Limited Scope Analysis of the Santa Clara Valley Transportation Authority’s 10-Year Financial Projections

Prepared for
Working Partnerships, USA
October 22, 2010
Project Objectives

1. Evaluate the assumptions and calculations included in VTA’s most recent 10-Year Financial Projection through FY 2018-19.

2. Determine whether capital projects funds can be used for operations.

3. Assess VTA’s reserve policies and current reserves.

4. Compare VTA’s unfunded pension liability with other agencies and analyze the impacts from establishing a two-tier pension system.
Finding 1:

VTA’s baseline assumptions and methodologies are narrowly defined, affecting reliability and allowing major swings in projections as key financial data becomes available.

1. The financial model used by VTA impacts results by calculating inconsistent year-to-year growth and restricting assumptions to a single scenario.

2. Projecting short-term financial results can be difficult due to the uncertainty of external variables beyond VTA’s control.

3. Projecting long-term financial results into an unknowable future is inherently subject to error.
10-Year Financial Projection

Financial Modeling

VTA uses Moody’s Analytics to forecast changes in revenues and expenses over a 10-year projection horizon

1. The model uses analysis based on historical trends and forecasting of key variables to develop “Low”, “High” and “Most Likely” growth scenarios.

2. VTA has chosen to use the “Most Likely” growth scenario in its forecast, narrowing the range of forecasting possibilities.

3. The model shows variable results by year, which subjects it to greater uncertainty than using constant growth factors over the planning horizon.

4. By merely applying constant growth factors by year, the financial projection would improve by an average of $3.7 million per year.
10-Year Financial Projection

Short-Term Financial Forecasting

Forecasting accurate short-term financial results can be difficult and is subject to considerable uncertainty

1. The FY 2009-10 actual results of VTA operations resulted in nearly $16.3 million in additional unbudgeted and unanticipated resources.

2. Only two months later, by adjusting the baseline projection made in the August Update to reflect these additional resources, the model:
   - Delayed the year when the projected operating deficit would occur by one year, from FY 2010-11 to FY 2011-12.
   - Improved the projection of the FY 2018-19 Ending Operating Reserve by 61.6 percent, from a projected negative balance of -$328.86 million to a projected negative balance of -$126.15 million, a cumulative improvement of $202.71 million.
10-Year Financial Projection

Long-Term Financial Forecasting

Forecasting accurate long-term financial results based on an unknowable future is subject to even greater uncertainty.

1. While the 10-Year Financial Projection provides variable impact analyses, by forecasting finances assuming $35 and $40 million cost reductions, it fixes the long-term revenue and expenditure growth rates based on only one of three projection scenarios provided by Moody’s.

2. Fixing revenue growth rates at 2.25 percent and expenditure growth rates at 3.27 percent results in projection assumptions that are designed to create a structural deficit.

3. Moody’s creates multiple scenarios because it understands that long-term projections are inherently prone to error.
## 10-Year Financial Projection

### Long-Term Financial Forecasting

10 Year Comparison of Projections for
1976 - 1/2 Cent Sales Tax Collections

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Estimate for 2008 Bonds</th>
<th>Updated 10-Yr Projection</th>
<th>Over (Under)</th>
<th>Percent Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 2008*</td>
<td>165,183,267</td>
<td>163,038,000</td>
<td>(2,145,267)</td>
<td>-1.3%</td>
</tr>
<tr>
<td>FY 2009*</td>
<td>165,183,267</td>
<td>137,642,000</td>
<td>(27,541,267)</td>
<td>-16.7%</td>
</tr>
<tr>
<td>FY 2010*</td>
<td>174,317,902</td>
<td>140,036,709</td>
<td>(34,281,193)</td>
<td>-19.7%</td>
</tr>
<tr>
<td>FY 2011</td>
<td>184,062,272</td>
<td>136,470,000</td>
<td>(47,592,272)</td>
<td>-25.9%</td>
</tr>
<tr>
<td>FY 2012</td>
<td>194,406,572</td>
<td>147,230,000</td>
<td>(47,176,572)</td>
<td>-24.3%</td>
</tr>
<tr>
<td>FY 2013</td>
<td>205,409,984</td>
<td>152,870,000</td>
<td>(52,539,984)</td>
<td>-25.6%</td>
</tr>
<tr>
<td>FY 2014</td>
<td>217,097,812</td>
<td>156,500,000</td>
<td>(60,597,812)</td>
<td>-27.9%</td>
</tr>
<tr>
<td>FY 2015</td>
<td>229,515,807</td>
<td>155,120,000</td>
<td>(74,395,807)</td>
<td>-32.4%</td>
</tr>
<tr>
<td>FY 2016</td>
<td>242,139,176</td>
<td>156,610,000</td>
<td>(85,529,176)</td>
<td>-35.3%</td>
</tr>
<tr>
<td>FY 2017</td>
<td>251,824,743</td>
<td>160,030,000</td>
<td>(91,794,743)</td>
<td>-36.5%</td>
</tr>
</tbody>
</table>

