County of Santa Clara

Office of the County Executive

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MEMORANDUM

DATE: Friday, September 14, 2018

TO: Honorable Members of the Board of Supervisors
Jeffery V. Smith, M.D., J.D., County Executive

FROM: Sylvia Gallegos, Deputy County Executive, Office of the County Executive

SUBJECT: Financial Stability of the Santa Clara Valley Transportation Authority

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During the June 11, 2018, Budget Hearing, under Item 79 concerning the Measure B Transportation Improvement Program, the Board of Supervisors approved Supervisor Chavez's motion for staff to provide a report to the Board on the "financial health and vitality" of the Santa Clara Valley Transportation Authority (VTA). This memorandum provides an overview of the financial position and long-term financial stability of VTA, as reflected in recent Comprehensive Annual Financial Reports[1] and Biennial Budgets adopted by the VTA Board[2].

Executive Summary

- Since 79% of VTA's operating budget revenues are sales tax-based and susceptible to volatility in an economic downturn, it is prudent for the VTA to maintain operating reserves at sufficient levels to mitigate possible future impacts.
- The percentage of VTA's system-operated expenses recovered through fare revenue has declined and is lower than the rate collected by peer transit agencies within the state.
- Despite recent growth in sales tax revenues, VTA forecasts operating deficits exceeding $20 million in each of the next five years and total reserves to be exhausted by FY2020.
- A VTA Ad-hoc Financial Stability Committee was formed in January, and the Committee is developing possible mitigation measures to address VTA's structural deficits and promote long-term financial stability of the Authority.

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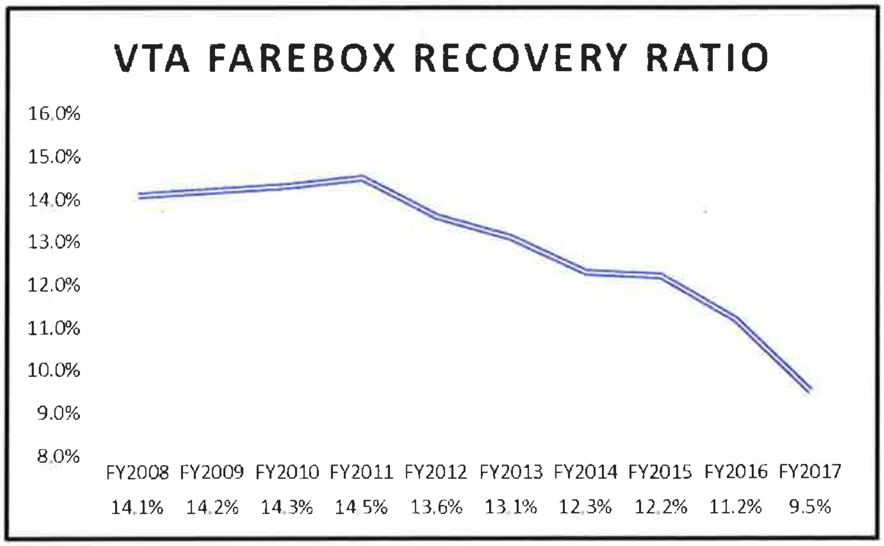
[1] http://vtaorgcontent.s3-us-west-1.amazonaws.com/Site_Content/CAFR_FY_2017.pdf
[2] http://vtaorgcontent.s3-us-west-1.amazonaws.com/Site_Content/adopted_budget_fy1819.pdf

Reliance on Sales Tax Receipts Increase as System Ridership and Fare Revenues Decline
According to VTA's Comprehensive Annual Financial Report for Fiscal Year Ended June 30, 2017, the major source of growth in VTA's net position in FY 2017 was due primarily to sales tax receipts, operating grants, and capital grants related to VTA's BART Silicon Valley Extension Project. The 1976 sales tax, 2000 Measure A sales tax, and BART operating sales tax collections for FY 2017 were $209.0 million, $208.7 million, and $50.0 million, respectively. The percentage of VTA's system-operated expenses recovered by fare revenue (Farebox Recovery Ratio) declined to 9.5% in FY 2017.

The Farebox Recovery Ratio is an important measure of the overall level of subsidy required to operate an agency's transit system and is calculated by taking the fare revenue generated from directly operated service (motor bus and light rail) and dividing it by the expenses for those same services.



