack of workload information described above, our review found other gaps in Caltrans' determination and management of PID activities. Specifically, the department should have (1) criteria it uses to determine the SHOPP projects for which PIDs should be prepared, and (2) information about the viability of the projects on the PID shelf (including whether a project is still the appropriate solution to address a transportation problem, or whether funding is still available for the planned project). Our review, however, finds that there are problems in each of these areas.

- ***No Criteria for Selecting SHOPP PIDs.*** The department was unable to demonstrate that it has standard criteria for selecting SHOPP projects for which PIDs would be developed. (Regional transportation agencies determine the choice of most STIP PIDs.) Discussions with district offices indicate that districts use different methods to select projects for PID preparation, ranging from district priorities to complaints by the public about highway conditions and facilities. This could lead to the preparation of PIDs for projects that are not a high statewide priority and, thus, that are unlikely to be programmed later for funding.

- ***Viability of Projects on PID Shelf Is Unknown.*** As noted earlier, Caltrans has 569 completed PIDs on the shelf. However, Caltrans apparently does not track whether and when these projects would likely be funded and if they are still viable projects. If they are, the department may need to allocate resources to update the respective PIDs. Conversely, if some of the projects are no longer a priority, then PIDs for different projects might be a more important priority. However, because it apparently does not track the status of these projects, Caltrans is unable to effectively manage its PID workload.

Assess Project Viability and Set Criteria for PIDs for SHOPP Projects. In order to determine the staffing it needs for its PID workload, the department should (1) assess the PIDs that are on the shelf to determine if the projects are still viable, and (2) set criteria to select the SHOPP

projects for which PIDs should be prepared. These requirements should apply beginning with the preparation of the department's 2010-11 budget. To ensure that the department carries out these two tasks, *we recommend that the Legislature adopt supplemental report language requiring Caltrans to report to the Legislature on these efforts.*

Caltrans—Other Issues

The 2009-10 budget proposes total expenditures of about $13 billion from various fund sources and about 22,000 positions for the Caltrans. The level of expenditures is lower than the estimated expenditure level in 2008-09—by about $1.3 billion (or 9.2 percent). The drop in spending reflects a reduction in the expenditure of bond funds in the budget year, primarily because the budget assumes that most Proposition 1B funds for STIP projects will have been spent in the current year.

The proposed budget provides approximately $11.8 billion for highway transportation, including capital outlay, local assistance, operations, and maintenance. The budget also provides $423 million for Caltrans' mass transportation and rail program, $514 million for department administration, and $173 million for transportation planning.

COS Request Will Be Amended

Capital outlay support (COS) is the term used by the department to refer to work required to produce capital outlay projects. Before a capital outlay project can be constructed, Caltrans must review environmental impacts, acquire rights-of-way, and design and engineer the project. Caltrans is also responsible for overseeing the progress of project construction. The COS budget consists primarily of the salaries, wages, benefits, and operating expenses of the more than 10,000 state staff who perform these functions. It also includes the cost of consultants who perform a portion of this work. The COS budget does not, however, include payments to the contractors who construct the actual projects. These costs are part of the capital outlay budget.

The Governor's budget requests $1.9 billion (from various transportation accounts) to fund COS activities in 2009-10—essentially the same level of spending as estimated current-year expenditures for these purposes. The department indicates that it will revise these estimates in the spring as part of the May Revision. At that time, the department indicates that it will have more accurate estimates regarding the amount of project development work that is to be performed during 2009-10. Pending our receipt of these updated workload estimates, *we withhold recommendation on the department's COS request.*

Fuel Cost Estimates Inconsistent

Caltrans plans to use about 13.6 million gallons of fuel (including gasoline, diesel, and alternative fuels) in 2009-10 to power vehicles and equipment used in the maintenance and improvement of the state's highways. The department's baseline budget includes $48.2 million in ongoing funding (SHA) for these fuel costs. However, due to lower prices, Caltrans estimates it would need $373,000 less (for a total of $47.8 million) to purchase fuel in 2009-10. Accordingly, the budget proposes to permanently reduce the department's budget for fuel by $373,000.

Our review finds that the estimated price of fuel used by Caltrans in developing this request ($3.52 per gallon) is inconsistent with the fuel

prices used by the administration in developing other budget estimates. For example, for purposes of estimating fuel tax revenues, the administration assumes average fuel prices of about $2.10 to $2.35 per gallon, depending on the type of fuel.

Because the price of fuel has fluctuated substantially in recent months, it is likely that the administration's estimated fuel prices will change in the May Revision. *Therefore, we recommend that the Legislature take no action on this request at this time and await updated fuel price estimates that will be available in May.* At that time, Caltrans' budget for fuel costs should be adjusted to reflect the best available information on projected 2009-10 fuel costs.

Withhold Amtrak Contract Funding Until Cost Estimates Are Revised

The Governor's budget requests $90 million (from PTA) to pay Amtrak to operate the state's intercity rail program. This is $4 million more than the current-year contract due to increased fuel prices. However, the fuel cost estimates used in the request are based on an average pre-tax diesel cost of $3.65 per gallon for 2009. The DOF is now estimating average diesel prices for that period to be $2.33 per gallon, including taxes. The department indicates that it will receive revised cost estimates from Amtrak later this spring. Due to lower fuel price estimates since the initial budget request, *we withhold recommendation on the request for $90 million until the department receives an updated estimate of these costs from Amtrak.*

Deny Request for New Furniture

The department plans to complete construction of two new office buildings in 2010. The Southern Regional Lab in San Bernardino is scheduled to open in June and the District 8 (San Bernardino) Traffic Management Center is to be finished in December. The budget proposes a one-time increase of $768,000 (from SHA) to cover the costs associated with moving into the new buildings. Of this request, $686,000 is for new modular and conventional furniture. The department is requesting the funds in the budget year because it will take time to procure the new furniture.

