

**PUBLIC ACT 51 OF 1951:
MTF REVENUE/DISTRIBUTION, CONSTRUCTION
WARRANTIES, RAIL GRADE CROSSING PROGRAM**

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**House Bill 4613 (reported from committee as H-3)
Sponsor: Rep. Dan Lauwers
Committee: Roads and Economic Development
Complete to 6-4-15**

SUMMARY:

House Bill 4613 is similar in content to Enrolled House Bill 5460 of the 2013-2014 Legislative Session. House Bill 5460 was passed by both chambers and signed by the governor on December 31, 2014. However, House Bill 5460 was tie-barred to House Joint Resolution UU, which became Ballot Proposal 15-1. Because Ballot Proposal 15-1 was not approved at the May 5, 2015, election, House Bill 5460 was not enacted into law.

The Committee substitute, House Bill 4613 (H-3) is identical to the bill as introduced with the following exceptions: as described further below, the bill established additional warranty reporting requirements; and the bill reduces the Michigan Department of Transportation's maximum allowable administrative expense from 10% to 7%.

A SUMMARY OF HOUSE BILL 4613 (H-3) AS REPORTED FROM COMMITTEE

House Bill 4613 would amend five sections of Public Act 51 of 1951 (Act 51), the act that establishes major state transportation funds and programs. Among other things, Act 51: establishes the Michigan Transportation Fund (MTF); directs the distribution of MTF revenue to other state funds and programs, as well as to local road agencies (county road commissions, and cities and villages); prescribes uses of MTF revenue by local road agencies; and establishes the State Trunkline Fund (STF) and prescribes uses of STF revenue.

House Bill 4613 would make the following changes to Act 51:

- Amend Section 10 to strike current language that describes the revenue sources which are to be credited to the MTF – specifically, fuel tax revenue from the Motor Fuel Tax Act, vehicle registration taxes and title fees under Sections 801 to 810 of the Michigan Vehicle Code, and certain revenue under the Motor Carrier Act. The bill would allow the state Treasurer to receive money or other assets from any source for deposit to the MTF.
- Amend Section 10 to earmark up to \$3.0 million from the MTF for a new [railroad] grade crossing surface account established and defined in Section 11.
- Amend Section 11, Subdivision (1)(g), regarding the department's authority to enter into contracts for the construction and preservation of state trunkline roads and bridges.

- Amend Section 11, Subsections 2 and 14, and Sections 12, 13, and 14 regarding highway construction warranties and related reporting requirements. The Committee substitute adds additional reporting requirements as compared to the bill as introduced.

- Amend Section 11, Subsection (11) to reduce the department's allowable administrative expenses from 10% to 7% of all "funds received and returned to the department from any source for the purposes of this section [...]". The bill also provides for the distribution of the calculated reduction in the department's administrative costs – two-thirds to county road commissions and one-third to cities and villages. [These provisions were added in the Committee substitute.]

BACKGROUND INFORMATION AND DETAILED ANALYSIS

Section 10 – Provisions Regarding Sources of MTF Revenue

Section 10 of Act 51 establishes the Michigan Transportation Fund (MTF) and directs the distribution of MTF revenue to other state transportation funds, to special program accounts, and to local road agencies (county road commissions, cities, and villages). MTF revenue is derived primarily from motor fuel taxes and vehicle registration taxes – taxes that are constitutionally dedicated for transportation. MTF revenue in FY 2013-14 totaled \$1.8 billion.

Section 10 currently lists revenue sources which are to be credited to the MTF, specifically, motor fuel tax revenue collected under the Motor Fuel Tax Act, vehicle registration tax and title fee revenue under Sections 801 through 810 of the Michigan Vehicle Code, and certain revenue under the Motor Carrier Act (1933 PA 254), as well as income or profit from investment of fund monies.

[The current reference to the Motor Carrier Act appears to be an anachronism, in that Motor Carrier Act regulatory fees are not a constitutionally dedicated fund source and Motor Carrier Act regulatory fees are not credited to the MTF.]

House Bill 4613 would amend Section 10 to strike the list of revenue sources. The bill would instead authorize the State Treasurer to "receive money or other assets from any source for deposit into the fund." The bill also authorizes the State Treasurer to direct investment of the MTF and requires the State Treasurer to credit to the MTF interest and earnings from fund investments.