By comparison, other independent public transit agencies operating in urbanized areas within the state reported significantly higher rates of service costs recovered through fares in FY 2017:

- San Diego Metropolitan Transit System: 36.1% [3]
- Sacramento Regional Transit District: 23.0% [4]
- Marin County Transit District: 19.4% [5]
- Los Angeles County Metropolitan Transportation: 19% [6]
- Alameda-Contra Costa Transit District: 17.1% [7]
- San Mateo County Transit District: 15.4% [8]
- **Santa Clara Valley Transportation Authority: 9.5%[9]**

Sustained ridership growth coupled with stable costs will lead to higher recovery ratios and enhanced financial stability for a transit agency. Unfortunately, VTA's costs of providing bus

[3] https://www.sdmts.com/sites/default/files/attachments/2017_mts_cafr_final.pdf
[4] https://www.sacrt.com/documents/financialdocs/RT-2017_CAFR.pdf
[5] https://marintransit.org/sites/default/files/inline-files/Marin Transit 2017 CAFR.pdf
[6] http://media.metro.net/about_us/finance/images/report_finance_cdarfy17.pdf
[7] http://www.actransit.org/wp-content/uploads/AC-Transit-FY17-Final-CAFR.pdf
[8] http://www.samtrans.com/Assets/_Finance/CAFR/ST/SAMTR+CAFR+2017.pdf
[9] http://vtaorgcontent.s3-us-west-1.amazonaws.com/Site_Content/CAFR_FY_2017.pdf

and light rail services have consistently increased over the last decade (up $100 million dollars, representing a 39.2% increase since FY 2008), while overall system ridership and operating revenues have declined – a trend that continued in FY 2017 for VTA:

- **Expenses** for bus and light rail operations increased by $19.4 million in FY 2017, a 5.8% increase from FY 2016.
- **Revenues** from directly operated transit services (bus and light rail) decreased in FY 2017 by 10.5%, a $3.9 million decrease from the prior fiscal year.
- **System ridership** (bus and light rail) decreased by 11.0% in FY 2017 from the previous year. Bus ridership totaled 29.1 million, a 9.7% decrease, and light rail ridership totaled 9.1 million, down 14.8%.

Decreases in passenger fare revenues were attributed to various factors, such as, low gas prices, a wet winter with a record level of precipitation, and increased competition with on-demand private cars/taxi companies. VTA completed an 11-month process in 2017 to review the Authority's Fare Policy with the objectives of increasing ridership, providing free VTA-to-VTA transfers, aligning youth fare discounts with the region, and increasing farebox recovery to enhance financial sustainability. As a result, the Adopted Biennial Budget for Fiscal Years 2018 and 2019 included a fare increase phased over two years starting January 1, 2018, a decrease in youth fares, continuation of the Transit Assistance Program for low-income riders, and free VTA-to-VTA transfers for 120 minutes of travel for customers using a Clipper card—specifically to optimize the service redesign and increase ridership.

VTA Structural Imbalances Projected to Deplete Operating and Capital Reserves
In 2012, the VTA Board adopted as policy the goal to maintain an Operating Reserve of at least 15% of the operating budget for the VTA Transit Fund. The purpose of the Operating Reserve is to ensure that sufficient funds are always available in the event of either unanticipated revenue shortfalls (other than sales tax revenues) or unavoidable expenditure needs. These funds are to remain unappropriated for any operating or capital use except to meet emergency needs that cannot be funded from any other source.

In addition to the Operating Reserve Fund, VTA maintains two other Board-designated reserve funds designed to promote long-term financial stability - a Debt Reduction Fund and a Transit Sales Tax Stabilization Fund. VTA Operating Reserves in excess of 15% of the operating budget at year end are transferred to the Debt Reduction Fund, which may be used to reduce long-term liabilities or provide funding for approved transit-related capital improvements. The VTA also maintains a Sales Tax Stabilization Fund reserve to mitigate the impact of the volatility of sales tax-based revenues on service levels and the operating budget, and the fund may be utilized if sales tax-based revenues are projected to decline.

VTA's FY 2018 and 2019 Adopted Biennial Budget included a 5-year projection of VTA's revenues, expenses, operating balance, and reserve balances through FY 2022, and VTA projects operating balance deficits in excess of $20 million for each of the next five fiscal years.

