CALIFORNIA TRANSPORTATION COMMISSION

Proposition 1B Highway Safety, Traffic Reduction, Air Quality and Port Security Bond Act of 2006

Semi-Annual Status Report
July 2009

BACKGROUND

Proposition 1B, approved by the voters in November 2006, authorized the issuance of $19.925 billion in State general obligation bonds for specific transportation programs intended to relieve congestion, facilitate goods movement, improve air quality, and enhance the safety of the state's transportation system. These transportation programs included the Corridor Mobility Improvement Account (CMIA), State Route 99 Corridor Account (SR 99), Trade Corridors Improvement Fund (TCIF), State and Local Partnership Program (SLPP), Local Bridge Seismic Program, Highway-Railroad Crossing Safety Account (HRCSA), and the augmentation of the existing State Transportation Improvement Program (STIP) and the State Highway Operation and Protection Program (SHOPP). Consistent with the requirements of Proposition 1B, the Commission programs and allocates bond funds in each of the above-mentioned programs.

In clarifying legislation to Proposition 1B, Senate Bill 88 (SB 88), enacted in 2007, includes implementation and accountability requirements for Proposition projects and further defines the role of the Commission as the administrative agency for the CMIA, SR 99, TCIF, STIP, SLPP, Local Bridge Seismic Account, HRCSA, and SHOPP funded by Proposition 1B. SB 88 requires the Commission to report to the Department of Finance, on a semiannual basis, on the progress of the Proposition 1B bond projects in these programs. This report, as well as the Commission's Annual Report issued in December of each year, satisfies the reporting requirements of SB 88.

To date, the Commission has programmed $10.718 billion of the $11.625 billion of the Proposition 1B funds within its purview. The remaining $907 million represent primarily State-Local Partnership Program (SLPP) funds, which are to be programmed on a five year period on a formula basis. The Commission has allocated $3.831 billion of the programmed Proposition 1B funds, primarily to projects that were ready to commence construction.

PROJECT FUNDING ISSUES

Availability of Bond Funding

As with almost any State program during Fiscal Year 2008-09, the most pressing issue for the Proposition 1B Programs has been the State's ongoing financial challenges and the limited availability of cash to fund projects. In December 2008, the Pooled Money Investment Board (PMIB) suspended disbursements from the Pooled Money Investment Account (PMIA), which provides short term financing for bond projects. In response to the actions of the PMIB, the Commission suspended allocations for Proposition 1B bond projects, impacting 98 projects with total construction costs of $2.1 billion (including $1.7 billion from Proposition 1B) planned for award between January and June 2009. The shortage of bond funds also threatened to stop work on 98 Proposition 1B projects that were under construction at the time of the PMIB suspension of disbursements.

Private placement bond sales to the Metropolitan Transportation Commission, the Los Angeles Metropolitan Transportation Authority, and the San Bernardino Associated Governments provided funding to specific Proposition 1B projects in those regions, alleviating some of the impacts of the funding crisis. Ultimately, the revised Budget Act passed in February 2009 enabled the State Treasurer's Office (STO) to sell bonds and bond sales in March and April provided funding to the 98 bond projects under construction and allowed the Commission to allocate to the projects that had been deferred during the PMIB suspension. However, the public bond sales in March and April only provided funding for these projects through March 2010. The STO plans to schedule a bond sale in the fall of 2009, with the intent to provide an additional six months of funding for those bond projects and allow the allocation of additional bond projects. Thereafter, the STO plans to schedule bond sales to fund ongoing and new Proposition 1B projects in the spring and fall of each year.

Although the worst of the bond funding crisis appears to have passed, the State's ongoing financial crisis continues to threaten the Proposition 1B projects. State revenues from all sources have continued to decline and the May 19, 2009 defeat of the propositions designed to help balance the Fiscal Year 2009-10 budget enacted in February 2009 leave the State with a $24 billion deficit. The Governor and Legislature are contemplating draconian cuts to State programs and there is no guarantee that transportation will not be affected. As most Proposition 1B projects are funded from multiple funding sources, a suspension of Proposition 42, which funds the State Transportation Improvement Program (STIP), could leave many bond projects without adequate funding to complete design and construction. In addition, a protracted fight in the Legislature to close the $24 billion deficit could make it untenable for the STO to sell bonds for Proposition 1B projects in the fall as scheduled, forcing the Commission to defer allocations to delivered projects, negatively impacting project baseline agreement schedules and reducing the economic stimulus generated through the construction of infrastructure projects.