In light of the state's current budget problem, we question the department's need for new furniture. At our request, the department was able to identify surplus furniture from another project that can be moved to the new facilities at a cost of $163,000. This cost estimate includes $148,000 for design and installation of the surplus modular furniture and $15,000 to move the furniture. *Accordingly, we recommend the Legislature deny the request for new furniture procurement and instead provide only $163,000 for the department to move the surplus furniture to the new buildings.* This action would result in a net savings of $523,000.

Training of Private Sector Workers Unjustified

The budget requests $1 million (half from SHA and half from federal funds) each year, beginning in 2009-10, to fund five workforce development centers. These centers would provide pre-apprentice level training to up to 300 people each year to teach basic skills to enable them to get jobs with private-sector construction firms. According to Caltrans staff, the training would teach "soft skills," such as how to show up to work on time, how to dress properly for a job, how to properly wear a hardhat, and how

to use a tape measure. The department indicates that some basic carpentry skills and other skills, such as truck driver training, would also be taught. Graduates of the program would then receive job placement assistance. For graduates that are placed in union apprenticeship programs with private businesses, Caltrans would also pay their first installment of union dues. The request specifically includes $25,000 for union dues and fees for private-sector workers.

Request Unjustified, Use of Funds Questionable. Our review finds that this proposal is unjustified. We do not think Caltrans should perform activities that are well beyond the scope of its core mission and that are duplicative of other state programs. The state already has a number of employment development programs that provide career counseling and job placement assistance. In addition, the state also funds apprenticeship training programs that teach specific skills used in the construction industry, such as the ironworking skills needed for bridge construction, cement masonry, and general construction. Furthermore, the proposed use of SHA funds is questionable and may not be allowed under Article XIX of the State Constitution. *Accordingly, we recommend the Legislature reject the request.*

More Cost-Effective Approach Needed To Meet Air Quality Regulations

Caltrans' budget includes about $63 million from SHA in 2009-10 to retrofit and replace many of the vehicles and equipment in its fleet in order to meet four different sets of state air quality regulations. About $54 million of this total would be provided on a one-time basis. Regulations adopted by ARB require Caltrans to replace substantially more of its fleet each year than the department would otherwise based on the useful life of its vehicles and equipment. The regulations also require Caltrans to make various retrofits to its fleet, such as installing specialized filters to reduce diesel emissions.

Compliance With Diesel Rules Much More Costly Than Planned. The department's ongoing efforts to comply with the state's air quality rules are not limited to the budget-year request. Over multiple years, Caltrans expects to spend a total of about $260 million (including $82 million in prior expenditures) to comply with four sets of state air quality regulations. The ARB's diesel regulations for both on-road vehicles (such as maintenance trucks) and off-road vehicles (such as graders and other heavy equipment) account for about 90 percent, or $240 million, of the total cost. These costs for Caltrans are substantially greater than ARB estimated when it developed the diesel rules. The ARB had estimated the total cost for all state agencies would be about $60 million over multiple years.

The department's high cost estimate is due in part to the requirement that many of its diesel vehicles must be retrofitted with a filter—known as a particulate matter trap. These traps cost about $20,000 each. For some vehicles, two such traps are required at a cost of $40,000 per vehicle. Additionally, as discussed below, our review finds that other factors are contributing to the department's high cost estimate.

Caltrans and ARB Disagree About Steps Needed to Comply. The ARB's diesel rules impose various requirements for Caltrans to replace and/or retrofit a specified portion of its fleet each year for a number of years. Additionally, in some cases, such as for off-road vehicles, even new replacement vehicles must be retrofitted with

particulate matter traps. These retrofit devices can be difficult and costly to install. Because most such devices are too large to easily fit onto the department's trucks, Caltrans is requesting staff to modify and rebuild some of its vehicles in order to install the retrofit devices.

Caltrans has concluded, based on discussions with ARB, that this expensive and difficult process is the only way it can come into compliance with the new air quality rules. However, ARB has advised us, to the contrary, that Caltrans should not need to modify or rebuild any vehicles to comply with its rules. According to ARB, the steps being taken by Caltrans are not necessary because the air quality requirements that would otherwise apply would be deemed to be technologically infeasible.

At the time this analysis was prepared, Caltrans and ARB had not resolved this disagreement over what steps are needed to comply with air quality requirements.

Exemptions Possible…But Not Necessarily for Caltrans. The ARB staff indicates there are some exemptions to its rules. For instance, if the retrofit device is too large to easily fit on a vehicle, as is the case with many Caltrans vehicles, the department could qualify for a one-year exemption based on a finding that the regulations were technologically infeasible to implement. However, ARB's process for providing such an exemption calls for a review of such issues on a vehicle-by-vehicle basis, rather than through a fleet-wide assessment of vehicles. While Caltrans may legitimately qualify for such an exemption, we are advised by the department that the process of applying for exemptions individually for each of the thousands of vehicles in its fleet is not practical.