	FY18	FY19	FY20	FY21	FY22
Revenues	$455.02	$466.78	$480.64	$492.85	$505.76
Expenses	(475.48)	(493.20)	(509.43)	(514.24)	(531.22)
Operating Balance	($20.45)	($26.42)	($28.79)	($21.40)	($25.46)
Operating Reserve	$62.60	$42.15	$15.73	$0.00	$0.00
Sales Tax Stabilization Fund	35.00	35.00	35.00	21.94	0.54
Total Available Reserves	$97.60	$77.15	$50.73	$21.94	$0.54
Operating Balance	(20.45)	(26.42)	(28.79)	(21.40)	(25.46)
Ending Reserves	$77.15	$50.73	$21.94	$0.54	($24.92)

At the June 1, 2017 VTA Board meeting where the FY 2018 and FY 2019 Biennial budget was adopted, VTA staff identified the use of reserves and/or short-term financing by way of a Commercial Paper program as ways to address VTA's projected deficits. VTA operating reserves over this five-year period are not projected to be maintained at the Board's adopted policy goal of 15% of operating budget; instead operating reserves are projected to fall to 8.5% of projected operating revenues in FY 2018, 3.1% in FY 2019, and to 0% by the end of FY 2020.

In addition to operating balance deficits associated with providing bus and light rail service, VTA also faces unfunded annual shortfalls of between $30 and $35 million to pay for the local share of VTA's capital expenditures. In previous years, VTA funded this amount from operating surpluses and capital reserves (Debt Reduction Fund), but these reserves, which had a $49.5 million balance on June 30, 2017, have been depleted to $5 million. As such, VTA now needs to budget a set-aside in excess of $30 million annually for this capital need in addition to the annual operating deficits currently projected – **bringing VTA's total funding gap to between $50 million and $60 million per year through FY 2021-2022.**

Possible Mitigation Measures to Address VTA's Structural Deficits and Financial Stability
At the January 4, 2018 VTA Board of Directors meeting, an Ad-hoc Financial Stability Committee (Committee) was established to address these structural deficits and to provide recommendations to the Board for this purpose. The Committee is composed of three VTA Board members and representatives from various stakeholder groups, and the Committee met regularly from March to August and reviewed the following information: VTA's revenue and expense drivers and current structural imbalance, emerging transportation trends, the transit service plan and related efforts, regional funding partnerships, VTA's capital program, workforce productivity, peer agency comparisons, and various options to address the structural budget deficit.

On August 17, 2018 the Committee reviewed possible mitigation measures for the VTA Board of Directors to consider that would address VTA's structural deficit and promote long-term financial stability[10]. Possible measures were considered based on the viability for implementation, contribution to long-term financial stability, and ability to address both

[10] http://vtaorgcontent.s3-us-west-1.amazonaws.com/Site_Content/ahfsc_081718_packet.pdf

components of VTA's structural deficit. Proposed measures that were considered by the Committee at the August 17, 2018 meeting included, but were not limited to:

- **Next Network Service Rollout Adjustment**: Next Network concepts would be implemented with fewer service hours, and staff's proposal was for bus and light rail hours to be reduced beginning in FY 2020 for potential savings of **$30 million annually.**

- **Equitable Employee Contribution to Pension**: 1,600 of VTA's employees are covered by the VTA/ATU Pension Plan and contribute 1.9% of their salary toward pension funding. An increase to a 6% contribution would generate **$5 million in annual savings**.

- **SB 1 Revenues or 2-year Wage Freeze**: VTA is projected to receive **$16 million** more from SB 1 revenues than originally projected. As an alternative, if SB 1 is repealed in the November election (Prop 6), a 2-year employee wage freeze would generate **$15 million.**

- **Early Retirement Incentive**: If VTA offered an early retirement incentive to a defined number of eligible employees near retirement age, there would be **$1 million** in savings.

At the conclusion of the August 17, 2018 Committee meeting, VTA staff were directed to prepare additional information for the Committee regarding Next Network service adjustments, planned VTA capital investments, and partnership agreements with other transit agencies.

On September 6, 2018, the Ad-hoc Financial Stability Committee Chairperson provided the VTA Board with an update on its deliberations and recommended the postponement of Committee meetings until after the November 2018 General Election, when the matter of Proposition 6 (SB 1 revenues) will be decided by California voters.

c: Chief Board Aides
Megan Doyle, Clerk of the Board of Supervisors
Greg Iturria, County Budget Director