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TRANSPORTATION FUNDING FORMULA

House Bill 5822 (Substitute H-1)
First Analysis (6-23-98)

Sponsor: Rep. Clark Harder
Committee: Appropriations

THE APPARENT PROBLEM:

The current allocation agreement for transportation funds is set to expire in law on September 30, 1998. Generally speaking that allocation agreement, sometimes called a "formula," specifies that Michigan transportation funds are divided among state, county, and city interests such that the state receives 39.1 percent of the funds, the counties receive 39.1 percent of the funds, and cities and villages receive the remaining 21.8 percent. (For more detail, see *BACKGROUND INFORMATION*.)

Throughout this decade, policy makers have proposed different ways to allocate the transportation funds, and some proposals to change the allocation have generated contentious debate among stakeholders whose interests are entrenched. Some reallocation schemes would shift funds from local to state government, increasing the state share. Chief among these has been a plan presented by the governor which would give the state control of more local roads and let private contractors handle state road projects. Another approach would shift decision-making authority and funds from the state to the counties. Yet another approach would shift funds between counties, increasing the share allocated to counties that have more people, so that the most densely populated regions in the state would receive funds commensurate with total road miles traveled.

Some local government stakeholders in this ongoing policy conversation have feared that the allocation formula might expire all together. Absent a move to reauthorize it, the state executive branch could collect and distribute the gas and weight taxes comprising the transportation fund with greater discretion. In order to heighten the sense of urgency about reauthorization and to ensure that the state local partnership would not be eliminated, policy makers adopted a provision in Public Act 79 of 1997 that specifies that unless the formula is reauthorized or rewritten, 20 percent of state transportation aid will be put into escrow when the state begins the 1998-99 fiscal year.

In order to ensure the allocation of all transportation funds to state and local units of government during the coming fiscal year, and to continue the current allocation percentages until a transportation needs study has been completed, some have argued that use of the current formula should be extended for six years. Further, some have argued that when it comes to decisions about local roads, local governmental jurisdictions should have greater policy making discretion within the federal-state-local partnership.

THE CONTENT OF THE BILL:

House Bill 5822 (H-1) would repeal sections 3, 4, 5, and 11e of Public Act 51 of 1951, the Michigan Transportation Fund Act, that provides for the classification and funding of Michigan roads. The bill would eliminate two uses for transportation funds (state debt and local program deductions), alter the amount of funds that would be allocated by the transportation formula, and extend the formula sunset date six years, from September 30, 1998 until September 30, 2004. Pending the completion of a needs study, the distribution percentages in the existing formula would not be changed.

<u>State local partnership and local authority.</u> The bill would remove the requirement that a contract or agreement by a county road commission be approved by resolution of a board of supervisors or a city or village legislative body. The bill also would remove the requirement that the state transportation department check, review, and certify the primary roads selected by the road commission. Instead, House Bill 5822 would allow county road commissioners to include or delete roads from the county primary road system from time to time, but would require the commission to notify the Department of Transportation. The bill would then specify that the county roads that were not included in the primary system would constitute the local road system.

Transportation needs study. The bill would require that beginning December 1, 1998 and every four years thereafter, the Majority and Minority Leaders of the Senate and the Speaker and Minority Leader of the House would appoint five people to four-year terms who would serve as a transportation needs study committee; and also appoint no more than 23 people to four-year terms who would serve as a citizen advisory committee. Under the current law, both of these committees are appointed by the governor, and the needs study committee appointees are subject to the advice and consent of the Senate. Currently, organizations submit the name of one organizational representative to the citizen advisory committee; under the bill each organization would submit three recommendations for each appointee. House Bill 5822 would require that, in consultation with the needs study committee, the Department of Transportation provide a recommended work program for the committee by March 1, 1999. The committee would be required to publish a preliminary report by January 1, 2000, and alterations of formulas or the distribution of funds before January 1, 2001.