An alternative, more practical solution, is also possible. The ARB does have a process available to reevaluate its regulations to determine if the technology needed to comply with air quality rules is currently in existence. If, upon reevaluation, the ARB determines that the technology does not exist, then an across-the-board exemption to compliance with the rule would be granted. If granted, no entity would be required to comply with the rule for that year.

The ARB staff has advised us that across-the-board exemptions may be approved in the coming months for a couple of air quality rules, including those currently being applied to Caltrans. However, there are further complications. This reevaluation of ARB regulations would occur no sooner than ten months before the compliance deadline. Thus, it is possible that Caltrans could eventually be exempted from at least some of ARB's rules in 2009-10, but that the department might not learn of this exemption until *after* the Legislature has had to make a decision on whether to provide funding for these compliance activities in the department's budget. Another complication is that, if a reevaluation does not result in the granting of exemptions, Caltrans would have only ten months to make all the required retrofits. That likely would not be enough time for Caltrans to comply with the rules due to the department's large fleet of vehicles.

Another potential solution would be for Caltrans to seek the exemption of some of its vehicles on the grounds that they are emergency vehicles. Our analysis indicates that ARB rules specifically exempt certain vehicles from air quality rules that are classified as emergency service vehicles. Because many other state departments have qualified for this exemption, they are not incurring substantial costs to comply with

these rules. However, at the time this analysis was prepared, Caltrans had not taken full advantage of this option. Caltrans has indicated that it has encountered difficulty in getting ARB to accept a number of its vehicles as qualifying for this exemption.

Interaction of Rules Increases Costs and Limits Benefits. In addition to ARB's statewide rules, one regional air district—the South Coast Air Quality Management District (SCAQMD)—has its own air quality regulations. One of SCAQMD's requirements is that any vehicle replaced by Caltrans in the South Coast region be fueled by an alternative energy source. For the types of trucks used by Caltrans, the only alternative fuel option available is natural gas-powered trucks that cost about $100,000 more than an equivalent diesel truck.

While Caltrans has been complying with the SCAQMD requirements, ARB's on-road diesel rule has recently caused an unexpected complication. Specifically, under ARB rules, Caltrans must either retrofit or replace large portions of its vehicle fleet over the next few years, including vehicles in the South Coast region. Because retrofitting vehicles can be costly, Caltrans would prefer to replace many of its diesel trucks with new ARB-compliant diesel trucks. However, if Caltrans replaces its trucks, SCAQMD would require Caltrans to buy more costly alternatively fueled vehicles. To avoid these extra costs, Caltrans instead plans to retrofit its diesel trucks in the South Coast region rather than replace them. Thus, due to the unintended interaction between the two sets of air quality rules, Caltrans is prevented from buying new diesel trucks that would have greater air quality benefits and are a more cost-effective option.

Recommendation: Legislature Should Determine Cost-Effective Approach. As discussed above, the costs for Caltrans to comply with ARB's regulations are substantially higher than had been originally estimated. This is in part because there is a lack of agreement between ARB and Caltrans on what specific steps the department must take to meet the air quality regulations and whether statutory changes are needed to allow a more cost-effective approach to do so. In addition, while Caltrans may legitimately qualify for some exemptions to the rules, ARB's process for obtaining such exemptions is not practical due to Caltrans' large fleet of vehicles. Furthermore, Caltrans is prevented from choosing the most cost-effective method of compliance due to an unintended interaction between statewide and regional rules.

In light of these factors, we think additional information should be provided to the Legislature to help it to determine how much Caltrans should spend to comply with these air quality rules in a cost-effective way, and what statutory changes, if any, are needed to do so. *Accordingly, we recommend that the Legislature direct Caltrans and ARB to jointly report the following information at budget hearings.*

- Any changes to the statewide and regional air quality regulations that should be made to allow the state to reach its air quality goals in a cost-effective manner.
- Any legislation needed to allow the state to take a more cost-effective approach to comply with these air quality rules. This could include changes in the way the ARB and SCAQMD implement their air quality rules.

- How Caltrans can comply with these air quality requirements, over multiple years, in the most cost-effective manner.
- The steps Caltrans can take that are technologically feasible to comply with these air quality rules and what actions are not technologically feasible.
- The number of Caltrans vehicles that provide emergency services and whether or not these vehicles have been (and can be) exempted from the regulations.

With this information, *the Legislature should determine a cost-effective approach for Caltrans to meet these requirements and consider any statutory changes, if necessary, to allow Caltrans to do so.*

High-Speed Rail Authority

The High-Speed Rail Authority was statutorily established to develop a high-speed rail system in California that links the state's major population centers, including Sacramento, the San Francisco Bay Area, the Central Valley, Los Angeles, the Inland Empire, Orange County, and San Diego. In November 2008, voters approved Proposition 1A, which allows the state to sell $9 billion in general obligation bonds to partially fund the development and construction of the high-speed rail system. The bond funds are available upon appropriation by the Legislature. (Proposition 1A also authorizes $950 million in bonds for the improvement of other passenger rail systems in the state.)

Proposition 1A specifies the first phase of the high-speed rail project to be the corridor between the San Francisco Transbay Terminal and the Los Angeles Union Station and Anaheim. Bond funds may be used to develop other specified corridors if doing so does not adversely impact the construction of this first phase of the project. Bond proceeds can be used for no more than 50 percent of construction costs. Thus, at least one-half of construction funding for each segment must come from some other sources—including federal, state, local, or private funds. Up to 10 percent of the bond money may be used for environmental reviews, planning, preliminary engineering and design, and up to 2.5 percent of the bonds may be used for administrative costs. Proposition 1A establishes requirements that the authority must meet before it can request, and subsequently encumber, bond funds for specified capital costs.

