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BOARD MEMORANDUM

TO: Citizens Advisory Committee
 Santa Clara Valley Transportation Authority
 Board of Directors

THROUGH: Michael T. Burns
 General Manager

FROM: Jerry G. Mikolajczyk
 Chief Financial Officer

SUBJECT: VTA Financial Update

FOR INFORMATION ONLY

FINANCIAL HIGHLIGHTS

- Increase in cash position of \$200 million over last 4 months
- 2000 Measure A outstanding debt reduced by \$54.7 million with an interest savings of \$35 million over the life of the bond
- Implemented various cash management procedure improvements resulting in increased cash balances and interest income, such as:
 - Accounts Payable terms and conditions enforced on contracts with annual potential savings of \$200,000
 - Accelerated billings on grants resulting in receipt of \$150 million in less than 90 days providing VTA with accelerated investment income of \$2.5 million
- Portion of Long-Term debt refunded with savings of \$1.6 million
- Reduce variable interest rate risk on portion of outstanding debt
- VTA's credit rating upgraded by two of the national credit rating agencies
- FY08 & FY09 Adopted Biennial Budget maintains healthy operating reserves and provides for reduction of passenger fares for selected fare media and categories

BACKGROUND

On March 23, 2007, the Hay Group presented the results of their assessment to the Board of Directors. The Hay Group developed and delivered:

- A fact based assessment of VTA's performance against goals and objectives
- An assessment of future performance based on VTA's current strategy and plans
- Recommendations for transitioning VTA to an organization that enjoys the confidence of the Board, the public and customers through:
 - An inclusive and effective governance structure
 - An organization that operates transparently and is responsive to the public
- Recommendations for building a sustainable organization structured to:
 - Promote efficiency, accountability and creativity
 - Successfully implement VTA's strategy at a predictable and reasonable cost

The Board of Directors adopted the Hay Group recommendation to be implemented by the General Manger of VTA.

On April 5, 2007 the Board of Directors approved the contract to retain the services of Jerry G. Mikolajczyk as the interim Chief Financial Officer for a 9-month period.

DELIVERABLES OF THE INTERIM CHIEF FINANCIAL OFFICER:

The expected deliverables for the interim CFO for the first phase of the assignment are:

1. Implementing a cash management system for all of VTA's Funds.
2. Updating the 30-year Measure A plan and validating the plan's assumptions.
3. Updating and validating the annual operations and capital budgeting process within VTA.
4. Beginning implementation and presentation of limited financial analyses to the Board of Directors.
5. Attending C-Level (Chief Executive Officers) meetings and begin to implement a formal communication process with C-Level management.
6. Conducting limited Fiscal Resources division supervision. Begin performance assessment of Fiscal Resources division management personnel.
7. Beginning the development of financial stability strategies

For the second phase of the assignment, the expected deliverables for the interim CFO are:

1. Developing and implement the financial stability strategies.
2. Implementing new financial reporting and analysis formats.
3. Establishing a new, comprehensive internal controls program for the organization.
4. Preparing full financial analyses and present to the Board of Directors.
5. Establishing investment and risk management strategies.
6. Serving as the C-Level advisor.
7. Implementing asset management controls over real estate.
8. Addressing risk management concerns.

PROGRESS OF THE DELIVERABLES OF THE INTERIM CHIEF FINANCIAL OFFICER:

CASH MANAGEMENT SYSTEM

- Cash balance reports of all bank accounts are now prepared by the Finance Department daily
- Implemented accelerated invoicing and recovery for Traffic Congestion Relief Program (TCRP) expenditures for engineering. Invoices are current with a recovery of \$159,287,833 within 90 days
- Project Request form has been revamped along with procedures to improve data to enable cash flow management

ANNUAL BUDGET

On June 7, 2007, the VTA Board of Directors adopted a two-year budget (for fiscal years 2008 and 2009). The adopted budgets provide for:

- Service levels holding steady
- Decreased reliability on grant funding for preventive maintenance with redirecting of those grant funds to address previously deferred infrastructure improvements
- Reduced Day Pass fares for all fare categories and reduced Monthly Pass prices for Youth and Senior/Disabled

The budget documentation was streamlined and condensed with the focus on providing the VTA Board of Directors with a concise budget work manual in order to make an informed approval for the FY 2008/09 budgets.

FISCAL RESOURCES RE-ORGANIZATION

On June 1, 2007, the General Manager announced the Divisional reorganization for VTA. Fiscal Resources was to assume the responsibilities of Enterprise Risk Management (ERM), the Real Estate Management (REM) portfolio and to be responsible for Grant Accounting.

On July 7 the General Manager announced VTA's new transformation organization structure. Included was the restructured Fiscal Resources Division. As part of the VTA reorganization and per the recommendations of the Organizational and Financial Assessment report, Risk Management was relocated to Fiscal Resources with the exception of Safety Services, including Environmental Health, System Safety and Substance Abuse.

