

MEMORANDUM

TO: Santa Clara Valley Transportation Authority
Board of Directors

FROM: Kurt Evans, Government Affairs Manager
Santa Clara Valley Transportation Authority

DATE: June 2, 2008

SUBJECT: Summary of Governor's FY 2009 May Revise

BACKGROUND

In his May revisions to his January 10 budget plan (May Revise), Gov. Arnold Schwarzenegger proposed borrowing against California Lottery income to help close a projected \$15.2 billion deficit, and reversed himself by deciding not to seek to close 48 state parks, ask for early release of 22,000 prison inmates or give K-12 schools less money than they are guaranteed by the state Constitution. In addition, the Governor called for deeper cuts to health care and welfare programs for the poor even as his Administration calculated that the projected demand for government assistance is growing, and recommended diverting an additional \$711 million in public transit money for General Fund expenditures. And citing changes in federal student loan regulations, the Governor postponed the sale of EdFund, the state's student loan guarantor program, to the FY 2010 budget, though he still hopes to generate \$500 million by selling the non-profit sometime in the future.

The centerpiece of Gov. Schwarzenegger's May Revise is a proposal to borrow against the proceeds of the lottery to help address the state's budget problems, rather than leasing it as previously suggested. Under the plan, California would seek investors to lend \$15 billion secured by future earnings from lottery games that the state hopes would be improved. Investors would be repaid from lottery revenues over 32 years. The \$15 billion would be deposited into a new "rainy day fund." About \$5 billion would be used to help balance the FY 2009 budget. The rest could be used over the subsequent two fiscal years. The lottery's current rules would be changed to allow broader promotion, bigger and more frequent prize payouts, and other incentives to create more player interest. The money going to schools would be capped at the amount that they have received in recent years—about \$1.2 billion a year of the \$3.3 billion in total lottery revenues. The \$1.2 billion is not guaranteed, however, as the investors must be paid first from lottery proceeds under the deal.

Voters would have to approve a November ballot measure to change the state Constitution, which currently requires 34 percent of lottery money—the amount left after paying prizes and overhead—to be allocated for K-12 education. Failure at the ballot would trigger a temporary 1-

cent sales tax increase for up to three years to raise the \$15 billion for the rainy day fund. After that, it is assumed the economy will have improved enough to feed the rainy day fund in good years. After the sales tax ends, taxpayers would get a full rebate using a formula yet to be determined.

The basic idea of the rainy day fund is twofold. First, governors would have more power to make mid-year budget cuts. Second, the rainy day fund would accumulate money in good years for use in bad years to even out the ups and downs of the economy. Because the state is experiencing a down period now, the fund would be jump-started with the \$15 billion from the lottery transaction. The creation of the rainy day fund also would have to be approved by the voters in a separate ballot measure.

Now the spotlight shifts to the Legislature, which has a June 15 constitutional deadline to submit a balanced budget to the Governor. That deadline, however, has been routinely missed in the past. In fact, a state budget has not been enacted on time in 17 out of the last 21 years.

Whether the Governor and Legislature will be able to come to an agreement on a spending plan in time for when the new fiscal year begins on July 1 is uncertain. Although a series of actions enacted in February of this year trimmed \$7 billion from the budget, the deficit continues to grow, and difficult decisions still lie ahead. Democratic legislative leaders have declared that they are prepared to delay the budget if that is what it would take to get a tax increase, which they believe is the only reasonable solution to California's multibillion-dollar shortfall. Republicans, on the other hand, have repeatedly said they will not vote for any budget that includes new taxes. All but two GOP lawmakers have signed a "Taxpayer Protection Pledge," vowing to "oppose and vote against any and all efforts to increase taxes." Although Republicans are the minority party in the Legislature, a budget cannot be approved unless at least eight GOP lawmakers sign off on it.

The following summarizes the key transportation elements of the Governor's May Revise.

