



May 3, 2023

Hon. Steve Bennett
Assembly Member, 38th District
1021 O Street, Suite 4710
Sacramento, California 95814

Dear Assembly Member Bennett:

You asked our office to identify various options the Legislature could consider to provide short-term fiscal relief to transit agencies, and to evaluate the associated benefits and trade-offs. Our response is organized into five sections where we: (1) provide background on transit in California and the operational funding shortfalls that transit agencies are projecting, (2) identify various options the Legislature has in providing short-term fiscal relief and assess the corresponding benefits and trade-offs, (3) discuss potential accountability measures the Legislature could adopt to accompany such relief, (4) identify potential statutory changes the Legislature could consider to help transit agencies address their funding shortfalls, and (5) discuss steps the Legislature could take now to begin longer-term reforms for transit across the state.

BACKGROUND

California Has Over 200 Local Transit Agencies. Over 200 transit agencies operate across the state, delivering services to the public through modalities such as buses, trains, ferries, and paratransit vans. Transit systems generally are owned and operated by local governments, such as cities, counties, and local transit authorities. These agencies largely operate without much direct state involvement, apart from the funding discussed below.

Transit Agencies Utilize a Mix of Funding Streams. As shown in Figure 1 on the next page, funding for transit services in California comes from a variety of sources and totaled \$12.8 billion in 2019. (While more recent data are available, we focus on 2019 to avoid skewing the information with impacts from the pandemic, such as the limited-term relief funding provided by the federal government.) Of the total amount, 63 percent was from a combination of local sources—such as local sales taxes—and passenger fares and fees. Local sources are used to support both operations and capital improvements, while fares are primarily used to support operations.

As shown, state and federal sources made up a notably smaller share of overall transit funding—20 percent and 17 percent, respectively. State funding for transit comes from various fuel taxes and vehicle fees, as well as a portion of annual cap-and-trade auction revenues through the Greenhouse Gas Reduction Fund (GGRF). The state provides this funding to local agencies through several formula-based and competitive programs that support both operations and capital

improvements. State formula allocations are largely based on population and agencies’ operating revenues. The federal government allocates most of its funding directly to transit agencies on a formula basis, with a smaller amount awarded competitively. Federal formula allocations vary by program. Federal funding is primarily intended to support capital expenditures, but can be used for operations in certain circumstances, such as by rural transit agencies.

Figure 1

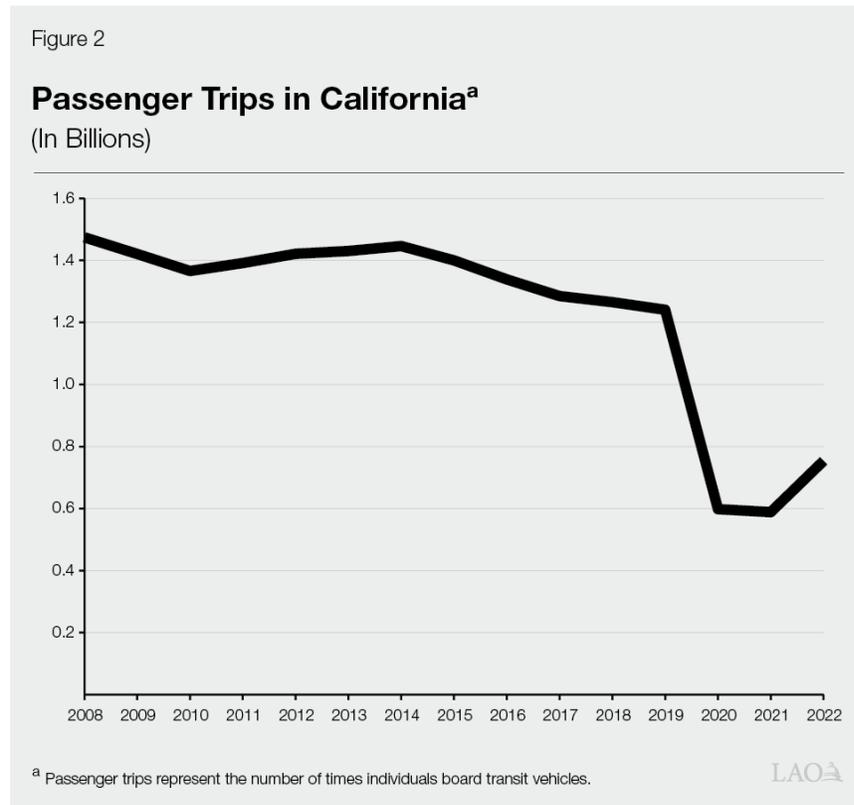
California’s Transit Services Are Supported by Various Funding Sources

2019 (Dollars in Billions)

| Source | Operations | | Capital | | Total | |
|----------------|--------------|-------------|--------------|-------------|---------------|-------------|
| | Amount | Percent | Amount | Percent | Amount | Percent |
| Local | \$3.6 | 44% | \$2.3 | 50% | \$5.9 | 46% |
| Fares and fees | 2.1 | 26 | 0.1 | 2 | 2.2 | 17 |
| State | 1.6 | 19 | 0.9 | 20 | 2.5 | 20 |
| Federal | 0.9 | 11 | 1.3 | 28 | 2.2 | 17 |
| Totals | \$8.2 | 100% | \$4.6 | 100% | \$12.8 | 100% |

Some Transit Agencies Are Facing Ridership Declines and Operational Funding Shortfalls. As shown in Figure 2 on the next page, transit ridership in the state had been on a gradual decline since 2014, but dropped dramatically when the pandemic began in 2020—falling by more than 50 percent compared to the previous year. As a result of these pandemic-related disruptions, transit agencies across the country projected significant declines in both fare revenues and state and local funds dedicated to transit—such as state fuel taxes and local sales taxes. In response, the federal government provided a nationwide total of nearly \$70 billion in operational relief to stabilize transit agencies’ budgets, prevent layoffs, and maintain service levels. In most cases, these funds were distributed through existing formula-based programs. In total, California’s transit agencies received \$9.8 billion in federal relief funds. As noted, the federal government historically has focused its funding for transit primarily for capital expenditures, however, it deemed this substantial and unprecedented operational support to be necessary to sustain agencies during the pandemic.

