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OVERSIGHT HEARING

Bridging the Gap: Local Government Infrastructure

1021 O Street, Room 2200
Wednesday, March 15, 2023

BACKGROUND

This background paper prepares the members of the Senate Governance & Finance Committee for the March 15, 2023, hearing titled “**Bridging the Gap: Local Government Infrastructure.**” Through this hearing, the Committee will examine local governments’ ability to build and maintain infrastructure, assess the state’s role in supporting local governments’ ability to meet those needs, and evaluate how recent events have interfered with efforts to improve local government infrastructure.

The opening panel will provide an overview of state efforts to help local governments meet infrastructure needs. On the second panel, a number of local governments will outline their infrastructure needs assess their ability to construct the projects necessary to accommodate economic growth and meet other state goals. The third panel will evaluate how recent storms, the COVID-19 pandemic, construction costs, and other challenges have hampered the ability of local governments to address their infrastructure needs.

This background paper:

- Examines local governments’ current infrastructure needs;
- Describes how local governments generally address infrastructure needs, and recent legislative actions to assist local governments; and
- Assesses how recent storms, the COVID-19 pandemic, construction costs, and other challenges have made it difficult for local governments to meet infrastructure needs.

Current local government infrastructure needs

California is one of the largest economies in the world. According to Bloomberg, California’s gross domestic product (GDP) will surpass Germany’s into fourth place worldwide.¹ However, a lack of housing supply harms economic growth more broadly because it keep residents from moving to more productive areas where they can take more productive jobs that pay higher wages. For example, one analysis found that highly productive cities in the United States have not contributed to economic growth as much as their

¹ <https://www.bloomberg.com/opinion/articles/2022-10-24/california-poised-to-overtake-germany-as-world-s-no-4-economy>

productivity would imply because of housing constraints that keep workers from those cities, and that GDP could be as much as 9.5 percent higher if those constraints were relaxed.²

In California, as housing costs in these areas have increased, workers reside further from their jobs, and commute longer distances. For example, Santa Clara and San Mateo counties added over 150,000 jobs between 2010 and 2014, but added only 22,000 new housing units.³ A recent story published by *KQED* highlighted the story of a Palo Alto fire captain who commutes from Roseville to Palo Alto, 147 miles each way.⁴ The average Californian commutes about 30 minutes to work each way, but over 12% of Californians commute over an hour.⁵ According to California's Statewide Housing Plan, the state needs to plan for an additional 2.5 million housing units over the next eight-year planning cycle. If California is going to address its jobs-housing imbalances, local governments will have to expand infrastructure necessary to provide services to residential housing, like sewer lines, water projects, and other infrastructure.

The most recent American Society of Civil Engineers' Report Card for California's Infrastructure (2019) gave the state a C- for its overall infrastructure.⁶ The state received its highest grades, a C+, in aviation, ports, and wastewater. Its lowest grade, a D-, was in the area of energy infrastructure. The report card suggests that California has a lot of catching up to do, and funding gaps to overcome, to improve its infrastructure.

Building this infrastructure represents both a significant fiscal and logistical challenge, as well as a great opportunity. Studies have shown that infrastructure investments can increase productivity, provide job opportunities, increase wages, and spur economic growth.⁷ For example, a report from the Center on Budget and Policy Priorities used data from Moody Analytics to estimate that for every dollar spent on infrastructure in response to the financial crisis in 2008 and 2009 yielded \$1.6 in economic productivity.⁸

How local governments address infrastructure needs

Funding and financing local government infrastructure is a core responsibility for local governments. The ways in which local governments have addressed these responsibilities has changed over time. Until voters passed Proposition 13 in 1978, cities, counties, and special districts could generally set property tax rates on property within its jurisdiction without an aggregate cap. Local governments received property tax revenue resulting from the appropriate property tax rate fixed by the local governments, and could use that revenue to build infrastructure projects and meet other needs. If a local government wanted to pay to build infrastructure in an area it planned to develop, it could increase its property tax rates to pay for those projects. Local governments could also enact taxes by ordinance. Proposition 13 both limited the maximum amount of any ad valorem tax on real property at 1% of full cash value, and imposed voter approval requirements for local taxes. Despite the notable benefits to property owners, these changes hampered local governments' ability to address infrastructure needs related to new development.

In response to Proposition 13, the Legislature enacted the Mello-Roos Community Facilities Act of 1982, which allows counties, cities, special districts, and school districts to levy special taxes (parcel taxes) to finance a wide variety of public works, including parks, recreation centers, schools, libraries, child care facilities, and utility infrastructure. A Mello-Roos Community Facilities District (CFD) issues bonds against

² https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=1045&context=housing_law_and_policy.