High-Speed Rail Business Plan Lacks Specific Information

Chapter 267, Statutes of 2008 (AB 3034, Galgiani), required the authority to submit an updated business plan for the high-speed train system to the Legislature by September 1, 2008. That plan must include a description of the anticipated system as well as primary benefits; a forecast of anticipated patronage, operating, and capital costs; an estimate and description of the federal, state, local, and other funds necessary for completion; a proposed timeline for the construction of the eligible corridors in the system; and a discussion of foreseeable risks and mitigation strategies.

In June 2008, an oversight report by the Senate Transportation and Housing Committee recommended that the business plan be similar to a financial prospectus prepared for investors in new stock or bond offerings and not an advocacy document. In the report, the committee proposed that the plan include a financial strategy

that clearly explains how the authority plans to fund the completion of the project. It also urged that the plan detail all the potential benefits of the system as well as the types and level of risk the state would be assuming for such a project.

The authority released the business plan on November 7, 2008. Our review shows that, while the document includes, to some degree, each of the statutorily required elements, the information provided is very general and does not provide specifics that are included in typical business plans. In fact, the plan claims to be only "an outline of the most recent economic and financial studies that, taken together, constitute the most current update."

Figure 15 highlights some of the questions that remain after our review of the plan. For instance:

- What are the anticipated service levels for each segment of each corridor at inception, and at what level of service will each segment break even with operating or overall costs?
- What steps are being taken to secure the additional funding necessary for completion, at the local and federal level, as well as for private funding?
- When is each segment expected to have environmental clearance, and when is construction planned to begin?

Lacking detailed information such as this, the Legislature really has no better sense than prior to the plan's submission as to how the authority plans to accomplish its objective.

Require Submission of More Details. As the authority continues to develop the high-speed rail system, it is essential that the Legislature have a clear understanding of how the state is proceeding with the project and, most importantly, the risks it may be assuming and how those risks would be mitigated. So that the Legislature would have the necessary information, *we recommend that the Legislature require the authority to expand upon its business plan and submit information to include specific elements missing from the*

Figure 15

Business Plan Fails to Provide Many Details

Statutory Requirements	Sample of Missing Details
Description of the anticipated system	• What are the expected service levels, by segment? • What is the assumed train capacity?
Forecast of patronage, operating, and capital costs	• How are the ridership estimates projected? • What is the operating break-even point? • How will costs be distributed by segment route?
Estimate of necessary federal, state, and local funds	• How would funds be secured? • What level of confidence is there for receiving each type of funding?
Proposed construction timeline for each segment	• What is the proposed schedule, by segment, for completing design/environmental clearance? • For beginning/completing construction?
Discussion of risks and mitigation strategies	• How would each type of risk impact the project? • What specific mitigation strategies are planned to be deployed?

original document before appropriating any bond funding for 2009-10. At a minimum, the supplemental information should include (1) further system details, such as route selection and anticipated service levels; (2) a thorough discussion describing the steps being pursued to secure financing; (3) a working timeline with specific, achievable milestones; and (4) what strategies the authority would pursue to mitigate different risks and threats.

Additional Accountability Measures Should Be Adopted

All Proposition 1A funding requests to pay specified capital costs must meet certain accountability requirements. These measures include the establishment of an independent peer group to review the authority's plans before the Legislature appropriates any funds. Also, before committing (encumbering) any funds, the authority must submit to the Legislature a detailed financial plan for the corridor (or segment) with a review conducted by an independent financial services firm that confirms the plan's viability. However, current statute governing the project does not include any accountability requirements relative to the *noncapital* expenditures nor ensure the funds are being spent effectively.

Require Adoption of Project Evaluation Criteria. According to its business plan, the authority plans to spend the majority of the bond proceeds on the front end of the project. This means that the bond funds would be exhausted well before the entire system is constructed, with the expectation that other fund sources would pay for its completion. As such, it is important that the funds be spent on projects that benefit the state's overall transportation system should the high-speed train program be delayed or suspended.

Statute requires that, in selecting which corridor or segment thereof to begin construction, the authority is to give priority to the ones expected to require the least amount of bond funds as a percentage of total construction costs. However, there are hundreds of individual projects to be constructed within each segment of the proposed high-speed train corridor, from grade separations to multitrack stations. In order to maximize the benefits of the high-speed system, the authority should prioritize individual projects according to the overall mobility solutions they provide.

For example, grade crossings that benefit the overall flow of traffic in a major metropolitan area should be designed and built before other projects that exclusively benefit the high-speed train, such as remote, dedicated tunnels. Before any capital construction costs are incurred, the authority should provide guidelines to evaluate and select projects that maximize mobility along the corridor. This would minimize the amount of funds spent on projects with limited benefits should the entire system not be completed. Accordingly, *we recommend that the Legislature require that the authority adopt project selection and evaluation criteria to ensure that bond funds are used efficiently and that they deliver projects with immediate mobility benefits.*

Require Annual Reports and Periodic Audits. Once money has been appropriated and committed to the construction of a particular segment of the system, there is no accountability to ensure that the funds are being spent effectively. In order to maintain accountability of bond funds and track the overall progress of the project, *we recommend the enactment of legislation directing the authority to provide an annual report to the Legislature at the time the*

authority submits its annual budget proposal. Similar reports have been prepared for the state's intercity rail routes and the Toll Bridge Seismic Retrofit Program. Based on these examples, this report should include, at a minimum:

- A work plan identifying work accomplished and anticipated in the budget year.
- Program funding status and projected funding sources for the budget and future years, by segment.
- Future contract obligations and expected schedule of costs.
- A program schedule including baseline comparisons from prior years and any projected timeline adjustments.
- Any changes in assumptions used in the system's planning and financial projections or technological advancements that may improve or hinder the progress of the project.

