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TO: BOARD OF DIRECTORS

THROUGH: ROGER SNOBLE
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SUBJECT: PROPOSITION 76

ISSUE

Proposition 76, also referred to as the Live Within Our Means Act, is on the November 8, 2005 ballot. This measure would place an additional limit on State expenditures and make fundamental changes in the way in which the state addresses its overall budget process. Proposition 76 also makes significant changes to the constitutional provisions relating to transportation by removing the ability of the state to borrow from transportation funds and to use transportation funds to solve state budget deficits. This memo outlines the provisions in Proposition 76 and their relationship to transportation funding. Staff recommends that the Board of Directors not take a position on this measure.

PROVISIONS

With respect to the broader State budget, Proposition 76 would:

- Limit state spending to the prior year's level plus the average of the previous three years' revenue growth.
- Make changes to education funding formulas to eliminate certain repayment requirements, and modify minimum school funding requirements.
- Require that a prior-year's expenditures be automatically extended when the State is late in passing a new budget.
- Direct excess revenues to a budget reserve, debt repayment and certain construction programs.
- Allows the Governor to declare a fiscal emergency when the Department of Finance determines that certain fiscal conditions have been met in any given quarter.
- Further allows the Governor to reduce appropriations, across the entire state budget, if the Legislature has not passed a bill responding to that emergency within 45 days.
- Prohibits borrowing from special funds.

With specific reference to transportation funding, Proposition 76 would:

- Allow the suspension clause in Proposition 42 to be used for only one more year and thereafter prohibits its use by the state.
- Declare the fund into which Proposition 42 funds are transferred to be a special fund and thereby prohibit future borrowing by the State. Proposition 42 funds are deposited into the Transportation Investment Fund before being allocated to the various subcategories.
- Extend the repayment of over $2 billion in Proposition 42 loans to 15 years, and require that only 1/15 of the total amount may be repaid in any given fiscal year and authorize the Legislature to issue bonds against this repayment.
- Remove the ability of the state to loan money from the State Highway Account (SHA) and the Public Transportation Account (PTA) to the General Fund.

DISCUSSION

While Proposition 76 makes major changes to the overall state budget process it also makes significant changes to the way in which state transportation funds are protected under the state constitution. Proposition 76 raises a variety of public policy issues but the measure does provide significant protections to transportation fund sources. These protections must be understood as they function within the overall structural changes proposed by the measure.

The basic spending control mechanism proposed by Proposition 76 is that no future state budget could expend more than a previous year's budget plus the average growth from the previous three years. In calculating the new spending cap, the revenue growth from special funds including Proposition 42 funds and the State Highway Account would be included in addition to growth in the General Fund. Because the expenditure limit is applied to total state expenditures, General Fund and special funds combined; there is still some question as to how the expenditure cap would apply to special funds.

With respect to transportation funding, the changes proposed by Proposition 76 would provide fairly strong safeguards. Foremost, is that the Legislature and Governor will not be able to use the suspension clause of Proposition 42 or borrow from the SHA and PTA. Proposition 76 does three key things to protect transportation. First is that Proposition 42 funds would not be subject to suspension clause after the next fiscal year. This means that Proposition 42 could only be suspended for one more year. Second is that Proposition 42 funds would then be declared "special funds" and then be subject to the prohibition against borrowing by the General Fund. Thirdly, Proposition 76 removes the ability of the state to borrow SHA and PTA funds.

Proposition 76 also includes a mechanism to ensure that past transportation loans are repaid by creating a dedicated revenue stream for repayment and authorizing bonds to be issued against that revenue stream.

Technically, under the provisions of Proposition 76 a Governor could reduce expenditures from the SHA and Proposition 42. However, since these funds cannot be used for anything else, their retention would not benefit the General Fund. These funds would be held in a reserve account until they could be expended in the future. In situations where the state has surplus revenues, Proposition 76 provides a mechanism for those funds to be spent on transportation projects.

Proposition 76 contains a number of safeguards that would be beneficial to transportation. The combination of these safeguards with major structural changes in state government does concern staff. We therefore recommend that the Board not take a position on Proposition 76.

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