Availability of Local Funding

The ongoing economic downturn also threatens local funding for Proposition 1B projects. Nineteen counties in California have adopted local sales tax measures to fund transportation improvements, including local contributions to Proposition 1B projects. As local sales tax revenues have declined about 5 percent to 20 percent in the last two years, project sponsors may have difficulty meeting existing local funding commitments to Proposition 1B projects or funding potential cost increases. In addition, many local agencies issue bonds against future sales tax revenues to raise funds to pay current project costs. However, local agencies may have difficulty issuing bonds because of the tight credit markets.

An example of the impact of declining local sales tax revenues on Proposition 1B projects played out at a recent Commission Meeting when the Commission deferred allocation to a Proposition 1B project, as the project sponsor could no longer fund the local contribution due to declining sales tax revenue. The project sponsor, with loans from the regional agency and the commitment of additional state funds, was ultimately able to fully fund the project. However, as most Proposition 1B projects include local funds and declines in local sales tax revenues are projected to continue for the foreseeable future, many projects face similar funding risks and challenges.

DELIVERY TRENDS & CHALLENGES

Construction and Preconstruction Cost Trends

The current economic downturn has provided one tangible benefit for the Proposition 1B projects, that is, lower construction costs. Through the third quarter of Fiscal Year 2008-09, the Department of Transportation has received an average of 9.0 bidders per contract advertised, an increase over the average 7.7 bidders per contract in Fiscal Year 2007-08. The low bid for contracts was 23.5% below the Engineer's Estimate for the same period versus 21.7% below the Engineer's Estimate for Fiscal Year 2007-08.

The good news regarding capital costs, however, is offset by increasing preconstruction costs. Increasing preconstruction costs, including environmental, design, and right of way costs, are an issue in all of the Proposition 1B programs, but most significant in the CMIA Program. Fourteen CMIA projects, 26% of the 54 projects, have known support cost increases. While the majority of these cost increases are less than $5 million and most of the projects are estimated to remain within the total project cost as committed in the project baseline agreement, any cost overrun can be problematic given the uncertainty of the economy and state and local funding.

Especially troubling from the Commission's perspective are increasing requests to use projected construction cost savings to fund preconstruction cost increases. The Commission is concerned that such proposals include a high level of risk, as projected construction cost savings may not materialize. The level of risk with such proposals

increases significantly for projects with construction start dates one or more years in the future. Although the current bid environment is extremely favorable, there is no guarantee that bids will continue to fall significantly below the Engineer's Estimate. In fact, given the substantial infusion of federal funds into infrastructure projects from the American Recovery and Reinvestment Act (Recovery Act) of 2009, there is a definite risk that the bid environment will not be as favorable in future years. The Commission has cautioned project sponsors regarding such proposals and has only approved these proposals on an exception basis and generally only when the project is ready to advertise, increasing the reliability of the Engineer's Estimate. Where the Commission has approved these proposals, project sponsors were required to commit to fund any construction cost increases with local funds.

Timeliness of Environmental Documents

For all projects that are anticipated to be funded through a program under the purview of the California Transportation Commission (Commission), full compliance with the California Environmental Quality Act (CEQA) is required. In addition, if federal requirements are applicable, compliance with the National Environmental Policy Act (NEPA) is also required.

The Commission will not allocate funds to projects for design, right of way or construction until the final environmental document is complete and the Commission has approved the environmentally cleared project for consideration of future funding. However, the Commission is not receiving environmental documents for some Proposition 1B projects in a timely manner in order to take the statutorily required action prior to allocation. Such delays in the receipt of the environmental document can lead to delays in allocation and ultimately, in the start of construction. The Commission is working with the Department and local agencies to address this issue and recently posted instructions for submission and approval of environmental documents for Proposition 1B projects.