Local critical bridge repair. The bill would remove the requirement that 3 cents of the gas tax go to the state trunkline fund, county road commissions, and cities and villages according to percentages provided in the formula. Instead, the bill would require that through September 30, 2001, revenue from one cent of the gas tax be appropriated such that half a cent goes to the state trunk line fund for repair of state bridges, and half a cent to the critical bridge fund for repair of local bridges. Currently one cent goes to the state trunk line fund for repair of state bridges.

Debt service and local program fund. The bill would remove the requirement that $43 million go to the state trunk line fund for debt service costs on state transportation projects. The bill also would remove the requirement that beginning October 1, 1995, a $33 million annual grant be made to the local program fund. Currently these funds--$76 million--are deducted from total gas tax dollars before the remaining funds are distributed to counties, cities, and public transit agencies.

Eliminate escrow requirement and reference to one-time supplemental. The bill would remove the provision that sets up a 20 percent 'escrow account' by eliminating the requirement that provides for the allocation of 80 percent of the transportation revenues in the same percentages as the distribution formula in effect before October 1, 1998. The bill also would remove the provision that allocated $20 million from the Michigan transportation funds for the fiscal year that ended September 30, 1997.

Economic development fund. The bill specifies that 35 percent of the funds appropriated to Michigan from the federal government would be allocated to the transportation economic development fund, an increase in the percentage from the current 31 percent. Of these funds, the bill specifies that 18 1/4 percent would be distributed for development projects for rural counties, and 16 3/4 percent would be distributed for capacity improvement or advanced traffic management systems in urban counties. (Currently, 16 ½ percent and 15 percent, respectively, are distributed for these purposes.)

Revenue worth determinations. Annually, the bill would require each county to determine the current average revenue worth per mile of a county primary road and a county local road; each city or village to determine the current average revenue worth per mile of its major streets and local streets; and, the state transportation department to determine the current average revenue worth per mile of state trunk line highways. The bill also would provide that all transfers of money to receiving jurisdictions would be calculated on the basis of the appropriate and previously calculated revenue worth per mile. Currently revenue worth determinations are made by the Department of Transportation, and funds are allocated based on the department's determinations.

Public transportation services; guarantees; match elimination. The bill would require that for the fiscal year ending September 30, 1998 and each fiscal year thereafter, eligible public transportation services in urban areas having a population greater than 100,000 would receive a grant of 50 percent of their eligible operating expenses; and further, that urban areas having a population of 100,000 or less, and non-urbanized areas, would receive a grant of 60 percent of their eligible operating expenses. Currently the law specifies "up to 50 percent" or "up to 60 percent" for the respective population categories. The bill also requires that any unreserved balance in the comprehensive transportation fund at the end of a fiscal year would be appropriated only to eligible authorities and governmental agencies, and distributed to meet these 50 and 60 percent funding levels. Under current law, if the fund is greater than $50 million, then the entire unreserved balance minus $50 million is appropriated to local bus transit authorities for discretionary capital expenditures. The bill also specifies that beginning with the fiscal year ending September 30, 1999 and each fiscal year thereafter, each eligible public transportation authority would receive a distribution from the comprehensive transportation fund for eligible operating expenses not less than the distribution received for the fiscal year ending September 30, 1998. The bill also would remove the reference to matching federal funds for local bus capital, so that for the fiscal year ending September 30, 1998 and each fiscal year thereafter, not less than $8 million will be distributed for 100 percent capital projects for eligible authorities and governmental agencies.

Transportation Commission. The bill would require that the State Transportation Commission submit its annual May 1 transportation program recommendations to the legislature, governor, and auditor general, or lose 10 percent of the funds from the state trunk line fund that would be appropriated to the Department of Transportation, until such time as the reports are submitted.