Although the bill adds language to authorize the State Treasurer to "receive money or other assets from any source for deposit into the fund," the bill retains contradictory language that "*except as provided in this act, no other money, whether appropriated from the General Fund of this state or any other source, shall be deposited in the Michigan Transportation Fund.*"

The bill also retains current provisions that direct the Legislature to appropriate funds [presumably from the MTF] for the necessary expenses incurred in the administration and enforcement of the Motor Fuel Tax Act, Sections 801 through 810 of the Michigan Vehicle Code, and the Motor Carrier Act. [The bill replaces the term "funds" with "money."] The reference to the Motor Carrier Act appears to be an anachronism in that the Motor Carrier

Act provides no revenue to the MTF, and MTF revenue is not used in the administration of the Motor Carrier Act. We believe the language directing reimbursement of necessary expenses should reference the Motor Carrier Fuel Tax Act (1980 PA 119).

Section 10 – Provisions Regarding the Distribution of MTF Revenue

As noted above, Section 10 of Act 51 establishes the MTF and directs the distribution of MTF revenue to other state transportation funds, to special program accounts, and to local road agencies (county road commissions, cities, and villages). The specific language establishing the MTF formula distribution is "All money in the MTF is apportioned and appropriated in the following manner:"

Sections 10 and 11 – Provisions Establishing a Rail Grade Crossing Surface Account

House Bill 4613 would amend Section 10 of Act 51 to create an earmark of up to \$3.0 million annually from the MTF for a new grade crossing surface account within the STF. Specifically, the earmark would be established in new subdivision, Section 10(1)(b). The bill would also amend Section 11 of the act to establish and define the grade crossing surface account "for expenditure for rail grade crossing surface improvement purposes at rail grade crossing on public roads and streets under the jurisdiction of counties, cities, or villages."

These provisions are similar to provisions in House Bill 4757 of the 2013-2014 legislative session. For a more detailed analysis of these provisions, see the HFA Analysis of House Bill 4757, as introduced, <http://legislature.mi.gov/doc.aspx?2013-HB-4757>.

Section 11(1)(g) – Provisions Regarding MDOT Contracting Authority

Section 11 of Act 51 establishes the State Trunkline Fund (STF) defines the authorized uses of STF revenue, including debt service, the transfer of STF revenue to certain categorical programs (Transportation Economic Development Fund, Rail Grade Crossing account), the construction and preservation of the state trunkline highway system, and administration of the STF.

Section 11 also contains provisions not directly related to STF appropriations: the section establishes a rail grade crossing program; authorizes the use of STF money and STF note or bond proceeds for loans to county road commissions, cities, and villages; and, in Subdivision (1)(g), authorizes the department to enter into agreements with county road commissions, cities, and villages "to perform work on a highway, road, or street." The subdivision authorizes such agreements to provide for "the performance by any of the contracting parties of any of the work contemplated by the contract including engineering services, and the acquisition of right of way [...]." Under provisions of this subdivision, these agreements may also provide for joint participation in costs.

It is our understanding that this subdivision currently provides authority for MDOT to enter into agreements with county road commissions, cities, and villages related to local federal aid projects and transportation economic development projects. Further, it is our understanding that this subdivision provides authority for the department to enter into cost-

sharing agreements with road commissions, cities, and villages related state trunkline construction contracts.

House Bill 4613 would substitute the term "local road agency" for county road commissions, cities, and villages, and would add "a private sector company" to the entities which whom the department could enter into agreements. The bill would also specifically include *maintenance* in the work for which the department may enter agreements. As a result, the proposed amendments to Section 11(1)(g) would authorize the department to enter into agreements with *a local road agency* or a *private sector company* to perform work on a highway, road, or street, including *maintenance*, engineering services, and the acquisition of rights of way.

House Bill 4613, in new Subsection 15, would define "local road agency" to mean what that term means under Section 9a of Act 51, i.e., "a county road commission or designated county road agency or city or village that is responsible for the construction or maintenance of public roads within the state under this act."

Sections 11(2), 11(14), 12, 13, and 14 –Highway Construction Warranties

Section 11, Subsection (2) currently includes provisions directing the department, with respect to state trunkline projects, where possible, to secure warranties of not less than five-year full replacement guarantee for contracted construction work. House Bill 4613 would amend this subsection to require the department, with respect to state trunkline projects, where possible, to "secure *pavement* warranties for full replacement or *appropriate repair* for contracted construction work *on pavement projects whose cost exceeds \$1 million and projects for new construction or reconstruction undertaken after the effective date* [of the enacted bill]." The bill would require the department to compile and make available to the public an annual report of all warranties secured under Subsection (2), and all pavement projects whose costs exceed \$1.0 million for which a warranty was not secured.

The bill would also add a new Subsection (14) to Section 11 to establish reporting requirements, in addition to those established in Subsection (2), with respect to these warranty provisions. Specifically, the bill would require an annual report listing all warranties secured under Subsection (2), and indicating whether any of those warranties were redeemed. The subsection would also require the report to list pavement projects whose costs exceed \$1.0 million for which a warranty was not secured. The bill would require the report to be made available upon request and posted on the department's website. The report would include the following information: the type of project, the cost or estimated cost of the project, and the expected lifespan of the project.