While state and local funding sources dedicated to transit generally have recovered to their pre-pandemic levels, ridership and corresponding fare revenues have not. In 2022, total ridership across California’s transit systems was roughly 40 percent lower compared to 2019. Despite ridership and fare revenues not fully recovering, transit agencies have been able to utilize federal relief funding to sustain their operations thus far, but many now project ongoing funding shortfalls as those funds run out. Absent any additional funding, many agencies indicate they likely will need to institute some combination of fare increases and service cuts to sustain their operations. At the same time, many agencies face issues related to labor shortages as well as safety and security concerns on their systems, which both create additional cost pressures and also make it difficult for them to increase ridership.



While projected operational funding shortfalls vary across the state, they generally increase in magnitude and quantity in future years as agencies exhaust their federal relief funding. Some individual transit agencies project operational funding shortfalls of as high as \$100 million in 2023-24, growing to as high as \$500 million in 2024-25 and \$800 million in 2025-26. Generally, larger commuter-orientated systems—which historically have depended more heavily on fare revenues to support operations—are more likely to experience operational funding shortfalls as compared to other transit systems. This is partially because commuter systems generally have had comparatively steeper and more sustained ridership declines, given the increasing trend of remote and hybrid work (particularly for higher-income workers who tend to be more concentrated in suburban locations).

Statewide Operational Funding Shortfall Difficult to Estimate, but Could Total Several Billion Dollars Over Next Few Years. Data we reviewed from individual transit agencies suggest the overall statewide operational funding shortfall could be about \$300 million in 2023-24, increasing to about \$1.2 billion in 2024-25 and \$1.9 billion in 2025-26. The California Transit Association estimates that the overall statewide operational funding shortfall could total at least \$6 billion across the next five years. However, developing an accurate statewide number is difficult given that transit agencies calculate their individual estimates based on different assumptions. In particular, agencies use varying methodologies to project how their ridership levels might rebound in the coming years and may include different types of costs in their “baseline” operation totals.

Concerns About Long-Term Sustainability of Transit Systems, Ability to Meet State’s Goals. Given the combination of pre-pandemic ridership declines and persistent post-pandemic ridership losses, how transit agencies will address their projected operational funding shortfalls on an ongoing basis is unclear. While some agencies will try to cover their shortfalls over the long run by raising additional revenues (such as through pursuing increases to local sales taxes), whether this is a viable strategy is somewhat uncertain since they would need to be approved by voters in most cases. Agencies likely also will need to consider fare increases and service cuts. However, such actions likely would make it harder to regain ridership. Moreover, the state has identified decreased driving—and, correspondingly, increased usage of transit above pre-pandemic levels—as one of its key steps in reducing greenhouse gas (GHG) emissions. Current circumstances and trends do not provide a clear path for how to achieve these desired outcomes.

KEY CONSIDERATIONS FOR PROVIDING RELIEF TO TRANSIT AGENCIES

You asked us to identify options for how the Legislature might approach providing short-term fiscal relief to transit agencies, given the significant funding shortfalls they are projecting for the coming years. In this section, we discuss the key considerations surrounding this decision, which are summarized in Figure 3 on the next page. We note that the Legislature’s choices around potentially increasing support for transit agencies are complicated by the context of the multibillion-dollar budget deficit the state is facing—which, as discussed in our report, [*The 2023-24 Budget: Multiyear Assessment*](#), could be even larger than previously projected. In the following sections, we discuss these considerations in further detail and provide an assessment of the benefits and trade-offs of various options.

Key Goals

Determining the Legislature’s primary short- and long-term goals for providing support to transit agencies will be key to informing the extent, structure, and conditions associated with any relief it chooses to provide. For example, if its main goal is to reduce GHG emissions, then it might want to focus aid on the transit systems it believes have the greatest impact on reducing vehicle usage. If the Legislature wants to focus on “buying time” for agencies to make reforms for the future, it may want to include certain requirements along with relief to ensure that agencies make the desired changes. Below, we discuss a few potential goals the Legislature could use to guide its approach.

Provide Time for Transit Agencies to Determine Long-Term Changes. Providing temporary fiscal relief could give transit agencies additional time to identify and implement ongoing changes needed to achieve fiscal sustainability over the longer term. Such changes could include (1) determining adjustments needed to align operations and capital projects to more accurately reflect current and projected ridership trends and preferences, (2) identifying additional revenue sources, and/or (3) developing plans to increase ridership and improve performance over the long run. Because such changes could be significant, agencies likely will need a few years for their planning and implementation. Short-term fiscal relief from the state could allow transit agencies to do this work without simultaneously needing to take near-term actions that could negatively

impact long-term fiscal sustainability. For example, reducing services or raising fares to address immediate operational funding shortfalls could reduce ridership and result in further revenue declines in the future.

Figure 3

Key Considerations in Providing Relief to Transit Agencies

Key Goals

- **Time for Change.** Provide time for transit agencies to determine long-term modifications?
- **Equity.** Mitigate near-term equity impacts of potential fare increases and service reductions?
- **Climate Goals.** Ensure transit agencies are well-positioned to help state reduce greenhouse gas emissions?

Structure

- **Timing.** Provide relief in the budget year or in a future year?
- **Duration.** Provide relief on a one-time basis or over multiple years?
- **Magnitude.** Provide relief that fully or only partially covers operational funding shortfalls?
- **Repayment Requirements.** Allocate relief as a grant or as a loan?
- **Distribution.** Distribute relief based on need or via an existing formula?

