

# Leveraging SB1 Funding:

## Considerations for California Public Entities Entitled to Receive SB1 Revenues and their Financial Advisors and Underwriters

In April 2017, the Road Repair and Accountability Act of 2017 was enacted in California (also known as California Senate Bill "SB1"). Key facts about SB1 are as follows:

- SB1 is the landmark transportation funding package which generates new revenues from several transportation-related taxes and fees.
- \$5.2 billion a year is the new estimated revenue expected to be generated for use by the State, cities, counties and certain other governmental entities on transportation infrastructure in California.

Governmental entities entitled to receive the new SB1 revenues may be evaluating whether there is a need for accelerating the SB1 funding by leveraging the revenue stream(s). This will depend in large part on the amount of eligible transportation projects that are construction ready.

### NEW REVENUE SOURCES FOR TRANSPORTATION PROJECTS

There are five new SB1 revenue sources:

- (1) increase in gasoline excise taxes – began November 1, 2017;
- (2) increase in diesel excise taxes – began November 1, 2017;
- (3) increase in diesel sales taxes – began November 1, 2017;
- (4) a new transportation improvement fee (similar to the vehicle license fee) – begins January 1, 2018; and
- (5) a new registration fee on zero emission vehicles (the "ZEV registration fee") – begins July 1, 2020.

The good news is, SB1 does not contain any sunset provisions on these new SB1 revenue sources. However, each of these new revenue sources has different restrictions under SB1 as well as under the pre-existing provisions of the California Constitution and statutes. SB1 does not contain any provisions that authorize bonding or borrowing against the SB1 revenues. Also, a proposed amendment to the California Constitution called ACA 5 accompanied SB1 and will be submitted to the electorate in June of 2018. If approved by the voters, ACA 5 would provide additional constitutional restrictions for the new SB1 revenues – see below for more details.



### EVALUATING FINANCING OPTIONS FOR TRANSPORTATION PROJECTS: IMPORTANT CONSIDERATIONS

Consider the following issues when developing a financing plan involving bonds or other borrowings payable from the SB1 revenues:

#### **May the SB1 Revenues be used for debt service under Article XIX of the California Constitution?**

Article XIX, added to the California Constitution in 1976, contains restrictions on the use of "revenues from taxes imposed by the State on motor vehicle fuels for use in motor vehicles upon public streets

and highways” and “revenues from fees and taxes imposed by the State upon vehicles or their use or operation.” Article XIX does not apply to fees or taxes imposed pursuant to the Sales and Use Tax Law or the Vehicle License Fee Law. There are provisions in the Streets and Highways Code that contain similar restrictions. This means that Article XIX and the related Street and Highways Code provisions restrict the gasoline and diesel excise taxes and the ZEV registration fee, but not the diesel sales tax and transportation improvement fee.

It is important to note that Article XIX contains provisions allowing up to 25% of the fuel (gas and diesel) tax revenues allocated to the State, cities and counties to be pledged or used by the State, cities and counties to pay debt service on voter-approved bonds. There is a similar restriction contained in the Streets and Highways Code. These constitutional and statutory limitations have applied to fuel taxes since 1976 (as to Article XIX) and 1980 (as to the statutory limit), and will apply to the increases in gasoline and diesel excise taxes under SB1. This means that there is clear authorization to secure voter-approved bonds with the appropriate percentage of fuel taxes.

As background, financings payable from gas taxes without voter approval have been structured since the early 1990’s using gas taxes to make installment payments for the sales price for transportation projects under installment sales agreements. The improvements were paid for by a separate joint powers authority and sold to the city or county involved. The installment payments were pledged as security for bonds or certificates of participation issued by the joint powers authority. Typically, the use of gas tax revenues exclusively for eligible transportation projects and for installment payments was validated by a California superior court action because of the questions raised under Article XIX.

Around 2015, the California State Controller began challenging the use of gas tax moneys for these financings in their audits of the use of gas tax funds because the bonds or certificates of participation secured by the installment payments were not voter-approved, ignoring the precedential effect of the

validation actions. Moreover, there have been two different California Court of Appeals cases invalidating the use of gas taxes to pay non-voter approved bonds.

As a result, it appears challenging going forward to structure a financing secured by the increases in gasoline excise taxes or diesel excise taxes given the Controller’s position unless the bonds involved are voter approved. The diesel sales tax increase and the transportation improvement fee, however, are not currently restricted by Article XIX (but see ACA 5 discussion below).

### **Would a financing payable from SB1 Revenues be permissible under the California Constitutional Debt Limit?**

In broad terms, the California Constitution prohibits the State, cities and counties from incurring “indebtedness” without the approval of two-thirds of voters. An obligation is not an “indebtedness” within the meaning of the California Constitution if it is payable solely out of a designated “special fund.” This is referred to as the “special fund” exception to the debt limit.

In order for a fund to be a special fund, it must not be maintained from the general funds or property tax revenues of the governmental entity making payments into the fund. SB1 revenues, when received by governmental entities, will be segregated for restricted transportation purposes and are not general funds or property tax revenues. In addition, there must be a “nexus” between the revenues comprising the special fund and the project financed with the special fund moneys. Because the SB1 revenues are generated from transportation activities and the project would be an eligible transportation project, it is likely that a borrowing secured by SB1 revenues would meet the special fund exception and satisfy the debt limit under the California Constitution.

### **What is impact of ACA 5?**

If approved, ACA 5 would extend certain constitutional restrictions from Article XIX to the diesel sales tax increase and the new transportation improvement fee. Specifically, ACA 5 would limit the use of the diesel

sales tax increase to transportation planning and mass transportation purposes and would limit the use of the transportation improvement fee to transportation purposes. In addition, ACA 5 would prohibit the transportation improvement fees from being used for payment of debt service on state transportation general obligation bonds authorized by voters on or before November 8, 2016, or after unless the bond act expressly authorizes that use. ACA 5 does not limit the use of the transportation improvement fee for debt service on local bonds.

### **How does possible repeal of SB1 impact the financing?**

There is an initiative measure circulating that would repeal most of SB1, ending all of the SB1 revenues. This measure would be placed on the November 2018 ballot (after the June 2018 vote on ACA 5) if the proponent collects 365,880 signatures by January 8, 2018. In addition, there is a second initiative measure circulating that would amend the California Constitution to reverse the taxes and fees under SB1

and require that the imposition, increase or extension of any future vehicle, gas or diesel taxes be approved by a majority vote of the electorate. Because this second measure involves a proposed amendment to the California Constitution, the proponent needs to collect 585,407 signatures for the measure to be placed on the November 2018 ballot. Even assuming that these initiative measures fail, there remains a risk of future initiatives repealing or future legislation changing, the SB1 revenues. This was a risk for the prior gas tax financings as well that was dealt with by coverage levels and through disclosure.

In summary, there are a number of challenges to structuring a financing payable from SB1 revenues. However, revenues from the diesel sales tax increase, new transportation improvement fees and new ZEV registration fees appear to be good candidates to leverage –especially on the local government level, where there are fewer limits than on the State. Those interested in leveraging these revenue sources will likely wait to see if either initiative measure possibly repealing SB1 obtains enough signatures in early 2018.

### **Contact Us**

For more information or to better understand if and how this new legislation can be leveraged to fund California transportation projects, please contact:



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