PROPOSITION 42

Background: In March 2002, the voters of California approved Proposition 42, which made the sales tax on gasoline a permanent funding source for transportation. These revenues were dedicated for the following purposes: (a) the State Transportation Improvement Program (STIP); (b) local streets and roads; (c) the Public Transportation Account (PTA); and (d) the Traffic Congestion Relief Program (TCRP), which consists of 149 projects that were earmarked in legislation that was enacted in 2000.

While state transportation funding was expected to increase as a result of the passage of Proposition 42, the Governor and Legislature took advantage of a "loophole" in the ballot measure to divert a significant amount of these revenues to the General Fund. To curb this practice, California voters approved Proposition 1A in November 2006, a constitutional amendment that puts restrictions on when and how often Proposition 42 revenues can be loaned to the General Fund. It also requires any outstanding prior-year Proposition 42 loans to be repaid

within a 10-year period and specifies an annual minimum amount that must be paid back in a given fiscal year.

Governor's May Revise Proposal: Consistent with his January 10 budget plan, the Governor is proposing to fully fund Proposition 42. However, the amount of money expected to be available for transportation programs in FY 2009 under Proposition 42 has dropped from \$1.485 billion in January to \$1.43 billion today. Of the \$1.43 billion, the STIP would receive \$572 million (40 percent), local streets and roads \$572 million (40 percent), and the PTA \$286 million (20 percent). While the Governor did toy with the notion of suspending Proposition 42 in the upcoming fiscal year to help with the General Fund problem, he did not include that recommendation in his May Revise. In the final analysis, he deemed that "the state cannot achieve budgetary savings" with such an action since the amount would have to be repaid in three years with interest pursuant to Proposition 1A.

TCRP: FY 2008 was the last year of Proposition 42 allocations to the TCRP, meaning higher funding levels for the STIP, local streets and roads, and the PTA from now on. While no Proposition 42 dollars will flow to the TCRP in FY 2009, the program is expected to receive \$83 million as a repayment for loans that were made to the General Fund during FY 2004 and FY 2005. While this loan repayment was originally intended to be a General Fund obligation, the Governor's May Revise proposes that the PTA cover it instead.

After FY 2009, the TCRP is still owed roughly \$1 billion for repayment of outstanding loans to the General Fund. These loans are to be repaid to the TCRP through a combination of Proposition 1A payments and revenues generated from new gaming compacts that were negotiated by the Schwarzenegger Administration with five Native American tribes. Under current law, these revenues would trickle into the program over the next eight fiscal years.

However, given that project sponsors have indicated that they will need to draw down their TCRP shares over the next three to four years to avoid delays to their projects, the program is currently suffering for a severe cash-flow problem. While legislation was enacted to allow the state to bond against tribal gaming revenues, this authority has been challenged in the courts. A final decision in this court case has yet to be rendered. If the court ruling is favorable, then the state could issue \$300 million-\$400 million in bonds immediately to address the near-term, cash-flow problem plaguing the TCRP.

Local Streets and Roads: The current fiscal year also is the last time that cities and counties will have to forego Proposition 42 funding for local streets and roads. In FY 2007 and FY 2008, cities and counties received no Proposition 42 money because of a requirement to repay prior-year loans that were provided in FY 2002 and FY 2003 for local streets and roads from the State Highway Account.

PROPOSITION 1B

The Governor's May Revise updates the numbers for Proposition 1B, which calls for issuing \$20 billion in bonds over a 10-year period for roughly 14 different transportation programs. This bond measure was approved by the voters of California in November 2006. In his May Revise,

the Governor recommends allocating \$4.59 billion in Proposition 1B funding in FY 2009, or roughly 23 percent of the \$20 billion total, as follows:

