Agenda Item 4

METROPOLITAN
TRANSPORTATION
COMMISSION

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Memorandum

TO: Legislation Committee DATE: Jan. 5, 2009

FR: Deputy Executive Director, Policy

RE: State Budget Update: Democratic Proposal to Restructure Transportation Funding

This memo provides a summary of the key elements of the Democratic proposal to address the state's budget crisis through a series of tax and fee changes that avert the two-thirds vote requirement as they affect transportation funding. We will provide you with more analysis and updates, including a summary of the Administration's FY 2009-10 budget proposal at your meeting on January 9.

Summary of Proposal

The transportation portion of the Democratic proposal consists of six key elements:

1. Eliminates the 18-cent per gallon excise taxes on gasoline and diesel fuel. This would go into effect on April 1, 2009.
2. Eliminates the state portion of the sales tax on gasoline, which now goes to Proposition 42, the "spillover" and the Public Transportation Account (PTA). Local sales tax measures would continue to include gasoline and diesel sales, but not the gasoline excise tax portion of those sales.
3. Imposes a new 39-cent per gallon fee on gasoline and a 31-cent per gallon fee on diesel fuel, both of which would be adjusted every three years to keep pace with inflation. This would go into effect on April 1, 2009.
4. Retains the state portion of the sales tax on diesel, which currently goes to the PTA.
5. Caps State Transit Assistance (STA) funding at $150 million annually, less than half of the amount provided in the FY 2008-09 State Budget.
6. Authorizes counties to double their one-quarter percent sales tax increase for transit and local streets and roads under the Transportation Development Act (TDA).

Bottom Line: More Funding Overall, But Less Flexibility and Less Public Transit Funding

The new plan generates approximately $2.4 billion annually in additional funds for transportation in comparison with Proposition 42 and the existing gasoline and diesel excise taxes (we exclude the spillover in this comparison calculation). This estimate is based on the FY 2008-09 Budget and is highly dependent on the price of gasoline, which determines overall Proposition 42 generations.

While the new funding is welcome, particularly funding that is indexed to keep pace with inflation, the plan raises substantial legal uncertainty as a result of shifting from a tax to a fee approach and it seems certain that fewer funds would be available for public transit.

How Would The Funds Be Distributed Compared to Today?
Under current law, all revenue generated by the state's gasoline and diesel excise tax (approximately $3.4 billion per year) is absorbed by cities and counties for local streets and roads and by Caltrans operations and the cost to maintain and rehabilitate the state highway system through the State Highway Operation and Protection Program (SHOPP).

As a result, the sole source of ongoing funding for highway and transit expansion projects in the State Transportation Improvement Program (STIP) is Proposition 42, which by law can only fund new projects and cannot be committed to the SHOPP program or Caltrans overhead. While Proposition 42 funding is very flexible as it is funded by the sales tax on gasoline, fees would be subject to new legal constraints that could make such revenue much less flexible.

The table below summarizes the key changes in funding levels.

(Dollars in millions)	**Existing Funding**[1]	**Proposed**	**Change**	**Percent Change**
STIP	$572	$640	$68	12%
Local Streets and Roads	$1,790	$2,346	$555	31%
Caltrans SHOPP	$2,175	$2,559	$383	18%
Transportation Funding Stabilization Account	--	$1,564	$1,564	NA
State Transit Assistance[2]	$969	$150	$(819)	-85%
PTA Transit Capital[3]	$588	$246	$(342)	-58%
Spillover – Mass Transportation Fund (for General Fund offsets)	$713	$0	$(713)	-100%
Total	$6,809	$7,504	$695	23%

Amounts may not sum due to rounding

Note that $1.5 billion annually in new revenue would be deposited in a new Transportation Funding Stabilization Account, leaving actual expenditures up to the Legislature to determine in a future statute. This poses some risk, such as the potential for funds to be redirected to offset general obligation bond debt service costs associated with transportation bonds.