Fund Source

- **Existing Capital Funds.** Allow transit agencies to use existing and planned transit capital funds for operations?
- **Existing Transportation Funds.** Shift funding from certain existing transportation funds and programs to support transit operations?
- **Greenhouse Gas Reduction Fund.** Redirect or provide additional funds from the Greenhouse Gas Reduction Fund?
- **General Fund.** Redirect funds from General Fund-supported programs?
- **New Revenues.** Temporarily raise state fuel taxes, vehicle fees, or other taxes to generate additional revenues?

Potential Accountability Measures to Accompany Relief

- **Future Planning.** Require agencies to conduct analyses of potential operational changes and future ridership?
- **Data Reporting.** Require agencies to collect and report additional data to the state?
- **State Oversight.** Increase state oversight and management of transit?

Potential Statutory Changes

- **Extend Suspension of Revenue-Related Provisions.** Continue pandemic-related program allocation adjustments and suspension of financial penalties?
- **Innovative Clean Transit Regulations.** Adjust time line for agencies to purchase zero-emission buses?

Mitigate Equity Impacts of Potential Fare Increases and Service Reductions. Without additional funding, transit agencies likely will have to institute some combination of fare increases and service cuts to address their operational funding shortfalls. Such actions could have disproportionate impacts on riders who are dependent on transit as their main mode of mobility to get to work, school, or other destinations—many of whom earn lower incomes. Providing some level of short-term relief could mitigate the need for agencies to take such steps in the near term and thereby avoid creating additional burdens for riders whose other transportation options may be limited. (We note that short-term relief would only help address equity impacts in the near term. Such impacts likely would still occur in the coming years if agencies are not able to achieve longer-term fiscal sustainability.)

Ensure Transit Agencies Are Well-Positioned to Help State Meet Its Climate Goals. The transportation sector represents roughly 40 percent of statewide GHG emissions, with a majority of these coming from passenger vehicles. Transit therefore likely will need to play an important role in helping the state achieve its aggressive GHG reduction goals by absorbing trips currently taken in passenger vehicles. However, if transit agencies are forced to reduce services or increase fares to address operational funding shortfalls, it could discourage individuals from shifting from

their personal vehicles to using transit, or even further decrease existing transit ridership. This would be counterproductive to the state's climate goals.

Structure of Relief

To the extent the Legislature chooses to provide financial assistance to transit agencies, the Legislature could structure this relief in a variety of ways. Factors to consider include the timing, duration, magnitude, repayment requirements, and distribution of relief. Below, we discuss options available to the Legislature for each of these factors as well as the associated benefits and trade-offs.

Timing

The Legislature will want to consider whether to provide relief in the budget year or in a future year.

Provide Relief Beginning in Budget Year. As noted previously, data suggest the overall statewide operational funding shortfall will total about \$300 million in 2023-24. Providing relief beginning in the budget year could give transit agencies greater confidence that they can maintain existing operations rather than needing to make immediate changes to their service levels or fare rates. However, we note that the state is expected to experience its own budget shortfall in 2023-24. As such, providing funding to transit agencies in the coming year could require the state to make cuts in other areas of the budget or find ways to raise additional revenues. In addition, such an approach would require the Legislature to develop the relief package relatively quickly, given the pending constitutional budget deadline. This could limit the Legislature's options in structuring the relief package and developing accountability measures.

Provide Relief Beginning in 2024-25 or Later. As previously discussed, transit agencies project the overall statewide operational funding shortfall will increase substantially to about \$1.2 billion in 2024-25 and \$1.9 billion in 2025-26. As such, the Legislature could choose to wait to provide relief until 2024-25 when the bulk of these funding shortfalls are expected to begin. By delaying a year, the Legislature could avoid needing to identify funding immediately and could explore options to raise revenues to address the funding shortfalls. In addition, the Legislature would have more time to work out details regarding the configuration of the relief package and to develop accountability measures. However, transit agencies facing funding shortfalls in 2023-24 would need to come up with alternative solutions in the interim, potentially including fare increases or reductions to service levels. Moreover, while delaying aid until 2024-25 or later would avoid potentially contributing to the budget problem in 2023-24, the state likely will be dealing with constrained budgets over the next several years. Notably, our office maintains that the economy is at an elevated risk of a recession, which could exacerbate the state's budget problem and leave it with less fiscal capacity next year.

Duration

The Legislature will want to consider whether to provide relief on a one-time basis or over multiple years.

One Time. The Legislature could provide relief to address identified shortfalls for one year. Doing so would give the state an opportunity to check in with transit agencies to see how they have utilized funding and ensure that they are planning for the long term before potentially providing additional funds. In addition, one-time funding would avoid committing the state to expenditures in future years. This is particularly important if the Legislature chooses to use General Fund to provide relief because current estimates suggest the state will face budget deficits over the next few years. On the other hand, this approach would provide transit agencies with less certainty about the availability of relief in future years—which could impact their ability to plan for longer-term solutions and might require them to reduce existing service levels or increase fares to be confident they will be able to meet their fiscal needs.

Multiyear. The Legislature could also provide relief over a multiyear period either by committing now to spreading funding across multiple years or by allocating a large lump-sum amount that agencies could draw upon over time as needed. Doing so could offer transit agencies more certainty regarding future funding and additional planning time, as well as further delay a need for potential service cuts and fare increases. However, this approach would commit a larger amount of state resources in the near term and/or future years when the state is experiencing its own budget deficits. The state likely would need to either increase revenues or redirect resources from other purposes to meet these commitments.

Magnitude

The Legislature will want to consider whether to provide relief that fully covers projected operational shortfalls, or that only partially addresses the identified needs.