In addition, because the work on this project is to be completed by contractors, the Legislature should require periodic independent audits of each contract to be funded with bond proceeds.

Hold Joint Legislative Hearings. Beyond requiring project specific information through annual reporting, *we further recommend that the policy committees and budget subcommittees of the Legislature hold periodic joint hearings in which the authority reports on the use of bond funds, the availability of other funds, and the timeliness of project delivery.* This would enable the Legislature to assess whether the program is being carried out effectively and provide meaningful oversight over the bond funds.

2009-10 Budget Proposals

The Governor's budget requests $125.2 million in Proposition 1A bond money to fund the authority's activities in 2009-10. Because all system development work will be performed by consultants, $123 million is requested for consultant contracts. The remaining $2.2 million is requested for administrative costs. Figure 16 lists the contracts to be funded in 2009-10.

Little Justification Provided for Contract Amounts. While the general types of proposed contract work appear reasonable, the authority's budget requests provide almost no justification for the specific amounts requested for each contract. Specifically, no information was provided on the work to be accomplished over the budget year, nor how that work fits into the total development of the system. Without this information, there is no basis for recommending approval of the authority's requests for contract payment funding. Accordingly, *we withhold recommendation on the request*

Figure 16

Proposed 2009-10 Contracts for High-Speed Rail Authority

(In Millions)

	2009-10
Project-level design and environmental review	$95.0
Program management services	22.6
Financial plan and public-private partnership program	2.0
New ridership and revenue forecasts	2.0
Other miscellaneous contracts	1.4
Total	**$123.0**

pending receipt of supplemental information on the amount of work to be accomplished in the budget year, by contract, and how each fits into the overall development of the system.

Deny Request for Additional Positions. In the proposed budget, the authority is requesting $258,000 and two staff to be added to the currently authorized 9.5 positions. The new staff would be structural engineers with experience in structure design in California. The authority is requesting these engineers to provide an additional review of project design documents for compliance with state and federal requirements.

In concept, the request has merit. Using such staff to review design documents should reduce the state's risk and help avoid future project delays. However, at this early stage in the system's development, it is unclear whether there is enough work for two full-time engineers. One alternative is for the authority to contract with Caltrans and thus pay only for the work that actually materializes. Caltrans has a number of structural engineers on staff with legal compliance expertise that could provide the authority with the needed services.

Accordingly, *we recommend the Legislature deny the request for adding engineer staff but provide the funding for the authority to contract with Caltrans to perform any necessary review of documents for legal compliance until such time that workload indicates it is more efficient to have in-house engineers.*

California Highway Patrol

The CHP's overall level of staffing is about 11,000 positions. The department is comprised of uniformed and nonuniformed personnel, with uniformed personnel accounting for approximately 7,600 positions, or 70 percent, of total staff.

Patrol Staffing Overbudgeted and Not Justified

Budget-Year Patrol Staffing Request. Since 2006-07, the department's goal has been to add 1,000 officers (compared to the 2005-06 level) over several years. To date, the Legislature has authorized 360 additional patrol officers. The Governor's budget requests $35 million from MVA to provide first-year funding for an additional 240 patrol officers and 8 automotive technicians. We would note that 120 of the officer positions being requested for 2009-10 were already approved by the Legislature (during the 2008-09 budget deliberations), but the funding and position authority were deferred until 2009-10 because CHP had a significant number of officer vacancies. (The Legislature also adopted supplemental report language requiring CHP to report by March 1, 2009 on its progress filling its officer positions.) The budget-year request would bring the total patrol officers added since 2005-06 to 600 officers.

We have two concerns with this request: (1) it is overbudgeted and (2) the 120 additional positions for 2009-10 have not been fully justified.

- ***Request Overbudgeted***. We have identified a technical error in the calculation of salaries and wages. Specifically, we found that while the positions would be phased in over the course of the fiscal year (as cadets graduate from the academy), they were budgeted as if all of the positions would be filled in July 2009. Based on our calculations, the request is overbudgeted by approximately $13 million.

- ***New Positions Not Justified—Baseline Level of Service Needed***. Historically,

CHP officer position requests have been justified based on growth in the number of registered vehicles, licensed drivers, or fatal accidents. While we concur that there is a relationship between these measures and the level of traffic on California's roads and highways, they do not provide a measure of the level of service provided for road patrol. For instance, at current staffing levels, how frequently does CHP patrol the most dangerous stretches of highway and how rapidly does the department respond to calls for assistance? Without that specific workload data, it is not possible to determine how many positions (if any) are needed to achieve a specific desired level of service, or statewide goal or objective. As such, we recommend the Legislature reject the 120 officer positions not already approved and further reduce the request by $9 million.

