

MEMORANDUM



DATE: April 11, 2019
TO: House Appropriations Subcommittee on Transportation
FROM: William E. Hamilton, Senior Fiscal Analyst
RE: The Comprehensive Transportation Fund and State Support for Public Transportation

Introduction

The Comprehensive Transportation Fund (CTF) is a state-restricted fund created in Section 10b of Public Act 51 of 1951 (Act 51). The fund is restricted for public transportation purposes.¹

CTF revenue is appropriated in annual state transportation budgets for various public transportation programs in accordance with the provisions of Section 10e of Act 51. CTF-funded programs include targeted transit programs (e.g. transportation-to-work, specialized services), intercity bus, rail passenger, and rail freight programs, as well as funding for the Michigan Department of Transportation's (MDOT) public transportation administrative and planning functions.²

However, the largest share of CTF revenue is appropriated for operating and capital assistance to the state's 82 public transit agencies. For FY 2018-19, the CTF-funded appropriation for local bus operating assistance totals \$190.7 million or 54.1% of total CTF appropriations; the transit capital appropriation totals \$50.1 million, or 14.2% of CTF appropriations. Together, state operating and capital assistance to local transit agencies represents approximately two-thirds of FY 2018-19 CTF appropriations.

The balance of this memo will describe in additional detail sources of CTF revenue and the use of CTF revenue to provide operating and capital assistance to local public transit agencies.

¹ Section 10c(h) of Act 51 provides the following definition of public transportation: *"Public transportation", "comprehensive transportation", "public transportation service", "comprehensive transportation service", "public transportation purpose", or "comprehensive transportation purpose" means the movement of people and goods by publicly or privately owned water vehicle, bus, railroad car, aircraft, rapid transit vehicle, taxicab, or other conveyance which provides general or special service to the public, but not including charter or sightseeing service or transportation which is exclusively for school purposes. Public transportation, public transportation services, or public transportation purposes; and comprehensive transportation, comprehensive transportation services, or comprehensive transportation purposes as defined in this subdivision are declared by law to be transportation purposes within the meaning of section 9 of article IX of the state constitution of 1963.*

² CTF revenue has also been used for other public transportation purposes, broadly understood, including, in 2003, as one of the funding elements in the expansion of the Midfield Terminal at Detroit/Wayne County Metro Airport.

CTF Revenue

The CTF has two primary revenue sources, an earmark of Michigan Transportation Fund revenue, and earmark of certain revenue in the General Sales Tax Act.

Michigan Transportation Fund Earmark – The largest source of CTF revenue is an earmark of Michigan Transportation Fund (MTF) revenue made in Section 10 of Act 51. The MTF is the main collection and distribution fund for dedicated transportation revenue. Estimated MTF revenue from constitutionally restricted motor fuel taxes and vehicle registration taxes for FY 2018-19 is estimated to be \$2.8 billion.

Section 10 of Act 51 provides for the appropriation of MTF revenue. Specifically, Section 10(1) directs the distribution MTF revenue to subsidiary state transportation funds and targeted programs, to local road agencies, and to the CTF; Subdivision h within the Section 10(1) directs 10% of MTF revenue to the CTF. However, because this earmark comes after a number of other MTF earmarks – at least with respect to the organization of Section 10(1) of Act 51— the actual CTF share of gross MTF revenue is approximately 8.8%.^{3, 4}

The estimated MTF transfer to the CTF for FY 2018-19 is **\$249.9 million**.

Auto-Related Sales Tax – Section 25 of the General Sales Tax Act directs that "not less than 27.9% of 25% of the collections of the general sales tax imposed at a rate of 4%" on the sales motor fuels, motor

³ The two main sources of MTF revenue, specific motor fuel taxes and vehicle registrations taxes, are *constitutionally* restricted for transportation. Article IX, Section 9 of the 1963 Michigan Constitution indicates that these two revenue sources, "*after payment of necessary collection expenses [shall] be used exclusively for transportation purposes as set forth in this section.*" The section goes on to require that *not less than* 90% of revenue from motor fuel taxes and vehicle registration taxes be used for state and local roads, streets, and bridges. The section provides that the balance, *if any*, of the revenue from motor fuel taxes and vehicle registration taxes, after the payment of necessary collection expenses, be used exclusively for comprehensive transportation purposes as defined by law.