Fully Cover Shortfall. The Legislature could attempt to fund the full statewide operational funding shortfall. By doing so, transit agencies potentially would be able to maintain existing fares and service levels without needing to make any other changes, at least in the near term. However, this approach would require significant state resources. In addition, depending on how the relief is structured, fully funding the statewide shortfall could reduce or eliminate incentives for agencies to consider alternative options to address their funding gaps beyond receiving relief from the state (such as restructuring their services to increase ridership and corresponding revenues).

Partially Cover Shortfall. The Legislature also could consider providing relief to address some, but not all, of the statewide operational funding shortfall. Specifically, the Legislature could tailor the funding to best align with the goals it intends to accomplish, and require each transit agency to identify alternative approaches to address any remaining funding gap it might face. Due to the state's current budget constraints, partial relief could reduce the need for the Legislature to redirect funding from other purposes, make substantial cuts elsewhere in the state budget, or raise additional revenues. However, if the state were only to provide partial relief, transit agencies potentially would need to make cuts to services or increase fares in the near term if they are unable to identify other options to address their remaining shortfalls. In such circumstances, low-income riders who are more likely to depend on transit as their primary mode of transportation likely would be disproportionately impacted.

Repayment Requirements

The Legislature will want to consider whether to provide relief as a loan or as a grant.

Loans. The Legislature could provide funding to transit agencies as no-interest or low-interest loans. Under such an approach, the Legislature would need to determine the duration over which loans would be made available, when agencies would need to begin paying them back, and to what extent the state should charge interest. Providing relief through loans has two key advantages. First, while it still would require state resources in the near term, providing loans could be budget-neutral depending on the associated terms. Second, because they would need to pay loan amounts and any potential interest back to the state at some point in the future, this approach would create an incentive for transit agencies to consider other potential options to address their budget shortfalls before relying on state funding. However, a key trade-off is that paying back loans could create an additional long-term financial burden for transit agencies—particularly if lower ridership levels and budget shortfalls remain a problem for them in future years. Alternatively, the Legislature could choose to make the loans forgivable if agencies meet certain terms, which could avoid creating a financial burden for the agencies and—depending on how the terms for forgiving the loans are structured—could provide agencies with a further incentive to develop plans toward long-term fiscal sustainability.

Grants. The Legislature could provide direct financial assistance to transit agencies without the expectation that they pay the state back. Grants could be less administratively challenging to implement and distribute than loans, allowing funding to be provided directly to transit agencies relatively quickly. In addition, unlike loans, agencies would not need to be concerned about raising future revenues to repay the funds. On the other hand, grants would result in greater long-term costs for the state as it would not be reimbursed in the future. Moreover, direct grants—depending on how they are structured—might not provide transit agencies with incentives to take alternative actions to address funding shortfalls, such as better aligning operations with current and future ridership levels. (We note that the Legislature could mitigate some of these disincentives by including accountability measures that agencies must meet in order to receive funding, which we discuss below.)

Distribution

If the Legislature chooses to provide fiscal relief to transit agencies, it will need to determine how to distribute the funding. For example, one question is whether to provide funding to all agencies across the state or only to those that are facing operational funding shortfalls. To further complicate allocation decisions, no funding distribution formula presently exists that perfectly aligns with current funding shortfalls. As such, the Legislature would need to either develop a new approach to distribute relief based on estimated funding need, or make use of existing formulas that may not fully address current issues.

Need-Based. The Legislature could attempt to distribute relief based on agencies' needs. However, implementing such an approach could be administratively burdensome and take time to implement because the state does not currently collect data on or uniformly define operational funding shortfalls. As such, the Legislature likely would need to establish a mechanism for assessing needs (such as the percent by which an agency's fare revenues have declined since

2019) or else rely on estimates of funding shortfalls from the individual agencies, which could be based upon different methodologies and assumptions. In addition, agencies have displayed varying capacity and willingness to take steps to address their operational funding shortfalls on their own without state assistance. As such, depending on how it defines “need,” the state could potentially disadvantage transit agencies that have fewer alternative options to address their shortfalls, or those that have already made tough decisions before they knew that receiving state aid would be an option.

Formula-Based. Federal and state funding for transit is often distributed on a formula basis. Using an existing formula to distribute relief could reduce administrative complexity and help expedite the distribution of relief. However, because the existing formulas were developed with different goals than the problem currently at issue, they would not necessarily align with needs. For example, currently the state distributes most of its transit funding based on population or an agency’s operating revenues from the previous fiscal year. Such factors do not neatly align with the variance in operational funding shortfalls that individual transit agencies currently are experiencing, as those have resulted from numerous other dynamics unrelated to, for example, population counts. As a result, by using an existing formula, relief likely would be distributed in a manner that is disproportionate to need. This could provide an unneeded windfall to some agencies while maintaining notable funding shortfalls for others.

Potential Fund Sources for Providing Relief

The Legislature has several fund sources upon which it could draw to provide relief to transit agencies. Available options include (1) providing flexibility over existing and planned transit funds, (2) redirecting funding from existing transportation funds and programs, (3) redirecting or providing additional funding from GGRF, (4) redirecting funding from the General Fund, and (5) generating additional revenues. Below, we discuss the benefits and trade-offs associated with each of these options.

Flexibility Over Existing and Planned Transit Funds

Recent Limited-Term Capital Funding. The Transit and Intercity Rail Capital Program (TIRCP) is an existing program that supports transit capital projects that reduce GHG emissions, vehicle miles traveled, and congestion. The 2022-23 budget package included an agreement to provide \$2 billion from the General Fund in both 2023-24 and 2024-25 for TIRCP. This funding is planned to be distributed to regional entities via a population-based formula. (As discussed later, the state also provides ongoing state funding from special funds for TIRCP to support transit capital projects through a competitive process.) The Legislature could continue to provide the intended funding for TIRCP but allow transit agencies to use their allocations for operations in addition to capital expenditures. We note that the Governor’s January budget included a proposal to (1) reduce the planned funding in 2023-24 by \$1 billion, (2) reduce the planned funding in 2024-25 by \$1 billion, and (3) delay \$500 million in planned funding from 2024-25 to 2025-26.