In total, we recommend a reduction of $22 million. The remaining $13 million would fund the expected 2009-10 costs related to the 120 positions already approved by the Legislature. *We further recommend that the Legislature adopt supplemental report language requiring the department to report to the Joint Legislative Budget Committee by January 10, 2010 on the following: (1) its current baseline level of patrol service and (2) the level of service it intends to achieve with recent and any future positions requests*. With this information, the Legislature would have a greater ability to evaluate the merits of future officer requests, as well as hold the department accountable for results.

Request for Replacement Vehicles Lacks Specifics

The department proposes to spend $34.5 million in 2009-10 from the MVA to purchase new vehicles to partially replenish its fleet. As part of our review, we asked the department to provide a breakdown of the number of vehicles, by type, that it plans to purchase in 2009-10, as well as the unit costs for each type. At the time this analysis was prepared we had not received this information. We therefore *withhold recommendation on the $34.5 million requested to purchase vehicles,* pending receipt and review of the specified information.

Department of Motor Vehicles—Real ID

Reject Real ID Request

What Is Real ID? The federal Real ID Act requires states to implement certain driver license and identification card issuance procedures and security enhancements aimed to prevent fraud. If a state does not comply, it will forfeit the ability of its citizens to use such forms of identification for federal purposes (such as boarding airplanes or entering federal facilities). Under the act, states are required to issue Real ID-compliant cards to all existing cardholders by December 2017.

Most, if not all, of California's 28 million driver license and identification cardholders could ultimately be required to visit a DMV field office to verify their identity and prove that they are legally in the United States before obtaining the new cards. Among other things, the act requires states to verify the authenticity of each applicant's identification documents—such as birth certificates, Social Security numbers, and passports—with the issuing agency. It also

requires states to verify that the applicant does not already possess a driver license issued by another state or territory. This verification is to be accomplished through the establishment and use of several national verification systems. (For more information on the Real ID Act, please see our *Analysis of the 2008-09 Budget Bill,* page A-72.)

Administration Proposes to Issue Real ID Cards in 2010. The Governor's budget requests $4.2 million from MVA (and 45 positions) specifically to implement Real ID in 2009-10. Under the administration's plan, DMV would start issuing Real ID cards beginning in January 2010. Specifically, the department proposes to issue the cards to all original driver license applicants and to give driver license renewal applicants the option of having a Real ID card or a "noncompliant" card. Renewal applicants who wished to obtain the Real ID card would be required to go into a field office, so that DMV could reestablish the applicant's identity, residence, and legal presence in the United States, as required by the act. Renewal applicants who choose not to obtain a Real ID card would still be able to renew their driver license online. The department has indicated that it plans to introduce legislation seeking authorization to issue two card types: a Real ID complaint card and a noncompliant card.

In addition, the Governor's budget is requesting funding in the current year and budget year ($11 million from MVA) to initiate a new contract to continue the production of the driver license, identification, and salesperson cards. The department proposes to fund the current-year costs using existing resources. However, because the contract costs are higher than originally anticipated, the administration has submitted a budget Control Section 11 letter for legislative review. At the time this analysis was prepared, we were still reviewing the administration's Section 11 request. Finally, the budget also proposes to increase the driver license fee by $3 to cover the costs of the contract, as well as partially fund implementation of the Real ID Act.

California Can Apply for a Second Extension. Under the act, states were originally required to be in full compliance—including reissuance of all driver license and identification cards—by May 2008. In recognition of the unrealistic timeframes adopted in the act, as well as many unresolved implementation issues, the U.S. Department of Homeland Security (DHS) extended the compliance date to as late as December 2017. In so doing, the federal agency established a process whereby states may file for an extension to be exempt from the original May 2008 deadline.

The DMV was granted such an extension. This extension, however, expires in December 2009, unless the state requests a further extension by October 2009. Under the regulations developed by the former federal administration, states are required to show progress toward compliance with the act in order to qualify for the second extension. States are not required to start issuing the Real ID cards by January 2010 (as DMV proposes) to receive a second extension. States that receive extensions, however, are still required to reissue Real ID compliant cards to all driver license and identification cardholders by 2017. The administration has indicated that it plans to seek a second extension.

Analyst's Concerns. We think the department's proposal is premature for a couple of reasons. First, a state must be deemed compliant with the Real ID Act by the U.S. DHS before it can begin issuing Real ID compliant cards. At the time this analysis was prepared, DHS had

not made any such determination about California's proposed issuance process, or in regard to the security features that would be used in the proposed new cards. Second, given the change in the federal administration, we think it makes sense to hold off on implementation of Real ID until more is known about the new administration's position on this hugely expensive and unfunded federal mandate. Finally, states are not required to begin issuing Real ID compliant licenses until May 2011. There would still be time for the state to come into compliance with this requirement by the federal deadline if the Legislature chose to reconsider this budget request next year.

LAO Recommendation. For the reasons discussed above, *we recommend the Legislature reject the request at this time and reduce the budget by $4.2 million*. The Legislature could reconsider this proposal as part of next year's budget process. We recognize that this delay could result in increased costs if the state decides later to implement Real ID. However, under our recommendation, the Legislature would have additional time to learn more about the intentions in this area of the new federal administration, including whether the federal government intends to cover any of the costs related to Real ID. At this time, we are withholding recommendation on the proposed increase in the driver license fee and the driver license production contract as we are still reviewing the administration's current-year request.