³ <https://www.kqed.org/news/10922660/in-search-of-cheaper-housing-silicon-valley-workers-face-long-commutes>

⁴ <https://www.kqed.org/news/10922660/in-search-of-cheaper-housing-silicon-valley-workers-face-long-commutes>

⁵ https://www.thecentersquare.com/california/average-one-way-commute-time-for-california-residents-reaches-29-3-minutes/article_e04a3ce4-18ae-11eb-8f57-cfd1dd2825c0.html

⁶ https://www.infrastructurereportcard.org/wp-content/uploads/2018/10/ASCE_Brochure%E2%80%9494CA2019_FINAL.pdf

⁷ <https://www.cbpp.org/research/state-budget-and-tax/its-time-for-states-to-invest-in-infrastructure>

⁸ <https://www.cbpp.org/research/economy/the-financial-crisis-lessons-for-the-next-one>

these special taxes to finance the public works projects. Like all special taxes, Mello-Roos Act special taxes require 2/3-voter approval. If there are fewer than 12 registered voters, the affected landowners vote.

Local governments also turned to other sources of funds after Proposition 13's passage. Since they cannot impose broad-based taxes without voter approval, cities and counties follow a simple principle: new developments should pay for the impacts that they have on the community and the burden they impose on public services. When approving development projects, counties and cities can require the applicants to mitigate the project's effects by paying fees—known as mitigation fees, impact fees, or developer fees. The California courts have upheld impact fees for sidewalks, parks, school construction, and many other public purposes.

Finally, some local governments used redevelopment agencies (RDAs) to finance infrastructure until their dissolution in 2011. Under the Community Redevelopment Law, RDAs used property tax increment financing to pay for economic development projects in blighted areas. Generally, property tax increment financing (TIF) involves a local government forming a TIF district to issue bonds and use the bond proceeds to pay project costs within the boundaries of a specified project area. To repay the bonds, the district captures increased property tax revenues that are generated when projects financed by the bonds increase assessed property values within the project area. To calculate the increased property tax revenues the district captures, the amount of property tax revenues received by any local agency participating in the district is “frozen” at the amount it received from property within a project area prior to the project area's formation. In future years, as the project area's assessed valuation grows above the frozen base, the resulting additional property tax revenues—the so-called property tax “increment” revenues—flow to the TIF district instead of other local agencies. After the TIF district repays the bonds using the incremental property tax revenues, the district is dissolved, ending the diversion of tax increment revenues from participating local agencies.

Citing a significant state General Fund deficit, Governor Brown's 2011-12 budget proposed the elimination of RDAs and the diversion of billions of dollars of property tax revenues back to schools, cities, counties, and some special districts to fund core services.

After the restrictions from Proposition 13 and the dissolution of RDAs, local officials had to pursue alternatives to help address infrastructure needs associated with new development. They have relied upon: (1) general purpose revenues, including state and federal grants; (2) tax-increment financing; and (3) streamlining project procurement.

General-purpose revenues. Local governments generate revenue to finance infrastructure from a variety of sources. They receive various sources of tax revenue, including state and federal grants.

For example, in 2006 voters approved Proposition 1C, which included the creation of the Infill Infrastructure Grant Program housed in the Department of Housing and Community Development. Since its inception, the program funded hundreds of infrastructure projects that were necessary preconditions for building new housing, including parks, sidewalks, water, sewer, and street projects. This program allows developers and local governments to partner in their application for infrastructure funding. Since its inception, the program has received multiple rounds of funding, most recently from the State General Fund, totaling \$1.65 billion, which has financed infrastructure projects for nearly 300 housing developments, and helped create over 35,000 housing units.⁹ This amount does not include the \$105 million the program received in the 2022-23 budget, which HCD is still distributing.

⁹ <https://lao.ca.gov/reports/2022/4535/Governors-Housing-Plan-021422.pdf>

The Legislature has also helped local governments address their infrastructure needs through one-time allocations from the state budget. Some examples from the *Budget Act of 2022* (AB 178, Ting, 2022) include:

- \$8.1 million to the Amador Fire Protection District for a new fire station;
- \$5 million to the City of Madera to rehab their sewer main; and
- \$3 million to the City of San Juan Bautista for their wastewater project.

Additionally, President Biden signed the Infrastructure Investment and Jobs Act in November 2021, which allocated \$1.2 trillion nationwide for infrastructure projects. The \$16.3 billion in federal infrastructure funding for California includes \$14 billion to upgrade the state's roads, bridges, rail, public transit, airports, electric vehicle infrastructure, ports, and waterways.¹⁰ Exactly how all these funds will be spent has yet to be determined.

