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Bond Initiative Post-mortem: Where to from here?

On November 7, 2006 California voters approved over \$42 Billion in General Obligation Bonds to fund transportation, flood protection, school construction, housing, and water supply protection. Now that these bonds have been approved, California will be challenged to appropriate and spend the funds on the projects which best address the state's enormous deficit in infrastructure investment. On November 9, 2006, the Keston Institute for Public Finance and Infrastructure Policy convened a panel of experts comprised of Senator Alan Lowenthal (D) Long Beach, Wally Baker, LAEDC, Jeff Kightlinger, Metropolitan Water District, and Mark Pisano, SCAG to participate in a discussion of the infrastructure bond initiatives and provide their insights on where we go from here and how we get there. The discussions were moderated by Richard Little, director of the Keston Institute. This summary presents highlights raised by the panelists in their prepared remarks and responses to questions from attendees, and summary observations by the moderator on a long-term transportation funding strategy.

Highlights

- There was true bipartisan support for the bond initiatives that was critical to their passage and leadership in both houses wants to move the state forward. This was reflected in the resounding message from the voters to "Rebuild California." The state is poised for major steps forward but needs to maintain this momentum as this series of bonds are only a down payment on much larger, long-term needs.
- Financial support for Proposition 1B was 66% from Northern California and 26% from Southern California despite most of the priority needs being located in the south. Business support of infrastructure is critical but business interests in Southern California were not well organized to support the initiative. Business needs to be better organized and more involved in future campaigns.
- The state will be challenged to assure the voters that the bonds will be used for priority projects of long-term statewide or regional value. Trust will be a major issue because some of the bond Propositions mentioned specific projects, others provided only general program guidance. For example, the California Transportation Commission (CTC) is using a performance approach to allocate funds to the highest priority projects based on expected outcomes. Normal bureaucratic oversight will not be sufficient to convince the voters that the funds are being used wisely and well; there needs to be a performance measurement process for the bond funds that will provide accountability that the funds were spent on appropriate projects. There was discussion of the need for an independent body to develop and apply consensus metrics both for individual projects and entire programs and evaluate the performance of the implementing agencies. There should include an on-going information program to keep voters informed as the programs roll out.
- The Legislature needs to work with the Administration to develop implementation language for spending bond proceeds including ground rules for allocations to local projects. This includes the potential of these projects to leverage additional funds, their regional and statewide benefits, and the capacity to provide environmental benefits.
- There is an overarching need for a Goods Movement Action Plan. Goods movement projects need an on-going revenue stream including matching funds to ensure that related pollution is permanently reduced because local communities will only support projects that provide positive environmental mitigation; goods movement projects must improve existing environmental conditions or they will not receive approval. There could be bottlenecks in transportation projects because of environmental and utility relocation issues. Pre-approving designated utility corridors could be a solution and the transportation industry may be willing to fund additional staff at state regulatory agencies to speed the review process. SB 927, the "Container Fee" bill will likely be reintroduced because the political climate for positive government action is growing – voluntary compliance programs are not viewed as successful. Southern California infrastructure saves U.S. consumers more in aggregate than the cost of the necessary improvements. The private sector needs to understand that "doing nothing" is not an option and that there are consequences for the goods movement economy if the private sector does not participate financially – this needs to be done together because if the private sector won't contribute to goods movement, projects won't be built. The 110th Congress may be more receptive to national approaches to goods movement strategies but there will be very little or no federal funds available for

goods movement projects absent a major shift in federal tax policy. The federal government's primary role may be removing obstacles to cooperation and joint participation.

- Proposition 1E received the most votes and voters were very likely influenced by flood damage caused by Hurricane Katrina in New Orleans and Gulf Coast. The condition of the Sacramento-San Joachim levee system is critical to Southern California water supply but most are old, non-engineered earthworks originally built for local agricultural land reclamation—not flood control. Reclaimed areas are now subsiding 1”-2” per year with some areas >25’ below sea level. the Department of Water Resources (DWR) estimates that 30-50 levees would fail during an M6.5 earthquake: because ~25% of Southern California’s drinking water moves through the delta this could result in 1-3 year loss of supply. All governmental elements and the private sector need to work together and pursue an equitable fee recovery structure for flood control.
- There is existing administrative capacity at the state level to spend the transportation bond funds and no new bureaucracies will need to be created. Maximum effort will be made to enhance existing partnerships, particularly with those local transportation commissions with self-help sales tax programs. The state can build on its experience from prior water quality initiatives so Proposition 84 funds should not present a problem; DWR will need to partner with private interests but these arrangements have not been worked out. The Everglades restoration program in Florida could provide a model for raising matching federal funds for water quality enhancements.
- The housing bond addresses a critical public need but enabling legislation and allocation formulas are needed. The housing bond ties low income housing proposals to infill development policies with funds for infrastructure being the enabling element. Transit-oriented development can serve as a driver but enabling authority is needed to implement tax-increment financing (TIF) in the absence of a declaration of blight. There are also CEQA compliance issues that are potential impediments to infill development that need to be resolved. There is about \$4 billion statewide for transit so even if Southern California receives its fair share, these funds won’t go very far in addressing transit needs. As a result, local governments may need help in allocating bond funds to achieve highest priority outcomes. SCAG’s work in modeling return on investment for transit-oriented development may be helpful.

Summary Observations on Transportation Funding

- California’s transportation system will require billions of dollars annually for maintenance, repair, replacement, and new capacity to avoid reaching a physical and fiscal “tipping point.” Current pay-as-you-go funding sources for transportation at the state level can address little more than maintenance and repair of the existing system. Despite the value of local self-help sales tax initiatives, funding from this source will still fall far short of what’s needed to bring major new capacity and new technologies on-line. These funding shortfalls are structural and the gap only widens over time.
- General obligation bonds cannot be considered the long-term solution to transportation funding for two reasons. First, the cost of debt service is drawn from the general fund. Each dollar borrowed in this manner for transportation potentially takes two dollars desperately needed for healthcare, housing, education, environmental, and other programs which are also high priorities for Californians. Increasing debt service demands on the general fund will ultimately result in funding cuts for these programs without statewide general tax increases. Second, using general fund dollar to pay for transportation runs counter to a long-established tradition that the users of the transportation system should pay for the privilege.
- One option to close this gap is to underwrite the cost of major new transportation capacity with revenue (as opposed to general obligation) bonds. The cost of this capacity is fairly borne by its users and can be recovered through tolls and fees. Another option is to permit private enterprise to build, own, and operate selected facilities using equity capital. Again, the costs would be recovered by fees paid by users, not the public at large.
- Innovative strategies to utilize private capital for funding a portion of California’s transportation infrastructure have been developed but there must first be better understanding and acceptance of the conditions under which the use of private funds is appropriate. At the same time, arrangements for the use of private capital must ensure that the public interest is protected and that fair and equitable options are provided for the motoring public. California voters deserve to know that unless there is a fundamental sea change in how California approaches transportation funding, necessary additional capacity will be long-delayed if provided at all.

The Keston Institute for Public Finance and Infrastructure Policy is a non-partisan research center established at the University of Southern California to raise the public's awareness of the value of infrastructure and to encourage strategic investment. The Keston Institute supports the formulation of infrastructure policies and practices that will improve the livability of California communities, ensure the economic well-being of its citizens, and promote environmental sustainability. Information about the Keston Institute may be found at <http://www.usc.edu/keston>.