Department of Motor Vehicles—Management of IT Projects

During the past three years, the administration and the Legislature have authorized eight different IT projects for DMV, with a total original estimated cost of approximately $350 million. Figure 17 (see next page) provides a brief description of each project. These projects range in size and scope, and touch on various different programs and business functions of the department. Currently, five of the eight projects are still being developed. The single largest continuing project is the IT Modernization (ITM) projects, originally estimated to cost $242 million. In this section, we provide an update on the status of these projects, with a focus on the projects' costs and schedules, and also discuss some of the challenges the department faces in implementing the projects.

DMV's IT Management and Oversight. The DMV implements and manages IT projects at the executive level and the project level. At the executive level, the department has an IT Governance Committee, which is responsible for department-wide planning and guidance. This group consists of the director, chief information officer, and other executive staff. At the project level, the project management team, which is responsible for carrying out the project, typically consists of a project executive, program sponsor, project manager, and a contract manager (or vendor). The teams may vary somewhat from project to project depending on the size, complexity, and cost of the project.

In addition, most projects also have an Independent Project Oversight Consultant (IPOC) and an Independent Validation and Verification (IV&V) Consultant. The IPOC is responsible for tracking project management activities, such as project scheduling, risk management, and change management. The IV&V consultant is responsible for oversight of deliverables, such as program codes, test scripts, and network configurations, as well as oversight of processes to

ensure these deliverables meet industry standards and the requirements of the department's contract with the IT vendor. The use of both the IPOC and IV&V consultants is a standard practice for managing IT projects in various state agencies.

Due to the number of projects being undertaken by DMV, and the significant level of resources involved, the Legislature in 2006-07 also established an Enterprise Wide Oversight Consultant (EWOC) to oversee the implementation of the projects in DMV's "project portfolio." The EWOC's role is to work with DMV management in overseeing all IT projects and provide periodic reports to the administration and the Legislature on the status and risks of the portfolio projects.

Some Project Delays and Cost Variations

The department has experienced delays in the implementation of most of its IT projects. There have also been changes in the estimated cost of most projects. We discuss these issues below.

Projects Take Longer Than Originally Estimated. Figure 18 shows changes in the projected cost and schedule of each project. It is important to note these projects are in different stages of implementation, therefore, the cost and schedule projections are subject to further change. In general, projects that are further along should have more reliable estimates of cost and schedule. This information provides a snapshot as of the date of the feasibility study report, or special project report, for each IT project.

Figure 17

Department of Motor Vehicles (DMV)—Information Technology Projects

	Project Description
Recently Completed Projects	
Document Imaging and Storage Replacement	Replaced the document imaging, storage, and retrieval system with five digital scanners and related storage capacity.
Remittance System Replacement	Replaced all components of the system with new equipment and new system hardware and software.
Telephone Service Center Replacement	Replaced the nine independent telephone systems in use in the Telephone Service Centers with a single virtual system.
Continuing Projects	
Information Technology Modernization	Will incrementally upgrade the DMV core systems with new equipment and new system hardware and software.
Financial Responsibility	Will develop an in-house system to track vehicle compliance with insurance requirements, and suspend vehicle registrations for lack of compliance.
Real ID[a]	Will expand DMV's driver license and identification card system name fields to improve security and enhance Web site to enable customers to conduct more business transactions online.
International Registration Plan (IRP) System Replacement	Will replace existing obsolete computer system for processing commercial vehicle registration and electronic payment and distribution of commercial vehicle registration fees among IRP member jurisdictions.
Driver License/Identification/Salesperson Contract	Will select a vendor to continue driver license, identification, and salesperson card issuance, including the addition of various security components.

[a] This project does not implement the federal Real ID Act. It is comprised of two projects—the Expanded Name Field and Web site Infrastructure System projects—that would make it easier for California to comply with the act.

As shown in Figure 18, all three of the completed projects experienced delays ranging from five months for the Document Imaging and Storage Replacement project to ten months for the Remittance System Replacement project. Of the five continuing projects, two have experienced significant delays. Specifically, the Driver License, Identification and Salesperson Contract (DL/ID) project and the Real ID project are behind schedule by 19 months and 28 months, respectively. The ITM project is now six months behind schedule.

Project Costs Can Increase or Decrease. Figure 18 shows that two of the three completed projects were delivered at a cost that was more than 20 percent below the original cost estimate. Of the continuing projects, the DL/ID and International Registration Plan projects are expected to cost 198 percent and 32 percent more, respectively, than originally estimated. A single project—ITM—is now estimated to come in significantly below the original cost estimate. Because ITM is in its early stages of development, however, there is still a risk of its costs coming in higher than estimated.

While the department has experienced some significant delays and cost variations in the development of its IT projects, we note that such occurrences are common in the IT arena. We would further note that, although some projects are still in the early phases of development, overall costs continue to be below the total amount appropriated by the Legislature.

What Have Been Some of the IT Project Challenges?

In various reports on the status of DMV's IT projects, as well as in our discussions with department representatives, the department and independent oversight consultants have identified

Figure 18

Department of Motor Vehicles' Information Technology Projects: Changes in Cost and Schedule

(Dollars in Millions)

	Project Cost Estimates				
			Change		
	Original Cost	Revised Cost	Actual	Percent	Delay in Completion
Completed					
Document Imaging and Storage Replacement	$6	$4	-$2	-29%	5 months
Remittance System Replacement	8	7	-2	-20	10 months
Telephone Service Center Replacement	19	22	3	16	8 months
Continuing					
Information Technology Modernization[a]	$242	$208	-$34	-14%	None
Financial Responsibility	19	19	—	—	None
Real ID	35	43	8	23	28 months
International Registration Plan System Replacement	8	11	3	32	16 months
Driver License/Identification/Salesperson Contract	11	34	23	198	19 months

[a] While the completion date for this project has not been officially changed, recent reports indicate the project is currently about six months behind schedule.

several reasons for changes in the schedule and cost of DMV's projects. These factors include staff turnover and a lack of internal IT expertise. We discuss the key problems that have contributed to project delays and cost variations below.