- Corridor Mobility Improvement Account (CMIA) = \$1.547 billion. VTA would not begin receiving money for its three CMIA projects until FY 2010 at the earliest.
- Public Transportation Modernization Improvement Account = \$350 million. Of this amount, VTA would receive roughly \$13 million under this formula program.
- STIP = \$1.187 billion.
- Trade Corridors Improvement Fund (TCIF) = \$413 million. No projects were programmed by the California Transportation Commission (CTC) for Santa Clara County under the TCIF.
- State/Local Partnership Program = \$200 million. Legislation still needs to be enacted to determine the allocation method for this program.
- State Highway Operation and Protection Program (SHOPP) = \$94 million.
- Grade Separation Program = \$65 million. The CTC is scheduled to adopt a program of projects for this Proposition 1B category in late August 2008.
- State Route 99 = \$108 million.
- Local Seismic Bridges = \$21 million.
- Intercity Rail = \$73 million.
- Traffic Signal Synchronization = \$122 million. The CTC recently programmed \$15 million for traffic signal improvements in the city of San Jose and \$900,000 for the county.
- Air Quality = \$250 million.
- Transit Security = \$102 million. Under this formula program, VTA would receive roughly \$3 million of the recommended amount.
- Port Security = \$58 million.

There are no recommended Proposition 1B appropriations for local streets and roads in FY 2009. The reason cited by the Schwarzenegger Administration is that the Department of Finance still is in the process of developing a template for administering \$950 million in Proposition 1B funding that was allocated to cities and counties in the current-year budget.

PUBLIC TRANSPORTATION ACCOUNT

PTA Revenues and Expenditures: Revenues in the PTA are derived primarily from the sales tax on diesel fuel, the sales tax on 9 cents of the state excise tax on gasoline, Proposition 42, and the so-called “spillover.” On the expenditure side, 50 percent of all PTA dollars historically have gone to the State Transit Assistance Program (STA), while the remaining balance has been used to fund the following:

- Mass transit planning activities of Caltrans and the CTC.
- Passenger rail safety responsibilities of the California Public Utilities Commission (CPUC).
- Operating costs of the state’s intercity rail system, including the Capitol Corridor trains.
- Rolling stock acquisition and other capital projects for intercity rail.

- California High-Speed Rail Authority.
- Transit capital projects programmed through the STIP process.

Spillover: The spillover has grown significantly in recent years because gasoline prices have been increasing at a faster rate than the general economy. As a result, it has become an attractive target for shoring up the General Fund. Under the Revenue and Taxation Code, the Board of Equalization and the Department of Finance are required to make a theoretical calculation every year that compares the revenues estimated to be generated by a state sales tax rate of 5 percent on all goods except for gasoline versus the revenues generated by a state sales tax rate of 4¾ percent on all goods plus gasoline. If the amount estimated at 4¾ percent is greater than the amount estimated at 5 percent, then the difference is supposed to “spill over” from the General Fund into the PTA. From there, the revenues are supposed to be divvied up 50 percent to STA and 50 percent primarily for transit capital projects programmed through the STIP process.

The spillover is not a stable or predictable source of funding. Sometimes the spillover calculation results in zero funds being transferred to the PTA. In other years, spillover revenues have fluctuated from a low of \$2 million to a high of \$867 million in FY 2008. Because there appears to be no end in sight to high gas prices, spillover revenues are projected to be significant for the foreseeable future. Today, it generates more money than any other PTA funding source. In the Governor’s May Revise, the spillover is estimated at \$1.177 billion, up from \$910 million in January.

Recent Legislative Changes to the PTA: The FY 2008 state budget turned out to be disastrous for the PTA. Not only was \$1.259 billion in PTA revenues diverted to pay for General Fund expenditures, but lawmakers also enacted SB 79, a budget trailer bill that amended the Revenue and Taxation Code to restructure the account in the following ways:

- Starting in FY 2009, one-half of all spillover revenues would be deposited into a newly created Mass Transportation Fund to be used for paying debt service on transportation bonds and yellow school bus service. Previously, these expenditures were General Fund obligations.
- The remaining 50 percent of spillover revenues would be split two-thirds to STA and one-third to transit capital projects programmed through the STIP process.
- Transportation services for clients of the state’s regional occupational centers would become a permanent obligation of the PTA, rather than the General Fund.

In September 2007, the California Transit Association filed a lawsuit challenging most of the \$1.259 billion diversion, as well as the legality of SB 79. This case is currently pending in the appellate court.