Federal-state-local partnership. The bill would require that not less than 25 percent of Michigan's federal DOT-FHWA highway, research, planning and construction funds be allocated to programs administered by local jurisdictions, after certain deductions are made to meet specific requirements. The bill also specifies that it is the intent of the legislature that federal highway aid that is allocated to local jurisdictions would be distributed in a manner that produces a minimum of 25 percent of applicable funds to programs in each fiscal year through September 30, 2005. The bill also specifies that beginning in the fiscal year ending September 30, 1999, the average allocation would be the average of the amount distributed in each succeeding fiscal year. The bill would prohibit the submission of the state transportation plan to the federal highway administration unless the state coordinates transportation plans, programs, and planning activities by agreements with local officials. Further, on November 1 of each year, the department would be required to estimate the amount of federal highway funds that are anticipated for that fiscal year, and all eligible recipients would be allowed to obligate, through a competitive bid process, up to 80 percent of their anticipated federal revenue. The bill would make permanent the provisions in the law that govern the department and local road commission reimbursement responsibilities for the elimination of grade crossings. Currently the law specifies that this provision applies through September 30, 1998.

Performance audits by Treasury Department. The bill would require that the Department of Treasury conduct performance audits that are undertaken according to government auditing standards issued by the United States General Accounting Office, and it would require the Department of Transportation to make pertinent records available to the Department of Treasury. The bill also would require that county road commissions file their annual report showing the disposition of funds with the state treasurer before May 2. Currently these reports are filed with the director of the Department of Transportation. The bill also would require the director to furnish the legislature, the governor, and the state treasurer with a detailed report of revenues credited to the Michigan Transportation Fund within 120 days after the close of each fiscal year. Currently this report is furnished to the legislature and the governor. Finally, the bill would require the state treasurer to review and comment on the report including any questions or concerns and any recommendations to the House and Senate appropriations subcommittees on transportation, the House and Senate fiscal agencies, and the state budget director within 60 days after receipt of the report.

Maintenance contract bidding. House Bill 5822 would prohibit the Department of Transportation from preventing a county road commission, city, or village from bidding on maintenance contracts on highways under the jurisdiction of the department, and would specify that these jurisdictions would be considered to be prequalified to bid.

Township road funds. Currently, county road commissions have jurisdiction for local and primary road systems, except that a county road commission in a county having more than 500,000 people may contract with a township board on an annual basis for road maintenance. House Bill 5822 would amend the Michigan Transportation Fund act to require a county road commission to divide its county local road funds among the townships in a specified manner and subject to certain conditions.

Three-Year Plans. In order to specify how local road funds would be used in its jurisdiction, a township would be required to file a three-year plan before October 1 of any year, with the board of county road commissioners. In that plan, the township would be required to identify the projects it proposed to fund, and to provide for the township to match the amount allocated. The bill also would require the county road commission to retain the funds it would distribute to townships in a separate account, and to notify each township within the county of the funds available. In any year a township did not file a plan, the amount allocated to that township would be divided on a pro rata basis among the other townships submitting plans, as would any funds allocated to a township but not expended within three years.

Funding. House Bill 5822 would not alter either 1) the amount of a county's allocation to be used on county primary or local roads in urban areas (currently 10 percent), or 2) the amount of a county's allocation to be used on county local road systems (currently four percent). However, under House Bill 5822, the county road commission would be required to divide the local road funds (currently four percent) among the townships within the county as follows: 65 percent of the county's allocation would be allocated to the township for those roads in the same proportion that total mileage in the township bears to total mileage in the county; and 35 percent of the county's allocation for those roads would be allocated to the township in the same proportion that total population in the township (outside of the incorporated villages and cities) bears to the total population of the county (outside of incorporated villages and cities), using the most recent federal census.

Major and local street funds. House Bill 5822 would amend the Michigan Transportation Fund Act to ease some of the restrictions on the ways local governments use their major street and local street grants, distributed by the state from the Michigan Transportation Fund. Specifically, the bill would revise two provisions in Section 13 of the act: the percentage caps on transfers from major to local street funds, and the out-year transfer assurance. Generally, House Bill 5822 would allow a city or village to maintain and improve its local street system using major street money, if its local match on local street projects was fulfilled, and if the local government notified the state.