Tax increment financing. While RDAs have dissolved, the Legislature has created other TIF tools in their place. The most widely used tool have been enhanced infrastructure financing districts (EIFDs). EIFDs can use TIF for projects of communitywide significance that provide significant benefits to the district or the surrounding community with an estimated useful life of 15 years or more. Once approved by the initiating city or county, an EIFD can receive funding from three revenue streams to fund its infrastructure financing plan. Similar to RDAs, EIFDs can use a portion of the property tax increment, if the local governments approve it. They may also use revenue that the infrastructure project generates, such as money generated from user fees, public-private partnerships, loans, and grants. Finally, an EIFD may receive the local share of sales and use taxes (SUT) and transactions and use taxes (TUTs). Like an RDA, an EIFD may issue bonds backed by these revenues to pay for projects. Unlike RDAs, EIFDs do not have access to the school's share of property tax revenue, and cannot force other taxing entities to participate, which means that they do not have the same revenue-generating potential as RDAs.

As of March 2022, nearly two dozen local agencies have initiated EIFD formation, including 15 that have adopted their infrastructure-financing plan. While the Legislature has created other TIF tools, local agencies have rarely used them. Most recently, the Legislature authorized the creation of climate resilience districts, or CRDs (SB 852, Dodd, 2022). Like EIFDs, CRDs can use TIF, but they also have additional financing powers, such as levying assessments, to finance climate resilience projects.

Streamlining project procurement. While local government staff may possess the resources and expertise to construct smaller infrastructure projects, local governments often contract with design experts and construction firms for larger and more complicated projects. The Local Agency Public Construction Act generally requires local governments to invite bids for construction projects and award contracts to the lowest responsible bidder. Local governments typically use the traditional design-bid-build method for constructing public works. This approach splits construction projects into two distinct phases: design and construction. During the design phase, the local government prepares detailed project plans and specifications using its own employees or by hiring outside architects and engineers. Once project designs are complete, local governments invite bids from the construction community and award the contract to the lowest responsible bidder.

Over the last couple of decades, the Legislature has gradually expanded local governments' authority to procure construction projects using various alternatives to the design-bid-build project delivery method. For example, state law allows state and local officials, until January 1, 2025, to use the design-build method for contracts in excess of \$1 million to procure both design and construction services from a single company before the development of complete plans and specifications. Under design-build, the owner contracts with a single entity—which can be a single firm, a consortium, or a joint venture—to design and construct a

¹⁰ <https://www.gov.ca.gov/2022/11/15/california-creates-17000-infrastructure-jobs-with-support-from-the-biden-administration/>

project. Before inviting bids, the owner prepares documents that describe the basic concept of the project, as opposed to a complete set of drawings and specifications of the final product. In the bidding phase, the owner typically evaluates bids on a best-value basis, incorporating technical factors, such as qualifications and design quality, in addition to price.

Most recently, SB 991 (Newman, 2022) provided local governments the authority to use progressive design-build for water projects. Progressive design-build generally includes two phases. In the first phase, the awarding authority uses a best value process to select a design-build entity who completes preliminary plans and preconstruction services necessary to provide a cost estimate and final design proposal. The project then “progresses” to the second phase of the project, where the awarding authority and the design-build entity agree to a final design, project cost, and schedule. If they cannot agree, there is an “off ramp” between the two phases where the awarding authority can pursue other options, but still benefit from having the first phase work complete. This is different from traditional design-build where the awarding entity contracts with a single entity to design and construct a project at a set price before design work begins, and without a similar off ramp.

Barriers to meeting local infrastructure needs

Despite efforts to fund additional projects and streamline procurement, local governments still face many barriers when it comes to meeting their infrastructure needs.

Cost constraints. California spends slightly more per capita on infrastructure projects compared to other states. According to the Urban Institute, the relatively high share of infrastructure spending that occurs at the local level, fiscal decentralization, demographics, geography, land use, and history are factors that contribute to relatively higher spending.¹¹

The City and County of San Francisco’s recent efforts to build a public restroom in its Nob Valley neighborhood help illustrate some of the cost constraints California’s local governments face when building infrastructure. Despite already installing plumbing, the City initially estimated that a single restroom would cost \$1.7 million and take until 2025 to complete, similar to other recent restroom projects. After receiving a \$1.7 million grant from the California Department of Parks and Recreation, stories initially published by the *San Francisco Chronicle* led to public outcry over the cost of the project.¹² The City’s Department of Recreation and Parks attributed the price of the project to increasing construction costs, as well as local, state, and federal policy decisions. According to the article, building the single restroom could require approvals from the Recreation and Parks Department, the Public Works Department, the Planning Department, the Department of Building Inspection, the Arts Commission, the Public Utilities Commission, the Mayor’s Office of Disability, and the Pacific Gas & Electric Company. Additionally, options to purchase prefabricated restrooms were limited due in part to the city’s prohibition on doing business with states the city has determined discriminate against LGBTQ+ individuals, restrict abortion access, or suppress voting.¹³ After pushback from the public and Governor Newsom, the City went back to the drawing board. On January 27, 2023, the City’s Department of Recreation and Parks announced that it had received a donation from the Public Restroom Company and Volumetric Building Company to cover a \$425,000 prefabricated restroom and much of the labor costs to install it. The Department says this will also save it nearly \$500,000 in design, construction management, regulatory, and design review costs. The donation will allow it to install the restroom by the end of summer 2023. While the City prohibits itself from conducting business with Nevada-based companies, it was able to accept the donation.¹⁴