The new Fiscal Resources was designed to provide a vertical level of functionality whereby the functional discipline and responsibility is within one group of leadership, management and control. The vertical functionality also provides for a segregation of duties within Fiscal Resources. Fiscal Resources should be the role model for ensuring internal controls are in place with segregation of duties one of them. The reorganization of Fiscal Resources has resulted in a

re-alignment of positions with the new departments. Two new positions were created, one new position in Finance to handle cash management and forecasting, and one new position in Enterprise Risk Management to handle the new role of Enterprise Risk Management functions. One full time position from Grants Management was transferred to Fiscal Resources as a result of the realignment of grant accounting to Fiscal Resources.

The Fiscal Resources Division was restructured to reflect a vertically functional organization to meet the needs of VTA on a system wide basis. Included in the design was the objective to develop a comprehensive training platform, which would allow staff members to develop a career in accounting and finance. Key positions will eventually be staffed by Certified Public Accountants, (CPA's). Training programs and Professional development programs will be developed to allow a staff member to qualify for the CPA designation by obtaining the minimum 2 years experience requirement, providing the CPA education requirements are met.

BUDGET AND COST CONTROL

The budgetary cost control and reporting for operations and management of VTA will be by Division level effective July 1, 2007 with the start of the 2008 Fiscal Year. Previously the budgetary cost control for operations and management was performed at a cost center level within SAP. While the control at this level was effective, in some areas it was not efficient. Having the control at the cost center level was very labor intensive and did not provide for adequate reporting and monitoring of historic costs versus budget..

The new cost control reporting system will continue to require the Cost Center Manager to manage their own budget and costs in coordination with their respective Division Chief, while allowing for flexibility within each Division's Budget. The Cost Center manager will maintain ownership of the budgets and the costs and will be responsible for forecasting the results for the Fiscal Year. The new system will not cause stoppages to work programs as a result of actual costs over running the budgets at the cost center level. It will also allow for accurate reporting of costs to the respective cost center and cost codes and be a valuable tool for monitoring and forecasting costs.

CONTRACTS AND MATERIALS MANAGEMENT

Materials Procurement

A Task Force consisting of VTA Buyers for materials and commodities along with members from accounting was formed on June 29, 2007 to review the procurement process at VTA. The Procurement Task Force (PTF) is reviewing and redesigning the procurement process at VTA to streamline it with increased controls and lower process costs for procurement of materials and commodities. Areas of cost savings recommendations for VTA that have been identified include:

- Overhaul of the requisitioning process to provide the buyers with adequate information to procure the goods and materials which meet VTA standards and specifications
- Standardization of goods and materials procured
- Quality control for inspection and receiving of goods and materials
- Dedicated Engineering to ensure quality and standard control

- Increased Vendor specifications and deliverables such as manufacturing drawings, spare parts alternates, spare parts pricing etc.
- Inventory turnaround and reduction

Contracts Procurement

A Task Force consisting of VTA Senior Contract Administrators, along with members from accounting was formed on June 29, 2007 to review the Contract Procurement process at VTA. The Contract Task Force (CTF) is reviewing and redesigning the contract procurement process at VTA to streamline it with increased controls and lower process costs for procurement of contracts including those for construction, maintenance and professional services. Areas of cost savings recommendations for VTA that have been identified include:

- Combining several contract requisition forms to one standard contract and services requisition form
- Lowering administrative costs of contracts for both VTA and the Contractor
- Risk analysis to determine the best type of contract to use for bidding purposes
- Performing Risk analysis to identify methods for sharing the risk of the contract between VTA and the Contractor
- Requesting discounts from Contractors for quick payment

Cost Plus Fixed Fee contracts converted to Lump Sum contracts

Three Professional Services contracts bid as Cost Plus Fixed Fee contracts, totaling \$14,807,680, are being converted to Lump Sum contracts. Two of the three engineering firms have agreed to the conversion citing that the conversion will lower administrative costs for them. The third contract is under negotiation with the engineering firm with positive indications that they will adopt the Lump Sum contract philosophy. VTA will achieve savings on the administration of the contract in both the Project Managements office and in Fiscal Resources. The conversion of the Cost Plus Fixed Fee contract to Lump Sum contracts transfers the risk of the contract from VTA to the engineering firm.

DISBURSEMENTS

VTA's payment procedure was to pay vendors as soon as possible and invoices were paid in an average of 14 days. VTA's Accounts Payable procedures have been revised to pay vendors per contract terms instead of early payment resulting in annual savings of approximately \$200,000 in lost investment interest earnings.

FINANCE

Financing

On August 2, 2007, 2006 Measure A, Series E Bond, \$54.7 million, was redeemed with cash obtained as a result of an accelerated recovery of funds of more than \$150 million from the state's Traffic Congestion Relief Program (TCRP) grant recovering the funds four months earlier than under normal billing practices. A comprehensive accounting of VTA's cash assets and

reexamining the project expenditure plans was performed as a result of the accelerated recovery from the TCRP. The redemption of nearly \$55 million of VTA's outstanding Measure A bonds reduced annual debt service costs and savings of more than \$35 million in interest expenses over the life of the bond.