The constitutional language cited above effectively sets a funding floor for state and local road programs of not less than 90% of motor fuel tax and vehicle registration tax revenue. There is no such funding floor for public transportation programs. The Constitution effectively creates a funding *ceiling* for public transportation programs of not more than 10% of motor fuel tax and vehicle registration tax revenue. As a result, the revenue from motor fuel taxes and vehicle registration taxes is *constitutionally* restricted for transportation, but the designation of a part of those taxes for public transportation purposes, (i.e. to the CTF) is a *statutory* restriction only, as provided in Act 51.

⁴ When the current framework for the distribution of MTF revenue was first established in Section 10 of Act 51 by Public Act 438 of 1982, the 10% CTF share came directly "off-the-top" of the MTF before any other statutory earmarks. However, subsequent amendments to Section 10 established MTF earmarks ahead of the 10% CTF earmark within the organization of Section 10, specifically: Public Act 348 of 1988 earmarked not more than \$3.0 million MTF for the rail grade crossing account beginning in FY 1987-88; Public Act 223 of 1992 earmarked not less than \$3.0 million MTF for local/critical bridge fund debt service beginning with FY 1992-93; Public Act 79 of 1997 earmarked \$43.0 million MTF for State Trunkline Fund debt service, revenue equal to one cent of the gas tax for state bridge programs (subsequently amended to include local bridge programs), and revenue equal to 3 cents of the gasoline tax for distribution to state and local road agencies.

Advocates for public transportation programs have argued that the CTF should receive "the full 10%" of all money in the MTF, i.e. that the 10% MTF transfer to the CTF be made prior to other statutory deductions from the MTF. This would result in an increase in CTF revenue of approximately \$31.5 million per year, with a corresponding decrease in MTF revenue available for state and local road programs.

vehicles, and automotive parts and accessories be deposited each year into the CTF. This earmark is commonly described as the "auto-related sales tax."^{5, 6}

For development of the FY 2018-19 transportation budget, the auto-related sales tax earmark was estimated to total \$89.8 million.

Other Revenue Sources – Interest on the CTF fund balance and other miscellaneous revenue sources account for the balance of CTF revenue. As shown below, CTF revenue as estimated for development of FY 2018-19 transportation appropriations totaled \$341.0 million.⁷

<u>CTF Revenue Estimate – FY 2018-19</u>	
MTF Transfer.....	\$249,906,900
Auto-Related Sales Tax	89,800,000
Interest & Misc.	<u>1,255,000</u>
CTF Revenue Total	\$340,961,900

In addition to the baseline CTF revenue sources described above, starting in FY 2012-13, and through FY 2015-16, a total of **\$59.4 million in state General Fund revenue** was appropriated for public transportation programs – primarily to ensure sufficient funding to match federal grants for transit capital and rail infrastructure programs.

⁵ In addition to restricting the use of motor fuel taxes and vehicle registration taxes, Article IX, Section 9 of the Constitution provides that not more than 25 percent of auto-related sales taxes, after payment of necessary collection expenses, be used for comprehensive transportation purposes. Again, this constitutional language creates an upper limit to the CTF's portion of auto-related sales tax; there is no constitutional minimum. The current earmark of auto-related sales tax in the General Sales Tax Act is well below the 25% constitutional limit.

⁶ Although the statutory language provides for a “not less than” earmark, in practice, the amount of auto-related sales tax credited to CTF has always been equal to or less than the amount calculated at 27.9% of 25% of the auto-related sales tax collected at 4% - never more.

⁷ CTF revenue estimates for the MTF transfer, auto-related sales tax, and miscellaneous revenue are from February 2018 ORTA revenue estimates used for FY 2018-19 transportation budget development.