¹¹ https://www.urban.org/sites/default/files/publication/102585/californias-infrastructure-challenges_1.pdf

¹² <https://www.sfchronicle.com/sf/bayarea/heatherknight/article/million-dollar-toilet-17518443.php>

¹³ <https://sfrecpark.org/CivicAlerts.aspx?AID=833>

¹⁴ <https://sfrecpark.org/CivicAlerts.aspx?AID=833>

Not every local government in California faces the same challenges, or at least not to the same degree, but the hurdles the San Francisco project faced highlight how costs have limited local governments' ability to address their infrastructure needs.

Funding gaps. No complete statewide assessment on the overall infrastructure needs of local governments and the funding needed to meet those needs exists. However, many local governments have capital improvement plans that outline planned infrastructure projects. For example, East Bay Municipal Utility District has a five-year capital improvement program (CIP) to upgrade its network of pipelines, water storage and treatment facilities, and wastewater treatment service. After each five-year period, the district creates a new CIP for the next five-years to help accomplish its long-term infrastructure goal to “maintain and improve the District’s infrastructure in a cost effective manner to ensure sustainable delivery of reliable, high quality service now and in the future, addressing economic, environmental, and social concerns.”¹⁵ The district then has to evaluate how much funding it can generate and how many projects it can complete. For example, their plan projects how much it will cost for the district to renew its infrastructure to continue “business as usual.” In some years, the forecast estimates that the district needs to spend as much as \$250 million.

Many of the tools that local governments have to generate funding for infrastructure financing require time to raise the revenue necessary. For example, if a city decided to create a TIF district, or impose a new tax, it needs to wait until it generates sufficient revenue to afford repayments before it can issue bonds to finance projects. Additionally, not all local agencies have the bonding capacity to address all their infrastructure needs, nor do they necessarily want to increase the taxes that their residents pay to finance these projects. While additional funding, such as the federal Infrastructure Investment and Jobs Act, may help address some funding gaps, such one-time funding may not be sufficient to finance local governments' ongoing infrastructure needs.

Evolving needs. Building and maintaining infrastructure has always been a core function of local governments. While wrestling with decisions about how to manage infrastructure needs in the midst of cost pressures and funding gaps has persisted, local government infrastructure needs continue to evolve.

At the start of 2023, many communities confronted a series of atmospheric rivers and severe weather events. In many places, these storms made it even more difficult for local governments to meet their infrastructure needs. The City of Madera received \$5 million from the state in 2022 to rehabilitate the City’s main sewage pipeline to carry wastewater to its wastewater treatment facility so that it could accommodate future development needs. The City contributed its own funds and received federal funding for the project. While it was able to overcome financial barriers to develop a long-term solution to fix the line, effects of the storms opened a hole that required emergency repairs, complicating efforts to complete the original rehabilitation project. On February 1, 2023, the Madera City Council declared a local emergency in regards to winter storm damage to help respond to the urgent need for repairs.

Furthermore, many local governments wrestle with difficult decisions about how to plan for additional infrastructure needs given the increasing threat of wildfires and other risks associated with climate change. The COVID-19 pandemic also illustrated the need for additional infrastructure to manage public health emergencies. The pandemic placed additional strain on local governments' ability to provide housing and other services to individuals experiencing homelessness.

While many local governments may have plans building and maintaining infrastructure, future proofing their infrastructure for unpredictable needs remains a persistent challenge for local governments.

¹⁵ <https://www.ebmud.com/about-us/construction-and-maintenance/capital-improvement-program-cip>

Questions

As members hear from experts on the subject of local government infrastructure, the Committee may wish to consider the following questions:

- How many infrastructure projects do local governments have in the pipeline without funding identified? What options have local governments pursued to generate that funding, and have they been successful?
- What should the state's role be in supporting local governments' ability to meet their infrastructure needs?
- Which state programs have provided the most support to local governments meeting their infrastructure needs?
- How have wildfires, floods, the pandemic, climate change, and other external factors affected local governments ability to address infrastructure needs? How can local governments better prepare so these situations do not result in emergency disruptions to infrastructure?
- What legislative solutions exist to support local governments' ability to address their infrastructure needs? Are there ways to further streamline project procurement?