Pending approval by the Board of Directors, the 2006 Measure A, Series F and G Bonds are scheduled to be refinanced by early November. The Series F and G bonds were issued as Auction Rate Securities with variable interest rates. At the time of issuance, VTA planned to redeem the Series F and G bonds with the proceeds received from the TCRP grant. However, following a comprehensive accounting of VTA's cash assets, re-examination of the project expenditure plans, and analysis of long-term interest rates, staff is recommending that the Series F and G Bonds remain outstanding and be refinanced as traditional fixed rate bonds. The refinancing of the bonds to a fixed rate will decrease VTA's exposure to variable interest rate risk and secure a lower interest rate than the assumption used in the adopted 2000 Measure A Expenditure Plan.

On April 24, 2007, VTA issued \$26.3 million of 2007 Sales Tax Revenue Refunding Bonds to refund a portion of the outstanding 1997 Series A Sales Tax Revenue Refunding Bonds. The resulting lower interest rate on the 2007 Bonds resulted in net present value savings of \$1.6 million or 5.85% of the refunded 1997 Bonds. Total cash flow savings on debt service as a result of the refunding is \$2.1 million.

Credit Rating Upgrades

In July 2006, Standard & Poor's upgraded its long-term credit rating to AA+ from AA on VTA's senior-lien 1976 sales tax revenue bonds. The upgrade was due to limited additional bonding plans against the 1976 sales tax and a substantial reliance on pledged revenues for operating funds; both of which contribute to very high debt service coverage.

In September 2006, Standard and Poor's further upgraded VTA's senior-lien 1976 sales tax revenue bonds to AAA, the highest rating possible, due to rating criteria changes made by Standard and Poor's on sales tax revenue bonds. As a result of the change in criteria, Standard and Poor's also upgraded the 2000 Measure A sales tax revenue bonds to AA+ from AA. The rating criteria change placed more emphasis on fundamental economic factors, the drivers of the sales tax revenue, and less on legal features regarding additional debt issuance and reserve funds.

In April 2007, Fitch Ratings upgraded its long-term credit rating to AA- from A+ on VTA's senior-lien 1976 sales tax revenue bonds. The rating upgrade reflects VTA's very high debt service coverage by pledged sales tax revenue, the sustained growth of sales tax revenues following severe declines, good reserve levels, and strong legal features such as a gross pledge on the 1976 sales tax.

FINANCIAL STATUS OF VTA:

PRELIMINARY UNAUDITED

Cash Position:

On June 30, 2007, VTA had a cash position, including investments, of \$609,911,773, consisting of:

• Operating and Capital	\$ 341,410,252
• Obligated	<u>\$ 268,501,521</u>
Total Cash and investments	\$ 609,911,773

The obligated cash position consists of obligations such as Debt service payments, Workers' Compensation, Retiree Medical, General Liability, Compensated Absences, Ancillary Measure B Payments, etc.

Capital Assets (less depreciation) \$2,555,050,596

Other Assets (including accounts receivable and inventories) \$ 200,059,207

Total Cash, Investments and Assets: \$3,365,021,576

Debt Position:

On June 30, 2007, VTA had debt of \$1,050,930,070, consisting of:

• Bonds Outstanding ¹	\$ 746,128,228
• Other liabilities ²	<u>\$ 304,801,842</u>

Total liabilities \$1,050,930,070

¹ Included in the Bonds Outstanding are the 2006 Measure A, Series E Bonds, \$54,700,000.00, which were redeemed on August 2, 2007.

² Included in the Other liabilities are: Trade Payables, Accrued Payroll, Internal Service Fund Liabilities (Workers' Comp, Retiree Medical, Self-Insurance and Compensated Absences), and Deferred Revenue (advances from other agencies – grants and fund swaps).

Pension

VTA's Pension obligations are 79% funded for the ATU pension fund, 85% funded for the PERS pension fund and 40% funded for the Retiree Medical fund. The ATU pension funds is controlled and administered by a Pension Board consisting of employees of VTA, including represented and non-represented employees. The Retiree Medical fund is managed by VTA Finance.

The table below illustrates the VTA pension obligations:

POST-EMPLOYMENT BENEFIT PLAN FUNDING STATUS									
PLAN	VALUATION DATE	Actual Value of Assets (\$mm)	AAL (\$mm)	UAAL (\$mm)	Earnings Assumptions	% Funded	Covered Payroll (\$mm)	UAAL as % of Covered Payroll	Annual Pension Cost (\$mm)
ATU Pension	1/1/2007	\$314.8	\$397.9	\$83.1	8.00%	79%	\$92.7	88%	\$15.6
PERS Pension	6/30/2005	\$135.5	\$160.1	\$24.6	7.75%	85%	\$50.2	49%	\$6.6
Retiree Medical ¹	7/1/2006	\$79.3	\$200.6	\$121.3	7.00%	40%	\$147.8	82%	\$15.7
Total		<u>\$529.6</u>	<u>\$758.6</u>	<u>\$229.0</u>					<u>\$37.9</u>

¹ Does not reflect impact of GASB 45 implementation. VTA will implement GASB 45 in FY 2008.

Prepared by Jerry G. Mikolajczyk, Chief Financial Officer