Local Bus Operating Assistance

State operating assistance to eligible transit agencies represents the largest annual appropriation of CTF revenue. Section 10 of Act 51 establishes the payment of operating grants to "eligible authorities and eligible governmental agencies" as the third CTF appropriation priority, after CTF-related debt service and payment of the department's costs of administering the CTF. Local bus operating assistance represents approximately 54.1% percent of FY 2018-19 CTF appropriations.⁸

For a number of years funding for the *Local bus operating* line item had been in fairly narrow range. From FY 2006-07 through FY 2013-14 the baseline appropriation was \$166.6 million, and was \$167.4 million for both FYs 2014-15 and 2015-16. The appropriation was increased in FY 2016-17 to \$186.3 million, increased again for FY 2017-18 to \$188.3 million, and increased again in FY 2018-16 to \$190.7 million.

Although this analysis uses the term "transit agencies," Act 51 refers to "eligible authorities and eligible governmental agencies." These terms are defined in Section 10c of Act 51 through reference to the various statutes under which transit agencies are organized. There are 82 transit agencies eligible for state operating assistance under provisions of Section 10e of Act 51 and the related definitions of Section 10c.

The state of Michigan does not own or operate any transit agencies in the state. All 82 transit agencies are local units of government in some sense; each is either a unit of county, township, or city government, or is an authority organized under one of several authorizing statutes. A list of the state's 82 eligible transit agencies and related form of organization is shown in **Appendix A**.

Of the 82 eligible transit agencies, some provide scheduled fixed route service in metropolitan or urban areas. These urban systems include the Detroit Department of Transportation (DDOT), the Suburban Mobility Authority for Regional Transportation (SMART), the Ann Arbor Transportation Authority (ATA), the Detroit Transportation Corporation (DTC/*People Mover*), Capital Area Transit Authority (CATA/Lansing), The Interurban Transit Partnership (*The Rapid/Grand Rapids*), Flint Mass Transportation Authority, Kalamazoo Transit, Saginaw Transit, and the Muskegon Area Transit System.

Some eligible transit agencies are small city systems; others are township or county-wide demand-response systems.

The service provided by a transit agency depends on the goals of the agency's governing body and the characteristics of the service population. While all agencies provide some form of general public service, many agencies also provide targeted service, including service targeted for people commuting to work; for college student populations; or for elderly and disabled populations.

Local bus operating assistance is distributed among the 82 transit agencies based on provisions of Section 10e of Act 51 as amended by Public Act 79 of 1997. Those provisions direct that operating assistance reimburse *up to* 50% of eligible operating expense for transit agencies that provide service in urbanized areas, defined as having a Michigan population greater than 100,000. Section 10e also

⁸ The FY 2018-19 *Local bus operating* share of total CTF appropriations, 54.1%, is relatively low as compared to prior years. From FY 2001-02 through FY 2011-12, *Local bus operating* represented between 66% and 71% of CTF appropriations. Starting with FY 2012-13 and through FY 2017-18, the *Local bus operating* share of CTF appropriations fell to an average of roughly 60% of CTF appropriations. The reduction in the *Local bus operating* relative share of CTF appropriations did not reflect reductions in the nominal amounts appropriated for local bus operating assistance but was rather due to increased CTF operating and capital support for other programs, specifically, rail passenger programs, as well as transit capital.

provides for the reimbursement of *up to* 60% of eligible operating expense for service provided by transit agencies to non-urbanized areas, i.e. service areas with a population less than or equal to 100,000.

Act 51 establishes the 50% and 60% reimbursements as ceilings. Except for FY 1997-98, state operating assistance to transit agencies has not reached the 50% and 60% ceilings.

Public Act 79 of 1997 also established a funding floor for transit agencies; no agency could receive less than the amount it received in FY 1996-97. However, this funding floor is subject to another provision of Section 10e that requires that *“the ratio between CTF and local funds in the fiscal year ending September 30, 1989 shall be maintained for all fiscal years by the eligible authority or eligible governmental agency. Reductions in this ratio shall require a proportionate reduction in CTF provided for any fiscal year.”*

For FY 2018-19, four non-urban transit agencies would be reimbursed at their FY 1996-97 funding floors based on initial calculated distribution based on budget estimates. Whether any agency is actually reimbursed at the 1996-97 floor will depend on the calculation of the final distribution, based on audited eligible operating expense. The Michigan Department of Transportation calculates a funding floor for Regional Transit Authority (RTA) as a whole based on the collective eligible operating expenses of the agencies comprising the RTA.