[1] Includes estimate of funds generated by existing state gasoline tax revenues and Proposition 42.
[2] Based on statutory requirement, including base funds, Proposition 42 and Spillover funds. The Legislature has overridden these requirements through legislative trailer bills as part of the budget process.
[3] Assumes PTA transit capital would continue to receive 50% of total PTA revenues, with any remainder transferred to Mass Transportation Fund to offset transit-related General Fund expenses.

New Funds Would Be Less Flexible Than Proposition 42
The new revenues generated by these fees would be subject to a legal nexus test which requires that the expenditure of revenues from fees provide a direct benefit to the user. Fees may also be spent for mitigation of the adverse effects associated with a fee payer's activities. How broadly user benefit and mitigation could be defined is a legal question that would have immense ramifications for this fee. For instance, would public transit be considered an eligible expense? Would existing distribution formulas – such as those used in the STIP – hold up under a fee scenario? There are differing legal opinions on these questions, including differing opinions from the State's Legislative Counsel, and no doubt the subject would be resolved through litigation. If plaintiffs sought injunctive relief, the court could halt the imposition of the fee until litigation is resolved, resulting in substantial uncertainty for transportation programming purposes.

Funds Would Likely Be Subject to Article XIX of State Constitution
In addition to the legal nexus test, the new fees would likely be subject to Article XIX of the State Constitution, which restricts taxes imposed on motor vehicle fuel to the research, planning, construction, improvement, maintenance and operation of state highways, local streets and roads, and mass transit guideways.

Loss of Funding for Public Transportation Account (PTA)
By eliminating the state portion of the sales tax on gasoline, the proposal wipes out three sources of PTA funding - Proposition 42, the sales tax imposed on 9 cents of the gasoline excise tax, commonly known as the "Proposition 111 portion," as well as the spillover. The loss of the first two items would result in a loss of approximately $350 million annually statewide, based on FY 2008-09 estimates, while the loss of the spillover amounts to as much as $713 million based on current fuel prices. The remaining source – the sales tax on diesel – would not be subject to Article XIX restrictions and would continue to have the same eligibility as current PTA revenues. At the time the current budget was signed, this was estimated to generate $492 million in the current year, but the actual amount will likely be much lower given the steep drop in diesel fuel prices. The reduction in PTA funds would also reduce funds available for intercity rail and transit projects in the STIP.

Additionally, the proposal includes a statutory change to cap STA at $150 million statewide, about half the current level. At that level, STA would provide about $54 million to the Bay Area, including $14 million in population-based funds and $40 million in revenue-based funds. This reduction would have substantial ramifications for Bay Area transit operators, as well as MTC programs that rely on STA population-based funds including Lifeline and TransLink®.

Authorize Doubling of Transportation Development Act
The proposal does include one potential source of new funding for transit but it would require local voter approval. Specifically, Senate Bill 6, included in the overall package, would allow counties the option of seeking voter approval (requiring a two-thirds vote of the electorate) to double their quarter-cent sales tax under the Transportation Development Act (TDA). Note that as part of this overall budget package, the Legislature also voted to raise the statewide sales tax by a half-cent and the local sales

tax by a quarter-cent, making yet another sales tax increase that much more difficult politically.

Small Loss of Local Sales Tax Funding
Because the proposal would eliminate the state excise tax on gasoline, local sales taxes would lose 18 cents per gallon from each gasoline purchase. This would affect three sources of local Bay Area funding – TDA funds, local voter approved sales taxes and the AB 1107 permanent sales tax in Alameda, San Francisco and Contra Costa Counties. The table below summarizes the estimated loss in each category for FY 2009. The elimination of the diesel excise tax does not have such consequences as it is not currently included in the sales tax base.

(Dollars in millions)	**FY 2009**
Local Sales Taxes	$3.9
AB 1107	$1.3
Transportation Development Act (TDA)	$1.4
Total	$6.6

Next Steps
While the Governor initially indicated his intention to veto the overall Democratic package, he did not state any specific opposition to the transportation proposal. Given its potential to generate sizable sums for the General Fund – by allowing other taxes to be increased by a simple majority vote – we believe this proposal or portions thereof stand a reasonable chance of being enacted. We seek your direction on what position, if any, we should take.

Therese W. McMillan

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