Ineffective Planning Contributed to Problems. Our review suggests that the department failed to do the initial strategic planning required to successfully launch and deliver multiple major IT projects at the same time. Although the department has had an IT Governance Committee whose role is to look at the big picture—in terms of the department's IT goals and resources—and to set priorities, our review suggests this committee has not been effective. For example, one of the major obstacles to DMV delivering IT projects on schedule and within their original budgeted cost has been a shortage of IT staff and expertise. We believe that, if the department had initially engaged in effective strategic planning, it would have identified these constraints and either (1) obtained the resources needed to deliver the projects or (2) scaled back the number of IT projects it requested in recognition of its resource constraints. The department, however, did neither, resulting in it taking on more IT projects than it could effectively handle at one given time.

Unclear Policy on State's Use of Oversight Consultants. As mentioned above, one strategy the state employs to reduce the risks associated with costly and complex IT projects is to contract with outside consultants—the IV&V and IPOC consultants—to oversee project progress and provide technical assistance to the department. Our review found that the state is not effectively using these consultants. One key ongoing issue, noted in several progress reports on DMV projects, is a difference of opinion within the administration as to when the consultant services should begin.

The department prefers to bring its consultants on board early in each project to assist with procurement. This allows the consultant to review and provide technical assistance in the development of the request for proposals (RFPs), a critical component of the vendor procurement process. (Procurement refers to the process of purchasing goods and services. Typically, it involves developing and issuing an RFP to solicit bids from vendors, evaluating bids, and selecting a vendor and awarding a contract.) The benefit of this approach is that the consultants can assist the department in proactively addressing any potential deficiencies in RFP, particularly since the consultants typically have a level of expertise about technology solutions which the department may not have.

The Department of General Services (DGS), which oversees procurement for the state, takes a very different view. The DGS perceives the involvement of independent consultants in the development of RFP as a conflict of interest that could lead to protests by vendors not selected for the job. Consequently, under the DGS approach, any problem in RFP would be addressed, not at the outset in the development phase, but rather through subsequent addendums (modifications) to the document after it has been released. However, the addendum process frequently causes delays in IT projects. In most projects that have been caught up in such delays, the oversight consultant had not been allowed to assist in procurement activities because of DGS' concerns, even though all other stakeholders agreed that there would be a significant benefit to having the independent consultants involved at some level during the procurement stage.

The DL/ID project, for example, was significantly delayed at the procurement stage and the vendor contract awarded more than a year later than planned. While the delay in this procurement was the result of a number of factors (including some changes in DGS' IT procurement processes), a main contributing factor was deficiencies in RFP for the project. These deficiencies were caused by a lack of expertise within DMV regarding the technological solutions required to meet the department's needs. Those deficiencies required the department to clarify the details of the project for prospective vendors and then make numerous, time-consuming addendums to RFP.

Some Project Managers Not Using Enterprise Oversight Tools. As noted above, an EWOC was retained to assist the DMV in its management of multiple IT projects. Specifically, EWOC was commissioned to establish an "enterprise oversight process" within DMV, as well as to provide monthly reports detailing the risks and status of each project in the portfolio. An enterprise oversight process essentially refers to management tools designed to assist the department in tracking IT projects, including schedules and IT resources needed to complete them, so that management can make informed decisions about them.

Our review finds that EWOC has assisted the department in establishing a database designed to facilitate enterprise oversight. However, recent reports indicate that some project managers are not using the enterprise management tools, such as the database of the status of each project and resource needs.

Legislative Oversight—Require Department to Report At Budget Hearings

While the department has experienced some delays and cost variations, based on our review and discussions, we concluded that the department has done a relatively good job in implementing its IT projects. The projects are still within the total amount appropriated by the Legislature. Moreover, at the time this analysis was prepared, none of the projects appeared to be at risk of failure. Nonetheless, given the number of continuing projects, and the fact that the most costly project (ITM) is still several years from completion, it is important that the department use all available tools to assure these projects stay on schedule and budget. Accordingly, *we recommend the department report at budget hearings on actions it is taking to address the issues discussed above*. In particular, the department should report on (1) the steps it is taking to manage its staff resources so that different projects within DMV are not competing for staff resources, (2) any recent or planned changes in its IT management approach to encourage better planning and coordination of IT projects among affected programs, (3) its use of oversight consultants and potential improvements in this regard that could achieve better IT project outcomes, and (4) efforts it will make to encourage staff to use the enterprise tools developed by EWOC to improve project oversight.

As regards DGS and its concerns related to the use of consultants for the development of IT requests for proposals, *we recommend that the Legislature require DGS and the Office of the Chief Information Officer (OCIO) to report on*

their respective points of view and identify options the state may pursue to alleviate potential conflicts of interest, so that the Legislature can determine the best policy for the state. We note that OCIO is currently reviewing the state's IT approval process, including what constitutes effective project approval documents. We recommend that this review also include a look at the RFP process and the appropriate timing and use of consultants to reduce project risk. The situation at DMV regarding these projects could serve as a case study to help inform this review.

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