In calculating the local bus operating distribution, the Michigan Department of Transportation does not recognize a funding floor for the fourteen agencies that were established after the enactment of Public Act 79 of 1997, or which were otherwise not included in the FY 1996-97 local bus operating distribution.

Public Act 79 of 1997 also directed that service provided by water vehicle (i.e. ferry service) be reimbursed at 50% of eligible operating expense. For FY 2018-19, there are four eligible systems (Beaver Island, Charlevoix/Ironon Ferry, City of Mackinac Island, and the Eastern Upper Peninsula Transportation Authority) that provide public transportation services by water vehicle and that will be reimbursed through the local bus operating appropriation at 50% of eligible operating expense.

The FY 2018-19 local bus operating appropriation of \$190.7 million is not large enough to fund transit agencies at the 50% and 60% levels. As a result, the Michigan Department of Transportation prorates the distribution. Using the department's proration methodology, (and ignoring the impact of agencies funded at the 50% level for ferry service, and agencies funded at the 1997 funding floor), FY 2018-19 state operating assistance would reimburse urban transit agencies at 32.0% of eligible operating expense, and non-urban agencies at 38.4% of eligible operating expense. These figures are based on transit agency *budgeted* eligible operating expense as submitted to the department in accordance with MDOT's *Revenue and Expense Manual*.

See **Exhibit A** for a model of the department's distribution method.

Note that because agencies that provide ferry service are reimbursed at 50% of eligible operating expense, and some agencies are at their 1997 funding floor, the actual distribution to other urban and non-urban transit agencies will be somewhat different from the 32.0% and 38.4% calculated in our example. Our calculated figures are simply used to illustrate the department's method of prorating operating assistance.

The department makes monthly distributions during the fiscal year based on the above calculation; i.e., based on each agency's budgeted eligible operating expense. This provisional distribution is adjusted twice: the first redistribution is based on reconciled transit agency expenditure reports are filed shortly

after the end of the fiscal year. The final distribution is made after audited financial statements are received from all agencies, typically a year or more after the close of the fiscal year.

After the final distribution is made, the entire *Local bus operating* appropriation will have been distributed to transit agencies; the department does not hold back or lapse any of the funds in this line item.

Over the last fifteen years, state funding for the *Local bus operating* line item increased from \$155.1 million in FY 2000-01 to \$190.7 million in FY 2018-19. However, as transit agency budgets increased in the aggregate, the state percentage share of operating cost has declined. In FY 2000-01, state funding reimbursed 38.1 % and 45.7% of urban and non-urban agency eligible expense, respectively. As noted above, the calculated reimbursement percentages for FY 2018-19 will be 32.0% for urban systems and 38.4% for non-urban systems – other than those agencies that provide ferry service and those agencies at their 1997 floor. And as noted above, FY 1997-98 was the only fiscal year in which state support provided 50% and 60% reimbursement to urban and non-urban transit agencies, respectively.

It is sometimes stated that the current state assistance formula, which reimburses based on eligible operating expense, creates an incentive for transit agencies to spend money, and that the distribution formula does not provide an incentive for transit agencies to be efficient. It should be noted that state assistance only covers a portion of eligible operating expense – 32.0% for urban systems and 38.4% for non-urban systems per the FY 2018-19 calculation. The portion of transit agency expense not reimbursed from the state operating assistance must be recovered from other sources, generally farebox revenue, local contributions, or federal funds.

It might be more accurate to say that the state operating assistance formula rewards local cost participation. Agencies that receive support through local transit millages, or who are able access other sources of local funding, can expand service, e.g. expand hours of service or add new routes, and effectively use local funding to leverage additional state funding. Since state funding is capped at the appropriated amount, every additional dollar of state assistance a transit agency can capture comes at the expense of other transit agencies. Under this formula, agencies that receive support through transit millages or other sources of locally-generated revenue, have tended to capture an increasing share of state assistance. This is another consequence of Public Act 79 of 1997, which eliminated a "growth cap" on local transit agencies.