One of the main benefits of potentially “opening up” this funding to allow agencies to use the resources for operational expenses is that it would not place additional cost pressures on the

General Fund beyond current planned expenditures, given the multiyear budget plan already set this \$4 billion aside for transit in 2023-24 and 2024-25. Another advantage is that regional entities would be responsible for determining how funding would be allocated to transit agencies facing operational funding shortfalls. In contrast to the state, such entities likely have better information on what the current needs are amongst the transit agencies within their jurisdictions. Finally, this approach would allow regional entities to assess what capital projects are worth delaying to prioritize operational support. For example, in some cases, delaying certain projects may make sense given current and projected ridership trends. (We note that spending on transit operations—as opposed to spending on capital improvements—is an activity that is subject to the state appropriations limit. In contrast to recent prior years, however, this limit is not likely to be a significant constraint for the Legislature’s budget decisions in the near term, due mainly to lower state revenues. As such, we do not believe the Legislature needs to take this consideration into account when deciding whether to make changes to how TIRCP funds might be used.)

However, major trade-offs of providing such spending flexibility would be a likely reduction in the overall number of capital projects the Legislature originally intended to support with this funding, as well as potential disruptions at the local level for agencies that had planned on receiving and applying these funds to undertake important projects. (To mitigate this, the Legislature could consider putting a limit on the amount of funding a region could redirect from these funds to support operations.) Another consideration is that the Governor proposed halving these TIRCP funds to help address the state budget problem. As such, should the Legislature choose to maintain the full \$4 billion across the two years—either to potentially meet operational needs or for capital projects as intended—it will have to find alternative General Fund solutions compared to the Governor’s plan.

Ongoing Formula Transit Funding. The Legislature could provide relief by (1) permitting transit agencies to utilize more of the existing funding they receive from the Low Carbon Transit Operations Program (LCTOP) on operations more broadly and (2) continuing recent statutory measures that allowed transit agencies to utilize existing funding they receive from the State of Good Repair (SGR) program on operations. LCTOP provides operating and capital assistance for transit agencies to reduce GHG emissions. The program is funded from a portion of annual GGRF revenues—projected to be about \$105 million in 2023-24. SGR provides funding to support transit maintenance, rehabilitation, and capital projects. The program is funded from a portion of the revenues collected from the transportation improvement fee (TIF)—projected to be about \$125 million in 2023-24. (We discuss TIF in greater detail below.)

Providing transit agencies with additional spending flexibility within the funding they receive from these programs would have several benefits. First, this type of relief would not place additional cost pressures on the General Fund, given they are supported by special funds and would utilize existing revenues. Second, this type of flexibility would allow transit agencies to determine how best to utilize these resources to secure their own budgets. For instance, an individual agency—which is best-positioned to assess its current needs—could decide whether or not it would be worth forgoing activities normally supported by these programs to maintain necessary service levels. Third, in the case of SGR, a precedent exists for the state to temporarily allow agencies to spend funding on operations. Specifically, in response to the pandemic, the

Legislature enacted relief measures that permitted transit agencies to use SGR funding on operations from 2019-20 through 2022-23. A major trade-off of allowing such flexibility for LCTOP and SGR, however, is that it likely would result in a reduction in the activities the Legislature originally intended to support with these programs. For instance, allowing flexibility within LCTOP likely would result in spending on activities that do not reduce additional GHG emissions beyond current levels, such as to sustain existing services rather than to establish new or expanded transit services.

Redirect Funding From Existing Transportation Funds and Programs

The Legislature could provide relief to transit agencies by redirecting funding from existing transportation funds and programs. Funding for transportation in California comes from federal, state, and local sources. State funding for transportation primarily comes from various fuel taxes and vehicle fees that are dedicated to specified transportation purposes. In 2023-24, total state transportation funding from these sources is estimated to be \$14.7 billion. (This does not include revenues from vehicle fees that support the Department of Motor Vehicles and the California Highway Patrol.) Funding flows through several transportation accounts and is then allocated to various programs. We note that the California Constitution restricts certain state revenue sources to specific transportation-related activities. With this in mind, we identify funds and programs where we believe the Legislature could legally and feasibly redirect funding away from current uses to instead support transit operations.

State Highway Account (SHA). SHA largely is supported by fuel excise taxes on gasoline and diesel and primarily is used to fund highway maintenance and rehabilitation projects. After transfers and other adjustments, revenues that support the account are estimated to total \$4.8 billion in 2023-24. Under the California Constitution, the account's primary fund sources can only be used to support highways, streets and roads, and certain transit-related activities such as improvements to transit guideways and their related fixed facilities. This makes funding from the account largely unavailable to support transit operations. However, the Legislature could redirect funding from SHA to support eligible transportation programs and activities that are planned to receive General Fund augmentations and then use the "freed up" General Fund to provide operational relief to transit agencies. For instance, the Legislature could use SHA to backfill eligible expenditures from the recent one-time General Fund augmentations agreed to for the population-based TIRCP (\$2 billion in both 2023-24 and 2024-25).

A major benefit of this approach is that it would not place additional cost pressures on the General Fund. The major trade-off is that any redirections from SHA ultimately would result in less funding available for state highway maintenance and rehabilitation projects. This is because SHA is one of the main funding sources for the California Department of Transportation's State Highway Operation and Protection Program (SHOPP), which supports capital projects that rehabilitate and reconstruct the state highway system. However, given the increase in formula highway funding the state is expected to receive from the federal Infrastructure Investment and Jobs Act (IIJA), the impacts of shifting funding away from SHA are less significant than they would have been in a prior year. Specifically, the state is expected to receive average annual increases of \$1.7 billion from IIJA, or \$8.5 billion more across five years, compared to previous federal funding levels. Of this amount, 60 percent will be dedicated for state-level activities—

largely highway maintenance and rehabilitation through SHOPP—and 40 percent will be apportioned to local agencies to address local transportation system needs. We note that the Governor’s January budget already proposes using \$500 million from SHA to backfill certain General Fund-supported programs in order to achieve budget solutions in the budget year. Should the Legislature approve that proposal, it will want to consider any potential relief provided through SHA within the context of the state’s goals for highways.

