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

House Bill 4737 as enacted
Public Act 175 of 2015
Sponsor: Rep. Michael D. McCready
House Committee: Transportation and Infrastructure
Senate Committee: Committee of the Whole
Revised as of 5-2-16

SUMMARY:

House Bill 4737, as enacted, amends five sections (Sections 10,11,12,13, and 14) 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; establishes the State Trunkline Fund (STF); and prescribes uses of STF revenue. The bill also add a new section, Section 1j.
House Bill 4737 makes the following changes to Act 51:

■ Amend Section 10(1) to strike current language that describes the revenue sources which are to be credited to the MTF – specifically, motor 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(1) to exclude certain revenue earmarked for the MTF in Section 51d of the Income Tax Act from the MTF distribution formula established in the balance of Section 10(1). [House Bill 4370, to which House Bill 4737 is tie-barred, would amend the Income Tax Act to earmark, starting October 1, 2018, certain revenue generated from the state income tax for credit to the MTF.]

■ Amend Section 10(1) 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 10(1) to change a current earmark of MTF revenue to the STF. Section 10(1) currently earmarks $43.0 million to the STF "for debt service costs on state of Michigan projects"; the bill would increase this earmark to $50.0 million.

■ Amend Section 11, Subdivision (1)(g), regarding the authority of the Michigan Department of Transportation (MDOT) 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.

■ Amend Section 11, Subsection (11) to reduce MDOT's allowable administrative expenses from 10% to 8% of all "funds received and returned to the department from any source for the purposes of this section […].

■ Add a new section, Section 1j, to establish a *Roads Innovation Task Force* within the department; a related reporting requirement; a new state-restricted *Roads Innovation Fund*, and a process for "releasing" money to the *Roads Innovation Fund*.

■ Amend Section 13 to authorize a city that meets specific criteria to use a portion of its MTF revenue distribution for public transit purposes.

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 and cities/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 2014-15 totaled $2.0 billion.

Section 10(1) 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.

<u>House Bill 4737</u> would amend Section 10(1) 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*."

[As noted above, the bill strikes the list of revenue sources for credit to the MTF, including the current reference to the Motor Carrier Act. However, the bill retains 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 reference to the Motor Carrier Act in the current list of revenue sources, and in the list of necessary expenses to be reimbursed by the MTF, appears to be an anachronism in that the Motor Carrier Act provides no revenue to the MTF, and MTF revenue has not been used for 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 of Section 10(1) establishing the MTF formula distribution is, "All money in the MTF is apportioned and appropriated in the following manner:"

House Bill 4737 amends Section 10(1) to exclude certain revenue earmarked in Section 51d of the Income Tax Act from the MTF distribution formula established in the balance of Section 10(1). [House Bill 4370, to which House Bill 4737 is tie-barred, would amend the Income Tax Act to earmark, starting October 1, 2018, certain revenue generated from the state income tax for credit to the MTF. House Bill 4370 also directs that the income tax earmark be "disbursed as provided in section 10(1)(k) of 1951 PA 51." Section 10(1)(k), as renumbered in House Bill 4737, provides for the distribution of MTF revenue to road agencies as follows: 39.1% to the STF, 39.1% to county road commissions; and 21.8% to cities and villages. As a result of these provisions, the money earmarked in the Income Tax Act for transportation would be directed for "road" purposes only and would bypass the Comprehensive Transportation Fund, which provides funds for public transit.]

House Bill 4737 would also amend Section 10(1) change a current earmark of MTF revenue. Section 10 currently earmarks $43.0 million to the STF for debt service costs on state of Michigan projects"; the bill would increase this earmark to $50.0 million.

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

House Bill 4737 amends Section 10(1) 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 identical 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 (2013-2014), 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), 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 department-local 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.

<u>House Bill 4737</u> 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.

<u>House Bill 4737</u>, in new Subsection 16, defines "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. <u>House Bill 4737</u> 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 $2.0 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 $2.0 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 $2.0 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; the expected lifespan of the project; 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 April 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 country 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 MTF 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 4737 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 and 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 […]." House Bill 4737 would reduce the department's allowable administrative expense from 10% to 8%.

Section 13 – Use of City MTF Revenue for Public Transit

As noted above, Section 10 of Act 51 governs the distribution of MTF revenue. Among other things, Section 10 directs that 28.1% of the MTF balance, after various statutory deductions, be distributed to cities and villages. Section 13 of Act 51 prescribes how this MTF revenue is distributed among the state's 533 cities and villages. Section 13 also provides directives on the use of MTF revenue by cities and villages. Generally speaking, Section 13 directs the city/village MTF distribution to city and village *Major Street* funds, and *Local Street* funds – city/village *major streets* and *local streets* are defined in Sections 6 through 9 of Act 51.

House Bill 4737 (S-4) would amend Section 13, by adding new Subdivision 14, to authorize a city to use up to 20% of its MTF distribution for *public transit purposes*. The bill would require approval by the director of the Michigan Department of Transportation for this use. The provision would apply only if "*more than 10 million passengers used public transit within the city during the previous fiscal year*."

We believe the reference to "more than 10 million passengers [who] used public transit within the city…" is intended to mean more than 10 million "unlinked trips" that start or end within a city. As defined in the National Transit Database glossary, an "unlinked trip" represents each time a passenger boards a transit vehicle. The City of Detroit is the only city that would meet the "more than 10 million unlinked trips" criteria. We do not believe this language is intended to limit the subdivision’s effect to cities where more than 10 million discrete passengers used public transit. No city in the state would meet that criteria.