Specifically, House Bill 5822 would require that the money distributed to cities and villages under Section 13 be used on the major and local street systems of those cities and villages, and that the first priority be the major street system. However, money designated for the major street system could be used for the local street system if matched equally by local revenues and construction expenditures. If a city or village transferred more than 25 percent of its major street funding to the local street system, the local government would be required to adopt a resolution and send a copy to the transportation department. That resolution would include (1) a list of the major streets, (2) a statement that the major streets are adequately maintained, (3) the amount of the transfer, and (4) the local streets to be funded with the transfer.

Further, the bill retains language that specifies that when a local government forgoes or exceeds a shift of major street money to its local street system in any given year, then major street money received during the next succeeding two years may be transferred for expenditure on the local system until the amount so authorized for transfer was fully expended.

The bill also would leave unchanged the requirements in this section that no more than 10 percent of the returned funds be used for administrative expenses; that a single administrator be designated locally to coordinate projects; and, that interest earned on funds returned be credited to the appropriate street fund. The bill would also continue to allow cooperative agreements between state and local government for consolidated street administration.

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BACKGROUND INFORMATION:

Public Act 51 of 1951 forms the basic structure of highway finance in Michigan. The act establishes the Michigan Transportation Fund as the primary receiving fund for the tax revenues and user fees dedicated to highway purposes. Expenditures from the fund are not made directly, but instead, appropriations or transfers are made from the fund to the various operating funds and to the county road commissions and cities and villages. Expenditures are governed by distribution formulae specified in the law.

As described by the Citizens Research Council in their memorandum (November 1996) and subsequent report (May 1997), both entitled "Michigan Highway Finance and Governance," the formulae require:

• Payment of principal and interest on outstanding debt; and, administration and collection costs (a series of grants, one of which goes to the Department of State because it collects revenue for the MDOT, and two grants to departments that perform specialized tasks for MDOT, the Department of Environmental Quality and the Office of the Attorney General).

• Appropriations to special revenue projects (including the Recreation Improvement Fund, the Critical Bridge Fund, the Rail Grade Crossing Account, and the Transportation Economic Development Fund.

• Allocation of 10 percent of the remaining funds to the Comprehensive Transportation Fund for mass transportation.

• Allocation of the remaining funds (almost three quarters of the Michigan Transportation Fund revenues) to state and local road agencies for highway construction, maintenance, and snow removal, according to the following percentages: the State Trunkline Fund, 39.1 percent; County Road Funds, 39.1 percent; and Cities and Villages, 21.8 percent.

State Trunkline Fund (39.1 percent). These funds are used for funding construction and maintenance of state-administered roads. Distribution of these funds is determined by the Department of Transportation and the State Transportation Commission.

County Road Funds (39.1 percent). One percent of these funds is directed to counties with annual snowfall of greater than 80 inches. Each county gets $10,000 to help pay for licensed engineers. Ten percent of the balance is distributed to counties with urban primary or local roads. Of the remainder, 75 percent is directed to county primary roads and 25 percent to county local roads. For primary roads, 75 percent of the distribution is based on the proportion of motor vehicle taxes collected in each county, 15 percent is based on the proportion of county primary mileage in each county, and the remaining 10 percent is divided equally among the 83 counties. The county share of local road dollars is based on the proportion of population residing outside of incorporated municipalities.

Cities and Villages (21.8 percent). After deducting a small amount for distribution to cities and villages with large amounts of snowfall, 75 percent of these funds is distributed according to the proportion of population in cities and villages (60 percent) and on the basis of "equivalent major mileage" (state trunkline mileage in the municipality multiplied by a factor) (40 percent). The remaining 25 percent is distributed on the basis of population (60 percent) and local street mileage (40 percent).