Road Maintenance and Rehabilitation Account (RMRA). RMRA receives most of the revenues generated from the increased fuel taxes and vehicle fees enacted under Chapter 5 of 2017 (SB 1, Beall). This includes a portion of the revenues generated from TIF. The account funds state highway maintenance and rehabilitation projects, provides funding to cities and counties for local streets and roads, and supports several smaller programs. After transfers and other adjustments, total revenues that support the account are estimated to be \$4 billion in 2023-24. Similar to SHA, most funds from RMRA—estimated to be \$2.4 billion in 2023-24—can only be used to support highways, streets and roads, and certain transit-related capital activities. However, TIF revenues—estimated to be \$1.6 billion in 2023-24—can be used under the California Constitution to support transit operations. Therefore, the Legislature could (1) free up resources to support transit operations by redirecting funding from RMRA to support eligible transportation programs and activities that are planned to received General Fund augmentations, similar to the approach that we described above regarding SHA, and/or (2) provide up to \$1.6 billion directly from TIF to provide operational relief to transit agencies.

Given that RMRA is fully supported by special funds, the Legislature could redirect these funds to support transit operations without worsening the state’s current General Fund deficit. However, such an action ultimately would result in less funding available for state highway maintenance and rehabilitation projects through SHOPP and/or less funding for local streets and roads. Similar to the discussion above regarding SHA, additional funding from IJA would reduce the impacts associated with shifting RMRA funding away from SHOPP. However, the extent to which IJA could offset any RMRA funding redirected away from supporting local streets and roads is less clear, since local agencies spend federal dollars on a variety of activities, some of which will not receive IJA augmentations. Additionally, the Legislature would want to coordinate any potential redirections it might make to RMRA—for transit support and/or for budget solutions—with those it is considering for SHA to ensure SHOPP funding is not reduced too significantly relative to the state’s goals for highways.

Federal Highway Funds. The Legislature could consider redirecting a share of IJA formula funds from SHOPP to instead support transit agencies. While federal highway funds cannot be used directly for transit operations, the state can direct a portion to support transit capital projects and maintenance. As such, the Legislature could provide additional federal funds directly to local agencies to use for allowable existing capital and maintenance costs that they are currently supporting using local funds. This would allow the agencies to free up that local funding to instead support their operational costs while still addressing their essential maintenance needs using the IJA funds. The benefits of redirecting federal funds from SHOPP are that it would not impact the state’s current General Fund deficit nor would it redirect state fuel taxes and vehicle

fees that voters approved to support specific transportation purposes. However, a key trade-off would be less funding available for state highway maintenance and rehabilitation projects.

TIRCP. As mentioned previously, TIRCP is an existing state program that supports competitive grants for transit agencies to undertake capital projects. The ongoing program is supported by GGRF and TIF, with total funding estimated to be about \$500 million in 2023-24. The Legislature could redirect a portion of these funds away from TIRCP to provide operational relief to transit agencies. Similar to the approaches above, shifting funding from TIRCP would not worsen the state's General Fund shortfall. However, any shifts in this funding ultimately would result in fewer transit capital projects being supported by the program over the long run. Additionally, the program awards funding to projects on a multiyear basis, with many of the approved projects being relatively far along and also involving local and federal funds. As such, reducing funding for TIRCP could potentially be disruptive for several local capital projects, depending on the amount and timing of the funding change.

Greenhouse Gas Reduction Fund

The Legislature could provide relief to transit agencies by allocating additional funding from GGRF—either from the discretionary portion or by redirecting away from existing statutory continuous appropriations. The Governor's January budget proposal includes a total of \$2.8 billion from GGRF. This consists of about \$1.6 billion for continuously appropriated programs, \$350 million for existing commitments, and \$860 million for proposed discretionary spending. (The Governor proposes using all of the discretionary funds to backfill proposed General Fund reductions to zero-emission vehicle programs and to the AB 617 Community Air Protection Program.) We note that there is a strong possibility that additional GGRF revenues will be available to spend in 2023-24, as the administration historically underestimates cap-and-trade auction revenues. Specifically, our office projects that the state will have a total of about \$800 million available in additional discretionary GGRF revenues to spend in the budget year. Because the Legislature and the Governor typically determine how to spend discretionary GGRF revenues as part of each year's budget negotiations, additional amounts likely will be available and still "unspoken for" in the coming years. While the amount of revenues that future cap-and-trade auctions will generate is subject to significant uncertainty, auctions in recent years have generated roughly \$1.6 billion for annual discretionary expenditures.

Utilizing GGRF to provide relief to transit agencies would have several benefits. In particular, this approach would not place additional cost pressures on the General Fund. Additionally, it would be somewhat consistent with how the state has historically utilized a portion of these funds; as mentioned above, GGRF currently supports transit programs such as LCTOP and TIRCP. A key trade-off associated with utilizing GGRF, however, is that it would result in less funding available to support other programs or to achieve General Fund budget solutions.

General Fund

The Legislature could provide relief by allocating additional General Fund resources to support transit agencies, such as by (1) redirecting funding from the one-time and limited-term augmentations the state's recent budget surpluses provided to transportation and/or other

program areas, (2) rejecting and redirecting new spending proposed in the Governor's January budget, or (3) redirecting funding from existing ongoing activities.