Transit Capital

In addition to operating assistance to local transit agencies, the CTF also provides capital assistance through the *Transit capital* line item.

The CTF revenue in the *Transit capital* line item provides the non-federal match for federal transit grants to local transit agencies. CTF revenue is used to both to match federal funds appropriated in the state transportation budget (for non-urban transit systems), and for federal grants made directly by the Federal Transit Administration (FTA) to local transit agencies.

FTA grants are typically for capital improvements, including bus acquisition or technology upgrades. And FTA grants typically require a 20% non-federal match.

Section 10e (4) of Act 51 effectively requires that not less than \$8.0 million from the CTF be distributed each year for matching federal capital grants. Section 10b (3)(f) of Act 51 further requires that the state pay not less than 66 2/3% of the local match required for FTA capital grants to local transit agencies. For a number of years, appropriations for the transit capital program provided more than these statutory

minimums, in fact, for a number of years state CTF appropriations provided 100% of the non-federal match for local transit agency capital grants.

From FY 2004-05 through FY 2010-11, reductions in CTF revenue resulted in reduced appropriations for transit capital programs. During this period, the department used other sources to provide the non-federal match for local transit agency transit grants. Those other sources included CTF bond proceeds and toll credits – a type of “soft match” authorized by federal law.

Increases in Transit capital appropriations starting in FY 2011-12, as well as the appropriation of General Fund revenue for transit capital starting in FY 2012-13, allowed the department to again provide 100% the non-federal match required for local agency federal transit capital grants.

c: Mary Ann Cleary, Director
Ben Gielczyk, Associate Director

Exhibit A – Computation of Local Bus Operating Distribution

When the Michigan Department of Transportation distributes state operating assistance, it computes the maximum possible state assistance based on the submitted budgets of all eligible transit agencies – 50% for urban agencies and 60% for non-urban agencies. The department then reduces the computed distribution amounts proportionally to hit the amount of the actual appropriation. For example, the FY 2018-19 appropriation of \$190.7 million is 64.1% of the \$297.7 million needed for reimbursement at the 50% and 60% ceilings. As a result, the department computes the distribution to urban agencies at 64.1% of the 50% ceiling, and the distribution to non-urban at 64.1% of the 60% ceiling. See below.

FY 2018-19 Distribution of Local Bus Operating Assistance Based on Budget Estimates			
To Compute Maximum Reimbursement (per Act 51)	Eligible Operating Expense	Act 51 % Ceilings	Maximum Reimbursement
Urban Systems	\$420,056,541	50.00%	\$210,028,271
Non-Urban Systems	<u>146,114,604</u>	60.00%	<u>87,668,762</u>
Total	\$566,171,145		\$297,697,033
Appropriation as a Percent of Maximum Reimbursement			
Appropriation	\$190,750,000		
Maximum Reimbursement	\$297,697,033		
Percentage of Maximum	64.1%		
To Compute Actual Reimbursement Percentages *	Act 51 % Ceilings	Percentage of Maximum	Computed % Reimbursement
Urban Systems	50.0%	64.1%	32.0%
Non-Urban Systems	60.0%	64.1%	38.4%

* The actual reimbursement percentage for many systems will be lower than the computed percentage because some agencies receive floor funding based on FY 1996-97 distribution, and water services are reimbursed at 50% of eligible operating expense. To the extent that some agencies receive more than the computed reimbursement percentage, some agencies will receive less.