Meanwhile, a second PTA bill, SB 717 (Perata), slipped out of the Legislature during the hectic final days of last year’s regular session and was signed into law by the Governor. This measure restructured the allocation of the account’s share of Proposition 42 dollars, pumping more money

into STA at the expense of the STIP. Specifically, SB 717 changed the split between STA and transit capital projects programmed through the STIP process from 50-50 to 75-25.

Governor's May Revise Proposal: Gov. Schwarzenegger's January 10 budget plan adhered to the provisions of SB 79, but his May Revise does not. In his May Revise, the Governor proposes to use all spillover dollars plus the growth in diesel sales tax revenues that has occurred since January for General Fund expenditures, which amounts to a shift of \$711 million in PTA revenues to non-public transit purposes. When combined with the amount diverted by SB 79, the total loss to the PTA in FY 2009 would be \$1.424 billion. These revenues would be used to cover the following General Fund expenditures:

- Transportation general obligation bond debt service = \$607 million.
- Proposition 1A loan repayment to the TCRP = \$83 million.
- Regional occupational center transportation = \$141 million.
- Yellow school bus service = \$593 million.

State Transit Assistance Program: STA is a formula-based program that provides funding to public transit agencies that can be used for either operating or capital purposes. In his January 10 budget plan, the Governor included a \$743 million appropriation for STA in FY 2009. However, with the additional \$711 million diversion of PTA revenues for General Fund expenditures proposed in the Governor's May Revise, the funding level for STA drops to \$306 million, the same level that was appropriated in the current fiscal year. This represents roughly a \$17 million difference for VTA (\$30 million under a \$743 million STA Program versus \$13 million under a \$306 million program).

PTA STIP: No PTA funding would be provided for the STIP in FY 2009 under the May Revise. This recommendation remains unchanged from the Governor's January 10 budget plan. Because all State Highway Account gasoline excise tax dollars are going to the SHOPP, the primary funding sources for the STIP are gasoline sales tax dollars from Proposition 42 and the PTA. This means that the STIP has become entirely reliant on funding sources that are subject to the vagaries of the annual state budget process. Proposition 1B also provided \$2 billion for the STIP, which was programmed by the CTC last year. In past fiscal years, the STIP has been able to withstand the impacts of PTA cuts because the CTC advanced Proposition 1B funds to backfill the loss. This essentially has pushed the impact of the PTA cuts off until FY 2009.

The impacts of the recent budget decisions that have been made by lawmakers and the Governor are clearly evident in the 2008 STIP, which was approved by the CTC on May 29, 2008. First, there is no programming for transit projects in FY 2009, reflecting the absence of PTA capacity. Second, most carryover highway and transit projects from the 2006 STIP have been delayed by at least one year.

HIGH-SPEED RAIL

In his January 10 budget plan, Gov. Schwarzenegger recommended a total of \$1.2 billion for the California High-Speed Rail Authority in the upcoming fiscal year. That number is now \$41.2 million under the May Revise.

On a related note, the Governor has dropped a request that lawmakers remove the \$10 billion high-speed rail bond measure from the November 2008 ballot. However, he wants the Assembly and Senate to pass legislation to tie the spending of the bond money to guarantees of support from the federal government and the private sector, each of which is assumed to be on the hook for a third of the funding needed to build the initial phase of the high-speed train project under the authority's financial plan. To address the Governor's concerns in this regard, Assembly Members Cathleen Galgiani (D-Tracy) and Fiona Ma (D-San Francisco) have introduced AB 3034, which is currently winding its way through the legislative process.

SHOPP

Consistent with his January 10 budget plan, the Governor's May Revise allocates \$100 million in revenues generated by renegotiated gaming compacts with several Native American tribes to the State Highway Account in order to repay prior-year loans to the General Fund. These tribal gaming revenues are targeted for the SHOPP, which consists of rehabilitation, safety and seismic retrofit projects on the state highway system. However, the May Revise proposes a new \$200 million State Highway Account loan to the General Fund for FY 2009, which would come at the expense of the SHOPP.