In each case, the Legislature would want to weigh the benefits and trade-offs associated with forgoing certain General Fund-supported activities to instead provide relief to transit agencies. Some options where redirecting General Fund might have more merit include where existing planned expenditures do not align with current legislative priorities (potentially including some new spending proposed by the Governor) or where additional federal funds are available (such as for zero-emission vehicles and refueling infrastructure). Overall, redirecting existing or planned one-time and limited-term funding likely would be less disruptive than reducing funding for ongoing programs. However, given indications that the state's budget deficit could be worsening, the Legislature may have to make additional General Fund reductions to solve its shortfall, making it even more challenging to identify programs from which to redirect funds in support of transit.

Generate Additional Revenues

The Legislature also has the option of raising additional near-term revenues to support transit agencies. This could be done in several ways. The Legislature could consider a broad-based tax increase (such as to personal income, corporation, or sales taxes). Alternatively, it could take an approach more directly linked to transportation-related needs. For example, the Legislature could increase fuel taxes or vehicle fees that support transportation and could legally be used for transit operations under the California Constitution, such as TIF or the diesel sales tax. TIF is a vehicle registration fee that is assessed annually, with current charges ranging from \$29 to \$206 based on the value of the vehicle. The diesel sales tax currently is set at 13 percent, with 10.5 percent dedicated to supporting transit agencies and state activities related to mass transit. (We note that the Legislature enacted legislation that temporarily reduced the diesel sales tax to about 9 percent beginning in October 2022, with the programs these funds support currently being backfilled by the General Fund. Under current law, the tax will return to its normal rate of 13 percent in October 2023.)

While raising additional revenues would not add any additional cost pressures to the General Fund or other existing programs, it would come with several trade-offs. In particular, higher charges would have direct impacts on the individuals and businesses who would be responsible for paying them. Such increases also could raise equity concerns. In particular, increases to the diesel sales tax likely would have disproportionate impacts since it is levied on all drivers equally regardless of income. (The Legislature could structure increases to TIF to avoid some of these adverse impacts by targeting them on vehicles above a specific value, such as by only increasing fees on vehicles valued at \$25,000 and above.) Potential distributional impacts associated with increasing non-transportation-related charges would depend on the specific actions undertaken. A consideration unique to raising additional revenues that would not apply to the other options discussed in this letter is that it would require approval by a two-thirds vote of the Legislature. This higher threshold may make it more difficult for the Legislature to adopt this approach. Moreover, the Legislature would also want to consider how new revenue measures might interact with existing budget formulas—such as those put in place by Propositions 98 and 2—which could affect how much of the new funding ultimately would be available for

spending on transit. Finally, the Legislature will want to consider how quickly it can raise additional revenues. In some cases, increases to certain charges would take time to implement and revenues might not be available immediately. That said, we note that given its historically high cash balances, the state likely has sufficient internal liquidity to provide a short-term cash loan until any such revenues were to materialize.

Potential Accountability Measures to Accompany Relief

Given the importance of addressing declines in ridership and operating funding shortfalls—and of precluding the need for continued state fiscal assistance—on an ongoing basis, the Legislature may want to adopt some requirements for transit agencies to ensure they are making progress on developing long-term plans for sustainability. Below, we discuss some accountability measures the Legislature could consider to accompany any fiscal relief it might provide.

Analysis of Operations and Future Ridership. While ridership has returned somewhat since the pandemic, some indications suggest it could be depressed for some time. In response, transit agencies likely will need to develop long-term plans for how they can adjust their operations to adapt to this “new normal.” To ensure that transit agencies are taking these proactive steps, the Legislature could require agencies that receive state relief to complete analyses that (1) examine future ridership trends and travel behavior, (2) identify potential improvements to make their operations more effective and efficient, (3) develop a series of scenarios to maximize services within the confines of available resources, and (4) assess options for generating additional revenues. These plans also could provide the state with useful cumulative information on steps transit agencies are taking to regain ridership and secure their budgets over the long run. Depending on how it decides to structure relief, the Legislature also could consider making the completion of such plans a condition for agencies to have their state loans forgiven. We note that identifying which state agency would collect and review these plans would be an additional decision-point for the Legislature, as no such direct state-local oversight relationship currently exists for transit.

Increased Data Reporting. The Legislature may also want to consider requiring transit agencies to submit data that would be helpful in conducting effective oversight of any additional funding it provides. For instance, the Legislature could require transit agencies to submit certain information before they access relief, such as (1) past and projected ridership levels, (2) past and projected expenditures and revenues, (3) a description of how they will use relief funding, and/or (4) estimates on how relief will impact their operational funding shortfalls.

The Legislature also could consider whether collecting certain data from transit agencies might be helpful on a more long-term basis. Currently, transit agencies report some limited information—such as farebox recovery rates and revenue sources—to the state. However, these data generally do not provide the state with a comprehensive assessment of transit agencies’ performance. The Legislature could require transit agencies to also measure and report on efforts to increase ridership, operating efficiency, and effectiveness in the coming years.

Increased State Oversight and Management. The Legislature could consider adopting a model similar to the one the state uses when it has to provide emergency loans to school districts

and require that a state-appointed administrator oversee fiscal restructuring at any transit agency that accepts state relief to sustain its operations. This could even involve removing some level of decision-making from local agencies until they pay back relief funding to the state—which is what the state requires for school districts. A benefit of this approach could be greater assurances to the state that transit agencies are making changes that improve their fiscal conditions. However, such an approach would create a new role for the state and involve significant new administrative workload at both the state and local levels. In contrast to local school districts, no existing fiscal management structure exists for transit at the state or regional level to help implement such a significant oversight role. As such, instituting such measures—including identifying which state and local agencies would play oversight roles and supporting associated staff—could be both time-intensive and costly.

Potential Statutory Changes

In addition to providing funding, the Legislature also could consider enacting statutory changes that could offer some assistance to transit agencies over the short term by providing additional funding certainty and relieving some of their cost pressures. These options include (1) continuing previously approved program allocation adjustments and financial penalty suspensions and (2) adjusting the Innovative Clean Transit (ICT) regulations.