Appendix A
List of Public Transit Agencies in Michigan and Legal Basis of Organization

<u>Agency</u>	<u>Public Act</u> (see Appendix B)
Adrian	279
Allegan County	94
Alma	279
Alger Transit Authority	196
*Ann Arbor Transportation Authority	55
Antrim County	94
Arenac County	94
Barry County	94
Battle Creek	279
Bay Area Transportation Authority (Grand Traverse & Leelanau counties)	196
Bay Metropolitan Transportation Authority (Bay County)	196
Beaver Island Transportation Authority	196
Belding	279
Benzie Transportation Authority	196
Berrien County	94
City of Big Rapids	279
Blue Water Area Transportation Commission (Port Huron)	7
Branch Area Transit Authority	196
Buchanan	279
Cadillac/Wexford Transit Authority	7
Capital Area Transportation Authority (Lansing)	55
Caro Transit Authority	196
Cass County Transportation Authority	196
Central County Transportation Authority (Kalamazoo)	55
Charlevoix County	94
Cheboygan County	94
Clare County	94
Clinton Area Transit System	196
Crawford County Transportation Authority	196
Delta Area Transit Authority	196
*Detroit Department of Transportation (DDOT)	279
*Detroit Transportation Corporation (People Mover)	7
Dowagiac	279
Eaton County Transportation Authority	7
Eastern Upper Peninsula Transportation Authority (Chippewa County)	7
Gladwin County	94
Gogebic County Transit	196
Greater Lapeer Transportation Authority	196
Greenville	279
Harbor Transit (Grand Haven)	196
Hancock	279
Hillsdale	279
Houghton	279
Huron County	94
Ionia	279
Iosco County	94

Appendix A
List of Public Transit Agencies in Michigan and Legal Basis of Organization

<u>Agency</u>	<u>Public Act</u> (see Appendix B)
Interurban Transit Authority (Saugatuck)	196
Interurban Transit Partnership (Grand Rapids)	196
Ironton Ferry	7
Isabella County Transportation Commission	7
Jackson Transportation Authority, City of	196
Kalkaska Public Transit Authority	196
Lenawee County	94
Livingston County	94
Ludington Mass Transportation Authority	196
Macatawa Area Express (Holland Area)	196
Mackinac Island (City of)	279
Manistee County	94
Marquette County Transit Authority	7
Marshall	279
Mass Transportation Authority (Flint)	55
Mecosta Osceola Transit Authority	196
Midland County	94
Midland	279
Muskegon County	94
Niles	279
Ogemaw County	94
Ontonagon County	94
Otsego County	94
Regional Transit Authority of Southeast Michigan	387
Roscommon County Transportation Authority	196
St. Joseph County Transit Authority	196
Saginaw Transit Authority Regional Services	196
Sanilac County	94
Sault Ste. Marie	279
Schoolcraft County	196
Shiawassee Area Transportation Agency	7
*Suburban Mobility Authority for Regional Transportation (SMART) (Wayne, Oakland, Macomb, Monroe counties)	204
Thunder Bay Transportation Authority (Alcona, Alpena, Montmorency counties)	196
Twin Cities Area Transportation Authority (Benton Harbor)	55
Van Buren County	94
Yates Township	359

* Transit service provider under the Regional Transit Authority (RTA)

Source: List provided January 2019, by the Michigan Department of Transportation, Passenger Transportation Services Division

Appendix B
Public Acts Governing Michigan Public Transit Agencies

Public Act 7 of 1967, Urban Cooperation Act

Authorizes authorities organized under interlocal agreements

Public Act 55 of 1963, Mass Transportation Authorities Act

Authorizes authorities in cities of less than 300,000

Public Act 94 of 1933, Revenue Bond Act

Authorizes public corporations to make public improvements, including transportation systems. Many county transportation systems are organized under this act.

Public Act 196 of 1986, Public Transportation Authority Act

Authorizes two or more political subdivisions (counties, cities, villages, townships) to form a public authority

Public Act 204 of 1967, Metropolitan Transportation Authorities Act

Authorizes regional transportation authorities formed by two or more counties in metropolitan. Governing statute for SMART and the Regional Transit Coordinating Council (RTCC) southeast Michigan.

Public Act 279 of 1909, Home Rule City Act

Authorizes city transit systems

Public Act 359 of 1947, Charter Township Act

Provides authority for charter townships

Public Act 387 of 2012, Regional Transit Authority Act

Establishes a regional transit authority for southeast Michigan.