Program Specific Issues

Trade Corridors Improvement Fund (TCIF)

Proposition 1B authorized $2 billion of state general obligation bonds for the TCIF. Funds in the TCIF are available for infrastructure improvements along federally designated "Trade Corridors of National Significance" in the state of along other corridors within the state that have a high volume of freight movement. Acknowledging that the freight infrastructure needs of the state far exceed the $2 billion provided under Proposition 1B, the Commission overprogrammed the TCIF by approximately $600 million upon adoption of the program in April 2008. The overprogramming assumed that new revenue sources would become available and would be dedicated to funding the adopted program. This assumption now appears to be at risk in the current economic environment. The Commission intends to review the programming and delivery status of all TCIF projects in 2010 and may adopt amendments to the program based on the availability of funds or changes in project delivery schedules.

Corridor Mobility Improvement Account (CMIA)
Route 99 Corridor Account (SR 99)
Project baseline agreement for CMIA and SR 99 projects required sponsoring agencies to develop and implement a corridor system management plan (CSMP). The CSMP, which involves the development of comprehensive agreements along a corridor, assess current performance, identify causal factors for congestion, and based on testing of alternative improvement scenarios propose the best mix of improvements, strategies and actions to restore throughput, improve travel times, reliability, safety, and preserve the corridor. At this time, many projects have missed or delayed the delivery of the CSMP. The Department of Transportation is currently assessing the status of the CSMPs and plans to report to the Commission at a future meeting.

ACCOUNTABILITY

In clarifying legislation to Proposition 1B, on August 24, 2007, the Governor signed into law Senate Bill 88 (SB 88) which designates the Commission as the administrative agency for the CMIA, SR 99, TCIF, STIP, SLPP, Local Bridge Seismic Account, HRCSA, and SHOPP funded by Proposition 1B. SB 88 imposes various requirements for the Commission relative to adopting guidelines, making allocations of bond funds, reporting on projects funded by the bond funds, and ensuring that the required bond project audits of expenditures and outcomes are performed.

In addition, Executive Order S-02-07, issued by Governor Arnold Scharzenegger on January 24, 2007, significantly increases the Commission's delivery monitoring responsibility for the bond funded projects. Specifically, the Commission is required to develop and implement an accountability plan, with primary focus on the delivery of bond funded projects with their approved scope, cost and schedule.

A key element of the Commission's responsibility for accountability as an administrative agency for specific bond programs is submitting reports to the Department of Finance on a semiannual basis. The purpose of these reports is to ensure that projects are proceeding on schedule and within their estimated cost. As part of its Accountability Implementation Plan, the Commission requires bond fund recipients to report to the Commission on a quarterly basis. These reports are reviewed by the Commission and posted on the Bond Accountability website. In addition, the Commission prepares an Annual Report to the Legislature, which includes the status of the Proposition 1B Programs.

The Commission has experienced difficulties in receiving timely and useful information from the Department and the regions on the status of bond projects. Reports were often unclear and contained conflicting or inaccurate information. The Commission has worked with the Department and the regions to improve the quality of bond reporting and the most recent reports reflect substantial improvements. A key unresolved issue is the certification of the data in the reports. The Commission expects project sponsors to certify in writing the accuracy of the data and information contained in the quarterly bond

reports, to ensure accountability for the bond projects. The quarterly reports submitted to date do not include this certification. The Commission is currently working with the Department and the regions to resolve this issue and expects the Fiscal Year 2008-09 Fourth Quarter Reports to include the required certification.

The Legislative Analyst's Office (LAO) reported in February 2009 that the Commission had failed to provide its statutorily required Proposition 1B Reports to the Department of Finance. The Commission believed that the information posted on the Bond Accountability website every six months met the reporting requirements of SB 88. In response to the LAO Report, the Commission will submit this Proposition 1B Semi-Annual Status Report to the Department of Finance. This report, as well as the Commission's Annual Report issued in December of each year, satisfies the reporting requirements of SB 88.

Another key element of bond accountability is the audit of bond project expenditures and outcomes. Specifically, the Commission is required to develop and implement an accountability plan which includes provisions for bond audits. Under the Executive Order, expenditures of bond proceeds shall be subject to audit to determine whether the expenditures made from bond proceeds:

- Were made according to the established front-end criteria and processes.
- Were consistent with all legal requirements.
- Achieved the intended outcomes.

The Commission's Accountability Implementation Plan includes provisions for the audit of bond projects. In order to ensure that the Commission is meeting the auditing requirements of an administrative agency, as mandated by SB 88 and the Governor's Executive Order, the Commission is entering into a Memorandum of Understanding with the Department of Finance to perform the required audits of Proposition 1B projects, effective July 1, 2009.