Section 1j – Roads Innovation Task Force/Roads Innovation Fund

House Bill 4737 would add a new section to Act 51, Section 1j, to establish a *Roads Innovation Task Force* within the department; a related reporting requirement; a new state-restricted *Roads Innovation Fund*, and a process for "releasing" money to the *Roads Innovation Fund*.

Subsection 1 – Under provisions of Subsection 1, the department would be required, no later than December 1, 2015, form a special internal task force, *the Roads Innovation Task Force*, charged with the creation of a comprehensive public report that:

(a) "Evaluates road materials and construction methods that, when implemented, could allow the department to build high-quality roads in this state that last longer than those typically constructed by the department, with a goal of roads lasting at least 50 years, higher quality roads, and reduced maintenance costs."

(b) "Focuses on materials and processes that may cost more in initial up-front spending but that still produce life-cycle construction and maintenance savings." The department is directed to "strive to achieve a reduction of at least 50% in its net present value 50-year life cycle costs as compared to the commensurate net present value 50-year life cycle costs for road construction and maintenance costs from 2015, in a manner that results in no state roads being rated in poor condition and has no net degradation from overall 2015 level pavement surface evaluation and rating (PASER) scores within the plan's first 10 years."

(c) "Focuses on longer-term time frames that seek to maximize value to the taxpayers of this state on a total cost basis, regardless of funding or financing considerations. The report shall not incorporate or reference plans or suggestions regarding bonding, refinancing, or financing innovations."

Subsection 2 – The bill requires the department, not later than March 1, 2016, to finalize and make public the report. The bill specifically directs the task force to present the report at a public hearing before a joint committee hearing of the Senate and House standing committees on Transportation.

Subsection 3 – The bill requires that not later than June 1, 2016, the task force update the finalized report described in subsection (2) "to provide suggested boilerplate language which coincides with how the department would execute the plan and attempt to achieve the targets described in subsection (1). The plan shall include sufficient detail to allow the legislature to monitor and track progress, estimate how long it is expected to take to achieve targets, and project what the inflation adjusted reduction in annual spending will be once fully implemented as compared to the costs associated with 2015."

Subsection 4 – The bill directs that beginning in fiscal year 2016-2017 and each fiscal year thereafter, the first $100.0 million in revenue collected under Section 8(1) of the Motor Fuel Tax Act, i.e., the motor fuel taxes on gasoline and diesel motor fuel, be annually deposited into the state treasury for credit of the *Roads Innovation Fund* established in Subsection 5.

Subsection 5 – Subsection 5 establishes a new state restricted fund within the state treasury, the *Roads Innovation Fund*. The bill authorizes the State Treasurer to receive money or other assets from any source for deposit into the fund and requires the State Treasurer to direct the investment of the fund, and to credit the fund with interest and earnings from fund investments. The bill indicates that money in the fund at the close of the fiscal year remain in the fund and not lapse to the General Fund. The bill also indicates that the Department of Treasury is the administrator of the fund for auditing purposes.

The bill would allow the Michigan Department of the Transportation to expend money from the fund "only after each house of the legislature approves a 1-time concurrent resolution on a record roll call vote to release money in the *Roads Innovation Fund*." The bill states that "Once released by the one-time concurrent resolution, money in the *Roads*

Innovation Fund shall be deposited in the Michigan Transportation Fund created in section 10 and distributed as provided in Section 10. Once money is released by the one-time concurrent resolution, the *Roads Innovation Fund* shall no longer annually receive the amount described in subsection (4)."

FISCAL IMPACT:

Amendments to Section 10 – MTF Distribution

The impact of House Bill 4737'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 4737 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. Assuming the appropriation of the full $3.0 million, 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.

House Bill 4737 would also amend Section 10 to change a current earmark of MTF revenue to the STF. Section 10(1) currently earmarks $43.0 million to the STF "for debt service costs on state of Michigan projects"; the bill would increase this earmark to $50.0 million. This would increase STF revenue by $7.0 million and reduce the amount available for distribution to other MTF recipients by a like amount.

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

House Bill 4737 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, 14 – Warranties
House Bill 4737 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 $2.0 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 Sections12 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 4737 would amend Section 11(11) to reduce the department's allowable administrative expense from 10% to 8% of all "funds received and returned to the department from any source for the purposes of this section […]." .

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 of actual "direct" program expenditures. The department's FY 2013-2014 calculation identified total administrative expenses of $236.4 million. These expenses represented 8.3% of the department's direct expenditure base. [At the time of this analysis, we do not yet have the department's calculation of FY 2014-15 administrative expenses.]

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 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.

New Section 1j – Roads Innovation Task Force/Roads Innovation Fund

The tasks required of the *Roads Innovation Task Force* established in new Section 1j would result in additional costs to the department although the amount cannot be readily estimated at this time. These additional costs would likely be borne by current FY 2015-16 department appropriations.

The impact of the new *Roads Innovation Fund* on the department and local units of government cannot be readily estimated. The fund would annually receive the first $100.0 million in revenue generated from the motor fuel tax on gasoline and diesel motor fuel. The bill would allow the Michigan Department of the Transportation to expend money from the fund "only after each house of the legislature approves a 1-time concurrent resolution on a record roll call vote to release money in the *Roads Innovation Fund*." The bill does not establish any criteria for the release of the funds or the concurrent resolution.

Once released by the one-time concurrent resolution, money in the fund would be credited to the MTF and distributed according to the provisions of Section 10 of Act 51. However, if the legislature did not release the money through a one-time concurrent resolution, an additional $100.0 million could be credited to the fund each year indefinitely.

It's not clear if the provisions governing the "release" of funds from the *Roads Innovation Fund* are in addition to or in place of the appropriations process established in Article IV, Section 31 of the state constitution and Section 363 of the Management and Budget Act.

Fiscal Analyst: William E. Hamilton