In addition to the reporting requirements noted above, the Committee substitute adds three additional requirements. The bill also requires the report to indicate whether or not the project met or is currently meeting its expected lifespan; if the project failed to meet or is not meeting its expected lifespan, the cause of the failure and the cost to replace or repair the project; and the entity responsible for replacing or repairing the project.

The bill would add similar requirements to Section 12 with regard to county road commission projects and to Section 13 with regard to city and village projects. However,

the warranty provisions dealing with county road commissions and cities and villages would only apply if allowed by the federal highway administration and the department.

The amendments to Sections 12 and 13 would require county road commissions and cities and villages, respectively, to submit a proposed warranty program to the department no later than February 1, 2016. The bill indicates that if approved the proposed warranty program of a county road commission or city or village would be implemented no later than one year after approval.

The warranty reporting requirements for county road commissions, cities, and villages would be identical to those established under Section 11 for the department. However, the vehicle for the report would be the annual report already required of local road agencies under Section 14 of Act 51.

Section 14 currently requires separate accounting by local road agencies of Michigan Transportation Fund revenue, accurate and uniform records of all road and street work and funds, and annual reports by local road agencies of "the mileage of each road system under their jurisdiction and the receipts and disbursements of road and street funds." House Bill 4613 would amend this section to require a local road agency to post its annual report on its website, if it has a website.

Section 11(11 – Provisions Regarding MDOT Administrative Expense

As noted above, Section 11 of Act 51 establishes the STF defines the authorized uses of STF revenue. Subsection 11 currently limits the department's administrative expenses to 10% of all "funds received and returned to the department from any source for the purposes of this section [...]." The Committee substitute would reduce the department's allowable administrative expense from 10% to 7%. House Bill 4613 (H-3) would also require the department to distribute "an amount equal to" the difference between the department's actual administrative expenses for the 2013-14 fiscal year and the maximum allowable administrative expense if capped at 7%. The bill directs two-thirds of this calculated amount to county road commissions and one-third to cities and villages, beginning with the 2015-16 fiscal year.

FISCAL IMPACT:

Amendments to Section 10 – MTF Distribution

The impact of House Bill 4613's amendment to Section 10 to allow the MTF to receive money from any source cannot be readily determined. The bill would strike language that generally limits sources of MTF revenue to constitutionally restricted motor fuel taxes and vehicle registration taxes and adds language to authorize the State Treasurer to "receive money or other assets from any source for deposit into the fund." However, the bill retains contradictory language that "*except as provided in this act, no other money, whether appropriated from the general fund of this state or any other source, shall be deposited in the Michigan transportation fund.*"

House Bill 4613 would also amend Section 10 to earmark up to \$3.0 million from the MTF for a new [railroad] grade crossing surface account established and defined in Section 11. This earmark would reduce the amount available for distribution to other recipients of MTF

funding, effectively reducing the amount available to the Comprehensive Transportation Fund by \$300,000; the distribution to county road commissions by \$1.1 million; and the amount available to cities and villages by \$588,600. However, the new targeted grade crossing surface program would be used exclusively on rail crossings on roads under county, city, and village jurisdiction. Although the bill would create the grade crossing surface account within the STF, it would effectively reduce the amount available for other STF programs by \$1.1 million.

Amendments to Section 11(1)(g) – MDOT Contracting Authority

House Bill 4613 would amend Section 11(1)(g) to authorize the department to enter into agreements with a *local road agency* or a *private sector company* to perform work on a highway, road, or street, including *maintenance*, engineering services and the acquisition of rights of way. The fiscal impact of the proposed amendments to this subsection cannot be readily determined. It is not clear how the inclusion of a "private sector company" among those entities with whom the department could enter into agreements, or the inclusion of "maintenance" in the work which could be contemplated by a contract, would affect the department's contracting authority. The department currently has broad authority to contract with both county road commissions, cities, and villages, as well as private contractors, for work on state trunkline roads and bridges under both 1964 PA 286 and 1925 PA 17.

The bill's amendments to Section 11, Subdivision 1(g) do not appear related to the apparent current intention of the subdivision to provide for state/local cost sharing agreements.

Amendments to Sections 11(2), 12, 13 – Warranties

House Bill 4613 would amend Section 11, Subsection (2), to require MDOT, with respect to state trunkline projects, where possible, to "secure pavement warranties for full replacement or appropriate repair guarantee for contracted construction work on pavement projects whose cost exceeds \$1 million and projects for new construction or reconstruction undertaken after the effective date [of the enacted bill]."