Continue Program Allocation Adjustments and Suspension of Certain Financial Penalties.

In response to the pandemic, the Legislature adopted statutory changes to help stabilize funding for transit agencies. First, the Legislature allowed the state to calculate allocations from SGR, LCTOP, and the State Transit Assistance (STA) program—which provides broad-based capital and operational funding—based on pre-pandemic numbers. The state typically calculates how much each transit agency will receive each year from these three programs based on population (50 percent) and an agency's operating revenues from the previous fiscal year (50 percent). Because ridership and revenues fell during the pandemic, this approach would have resulted in lower programmatic funding from these programs for most agencies, so the Legislature adopted language to hold them harmless for such declines. Based on 2023-24 estimates, the state will provide a combined total of about \$1.2 billion in annual formula-based funding to transit agencies through the three programs (\$125 million from SGR, \$105 million from LCTOP, and \$935 million from STA). Second, the Legislature adopted statutory changes to temporarily suspend financial penalties that transit agencies typically face when they do not meet certain requirements, such as farebox recovery rates. Both of these temporary hold harmless measures are scheduled to sunset at the end of 2022-23. The Legislature could consider reauthorizing these changes over the short term to provide relief to transit agencies.

By extending the time line for these changes, the Legislature could provide additional revenue certainty to transit agencies. This could be particularly important for agencies that are facing the largest operational funding shortfalls. However, continuing these suspensions may create a disincentive for transit agencies to improve their performance. For instance, continuing to allocate portions of SGR, LCTOP, and STA based on pre-pandemic operating revenues might diminish some of the urgency that transit agencies might feel to increase their ridership.

Adjust ICT Regulations. The Legislature could consider providing relief to transit agencies by directing the California Air Resources Board (CARB) to adjust the time lines for its ICT regulations. These regulations phase in a requirement for transit agencies to purchase only zero-emission buses (ZEBs) starting in 2029. The purchase requirements began in 2023 for large transit agencies and will begin in 2026 for small transit agencies. These regulations are designed to achieve 100 percent ZEB fleets statewide by 2040.

While the ICT regulations are aimed at helping the state reach its climate goals and reducing local air pollutants, they also represent an additional cost to transit agencies. This is because ZEBs are more expensive than conventional buses to purchase and also result in additional costs associated with building refueling infrastructure. Directing CARB to delay some of the time lines for complying with these requirements could provide near-term relief to transit agencies while still maintaining the long-term goals of the regulations. The degree to which this option might provide relief would depend on how long the requirements are delayed. Additionally, such adjustments could free up capacity for transit agencies to focus on improvements needed to regain ridership. A key trade-off to consider in adjusting the ICT regulations is that it likely would result in a delay in when transit agencies convert their fleets to ZEBs. However, some of the progress in GHG and local air pollutant reductions intended by the regulation ultimately could be negated if agencies' operational funding shortfalls force them to make service cuts which in turn lead to former transit riders shifting to more driving.

LONGER-TERM MEASURES

Many of the short-term relief measures discussed above likely would help transit agencies navigate their funding challenges in the near term. However, they are unlikely to solve some of the longer-term questions that we discuss above regarding the future of transit in the state, such as how to increase ridership to both improve transit agencies' long-term financial viability and meet the state's climate goals. If the Legislature has an interest in ensuring these longer-term issues regarding transit are addressed, it could begin laying the groundwork now to initiate more substantive changes. Below, we provide two examples of actions the Legislature could take with an eye towards these objectives. However, we note these examples are neither exhaustive nor intended as recommendations.

Conduct Analysis of Potential Changes to Statewide Transit Policies. As mentioned previously, statewide transit ridership was already in a state of decline prior to the pandemic and is expected to be depressed moving forward. As transit agencies begin to plan for the future, the state could take actions to support local efforts and ensure that transit systems are structured to reflect state goals. Identifying what such actions might be, however, is complicated—particularly given that the state has not historically played a significant role in designing, overseeing, or funding transit services. How—and whether—the state might want to revise its traditional role and/or direct local agencies to make changes are key questions. To better understand possible actions, the Legislature could conduct an analysis of potential changes it could make to statewide transit policies. Such adjustments could include statutory changes (both within transportation and other policy areas such as land use), restructuring the state and local relationship, or identifying additional funding sources to support transit on a long-term basis. This analysis could be

completed in several ways, such as by a legislative task force; blue-ribbon committee; or a state agency in coordination with representatives from various state and local agencies, academia, and stakeholder groups.

Adjust Current Transit Programs to Incentivize Improved Performance. As noted, the state currently allocates most of its formula transit funding based on population and agencies' operating revenues. Neither of these measures create a particularly strong incentive for agencies to improve their performance. For instance, higher operating revenues could reflect increases in fares and not increases in ridership. The Legislature could consider basing some amount of state funding allocations on a metric that incentivizes improved performance and aligns with legislative goals for transit. For instance, the state could provide some funding based on ridership levels or the amount of transit services provided. The Legislature could select which metrics to adopt depending on which outcomes it wanted to incentivize, such as increasing ridership or expanding service coverage. Given the various metrics it could consider, the Legislature may want to begin researching and deliberating now for how it might change current program allocations to ensure improved performance. Planning ahead before adopting new metrics also would give agencies time to prepare before facing potential adjustments to their funding allocations.

I hope that you found this information helpful. If you have any additional questions or would like my staff to brief you on these issues, please contact Frank Jimenez at (916) 319-8324 or Frank.Jimenez@lao.ca.gov, Luke Koushmaro at (916) 319-8355 or Luke.Koushmaro@lao.ca.gov, or Rachel Ehlers at (916) 319-8330 or Rachel.Ehlers@lao.ca.gov.

Sincerely,



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Legislative Analyst

cc: Hon. María Elena Durazo, Senator
Members of Assembly Budget Subcommittee No. 3 on Climate Crisis, Resources, Energy,
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