FISCAL IMPLICATIONS:

The House Fiscal Agency notes that although there is no direct fiscal impact on state revenues, the distribution of revenues to local governments would increase by approximately five percent. Specifically, the bill would increase the allocations to county road commissions by $14,163,800; to cities and villages by $7,895,100; and to the critical bridge fund for local bridge repair by $23,818,800, for a total of $45,877,700. In addition, the bill would increase the allocation to the Comprehensive Transportation Fund by $18,591,200, and would reduce the allocation to the State Trunkline Fund by $44,371,900. (6-18-98)

ARGUMENTS:

For:

There has been no comprehensive transportation needs study completed in Michigan since 1984, despite the fact that one is required under the law every four years. A comprehensive needs study is long overdue, and the findings from such a study are warranted before informed, research-based changes can be made to Michigan's transportation system. In order to ensure careful scrutiny of the system, scrutiny undertaken in a review environment that gives stakeholders some sense of continuity despite change, the sunset date for the formula should be extended more than a year or two. The needs study could then serve as the basis for a discussion about changing the state's transportation funding formula and state vs. local road jurisdictional issues. To that end, House Bill 5822 would extend the current road fund distribution formula for six years, until September 30, 2004. The six-year extension would allow an independent committee to conduct a needs study. Under this bill, the committee would be charged by the legislature to report a work program for the committee before March 1, 1999, to issue its preliminary report by January 1, 2000, and to publish its recommended alterations to road fund distribution formulas on or before January 1, 2001.

For:

This legislation guarantees that local road jurisdictions will continue to share in federal funds returned to Michigan. As the U.S. Congress moves to reauthorize the federal highway funding program (called the Intermodal Surface Transportation Efficiency Act, or ISTEA) during this fiscal year, members of Congress have moved to increase the revenue that will be returned to donor states like Michigan, and also to turn back more authority to governors and state transportation departments. As these changes take effect, it is important that local governments and local road agencies be assured of a fair and steady portion of federal funding for local projects, and also a continuing partnership with the state transportation department.

For:

Michigan has more than 1,500 county and city bridges that are in need of repair or replacement. The Critical Bridge Fund was created to prioritize repairs of the state's worst bridges. However, the fund has never been adequately funded to reduce the backlog of need. Currently, only 20 local bridges per year are repaired under the program. When the gas tax was increased in July 1997, one cent of the increase was earmarked for the repair of state-maintained bridges. This legislation would split evenly the revenue from the one cent raised through the gas tax increase, providing $23 million each for state and local bridges.

Against:

On October 1, 1998, the current road fund distribution formula will expire. The sunset date for that formula should be extended one year. If it is not extended the state of Michigan could lose $800 million in matching federal funds, and state and local governments could lose 20 percent of their current road funds. A bill to extend the formula one year would be easier to enact in a timely manner, since Senate Bill 1156, a straightforward one-year extension, has already passed the Senate with the support of the executive office and the Department of Transportation.

Response:

A motion to discharge Senate Bill 1156 from committee, a bill that provides for a one-year extension of the transportation formula sunset, failed to pass in the House on June 16, 1998.

Against:

This bill would eliminate $43 million that funds the current costs of the Build Michigan I bonding program, and $33 million that is set aside for a local program fund established under Build Michigan I. Eliminating funding for these programs and directing the $76 million elsewhere is both unlawful and unfair to local governments. The move to eliminate these programs jeopardizes the debt repayment plans for projects that are already underway.

Against:

The Michigan Townships Association points out that although House Bill 5822 would bring townships into the road funding decision making process and establish a set aside fund, the legislation would require that township projects be matched with local funds. The association opposes the matching requirement. The township provisions that have been made a part of House Bill 5822 are identical to a bill introduced earlier in the session, House Bill 5611. The association opposed that bill and supports instead House Bill 5753, which would create a set aside program that is more amply funded, and also eliminate the matching requirement. The association also notes that the legislation allows county road commissions to change the designation of county roads unilaterally. Currently any changes in road designations must be approved by the Department of Transportation.

POSITIONS:

The Michigan County Road Association supports the bill. (6-18-98)

The Michigan Public Transit Association supports the bill. (6-18-98)

The Michigan Association of Counties supports the bill. (6-18-98)

The Michigan Municipal League supports the bill. (6-18-98)

The Michigan Townships Association opposes the bill. (6-18-98)

The Department of Transportation opposes the bill. (6-18-98)

Analyst: J. Hunault

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.