The bill would add almost identical language to Section 12 with respect to county road commissions, and to Section 13 with respect to cities and villages. [The proposed amending language for Sections 12 and 13 would establish the warranty requirement *if allowed by the federal highway administration and the department.*]

The bill would also establish reporting requirements for the department, county road commissions, and cities and villages with respect to these warranty provisions.

The impact of these provisions on the Michigan Department of Transportation and local road agencies would depend on the number and nature of the warranties required under terms of the bill.

The department has had extensive experience with *materials and workmanship* warranties and with limited performance warranties on capital preventive maintenance (CPM) and bridge painting projects. The department's experience with full *performance* warranties on construction or reconstruction contracts has been limited.

Increased use of *performance warranties* for construction and reconstruction work could increase the cost of construction and preservation work. In a performance warranty contract, the contractor may be forced to obtain a warranty bond to ensure that any corrective work will be performed during the warranty period. The warranty bond is a direct cost to the contractor which would likely be passed on to the owner in higher bid prices. How much bid prices would increase, and whether the owner receives additional value – e.g., increased assurance of a well-built road – for the increased cost is difficult to determine.

In addition to possible direct cost increases, the bonding requirements of performance warranties may indirectly increase construction bid prices by limiting the number of bidders on some jobs and thus reducing competition. Under a performance warranty, contractors are generally required to secure a warranty bond for the warranty period – which may be as long as 10 years. If the contractor goes out of business, the bonding company guarantees that the warranty will be honored. As long as the warranty bond is outstanding, contractors have diminished bonding capacity. Contractors, particularly smaller contractors, may find it hard to obtain sufficient additional bonding to bid on new jobs. Some small contractors may simply be unable to obtain bonding needed to secure performance warranties.

For additional background information on road construction warranties, see the House Fiscal Agency publication: ***Transportation: Road Construction Warranties***, March 2001, at: <http://www.house.mi.gov/hfa/Archives/PDF/warrant.pdf>

Amendments to Section 11(11) – MDOT Administrative Costs

House Bill 4613 (H-3) would amend Section 11(11) to reduce the department's allowable administrative expense from 10% to 7% of all "funds received and returned to the department from any source for the purposes of this section [...]." . The bill would also require the department to distribute "an amount equal to" the difference between the department's actual administrative expenses for FY 2013-14 and the maximum allowable administrative expense if capped at 7%. The bill directs two-thirds of this calculated amount to county road commissions and one-third to cities and villages, beginning with the 2015-16 fiscal year.

The department indicates it monitors for compliance with the current 10% administrative limitation in two ways:

In developing recommendations for the annual transportation budget, the department determines that administrative line items represent less than 10% of total appropriations.

In addition, at the close of the fiscal year, the department calculates actual administrative costs as a percentage for actual "direct" program expenditures. The department's FY 2013-2014 calculation identified total administrative expenses of \$236.4 million. These expense represented 8.3% of the department's direct expenditure base.

The difference between the department's actual FY 2013-14 administrative expenses of \$236.4 million, and allowable administrative expenses if capped at 7%, is \$37.0 million. As a result, under provisions of House Bill 4313 (H-3), two-thirds of this amount, \$24.7 million, would be distributed to county road commissions, and one-third, \$12.3 million, to

cities and villages. This distribution would presumably be made from the STF, although this is not explicitly stated in the bill.

Section 11 currently defines administrative expenses to mean "*those expenses that are not assigned including, but not limited to, specific road construction or preservation projects and are often referred to as general or supportive services. Administrative expenses shall do not include net equipment expense, net capital outlay, debt service principal and interest, and payments to other state or local offices which are assigned, but not limited to, specific road construction projects or preservation activities.*"

Based on this definition, the department effectively includes all expenditures as "administrative" that are not assigned to capital projects or direct state trunkline maintenance activities. As a result, calculated administrative expenses include executive office staff, finance and administrative support services, information technology, and, apparently, engineering activities not charged to projects, such as traffic safety and material testing. In addition, as calculated by the department, administrative costs also include statewide planning, asset management programs, engineering and contract administration services provided to local road agencies.

The \$37.0 million reduction in department administrative costs represents a 15% reduction in the department administrative costs, as broadly defined. This reduction would conflict with the FY 2015-16 line item appropriations made Enrolled Senate Bill 133.

House Bill 4613 (H-3) provides for the redistribution of the difference between actual FY 2013-14 administrative expenses and administrative expense capped at 7% beginning with the fiscal year ending September 30, 2016. It's not clear if the bill would effectively require the same redistribution of \$37.0 million each year going forward.

Fiscal Analyst: William E. Hamilton

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