Cumulative: 2,029,140,802 1,505,546,709 (523,594,093) -25.8%

* Updated Projection reflects reported actual for FY 2008, FY 2009 and FY 2010.
Recommendations

The Board of Directors should direct the VTA General Manager to:

1. Reduce the financial planning horizon to five-years or less to increase the likelihood of achieving anticipated results.

2. Prepare and present best-case, likely-case and worse-case projection scenarios for consideration by the Board.
   
   – Using a range of key variables, including possible differences in baseline assumptions (e.g., variances from budget)

   – Using the full range of financial modeling alternatives provided by Moody’s Analytics.
Capital Project Funding

Finding 2:

VTA has considerable flexibility to use funds for operations that are anticipated for capital projects.

1. FTA Section 5307 and 5309 funds can be flexibly used for preventive maintenance, including “activities, supplies, materials, labor, services, and associated costs required to preserve or extend the serviceability” of assets.

2. There are no limitations on the use of 2000 Measure A funds for “increased services”, which can include backfilling operating deficits.

3. The receipt of ARRA Stimulus Funding has improved the “state of good repair” of the VTA’s fleet, reducing the amount of resources that may have otherwise been necessary for this purpose.
FTA Section 5307 and 5309

FTA Section 5307 and 5309 are eligible to fund a wide range of capital project and related activities, including preventive maintenance and paratransit operating costs.

1. Preventive maintenance is broadly defined, but has limitations embedded in federal legislation.

2. Funding allocated for Paratransit can be programmed for other authorized purposes, provided the Authority meets or exceeds minimum ADA requirements.

3. The Biennial Budget and financial projections allocate some of these funds for preventive maintenance, but the stated intent is to return the appropriation to an historical 35% operating and 65% capital ratio.
Capital Project Funding

2000 Measure A Funds

There is no limitation on the use of 2000 Measure A funds for operations, including backfilling for budget deficits that would reduce service levels.

1. Measure A was designed to provide “increased bus, rail and paratransit services,” including both capital and operating costs.

2. Using the ratio of the total projected revenues and program operating expenses, VTA has been appropriating approximately 18.46% of its budget estimate for operations in each year since the tax was enacted (approximately $24.6 million of $133.26 million in FY 2009-10).

3. A 2003 Court Order clarified that there are no limitations on the amount that can be used for operations, and that funds can be used to backfill projected operating deficits, when needed.
Capital Project Funding

Impact of ARRA Stimulus Funding

ARRA Stimulus funding allowed the VTA to replace 95 buses, or approximately 25% of its fleet, improving the fleet’s “state of good repair” from levels reported in FY 2009-10.

1. The August Update reported that 24% of the VTA’s existing bus fleet was not in a state of good repair during FY 2009-10.

2. However, federal ARRA Stimulus funds permitted the VTA to replace 95 of its buses during the year, reflecting 25% of the VTA’s fleet.
Reserve Funding

Finding 3:

VTA did not recognize $16.3 million in unbudgeted resources; and, had funded excess reserves amounting to $40.1 million as of June 30, 2010.

1. Consistent with policy, the August Update assumed a $52.18 million reserve, equal to 15% of the Adopted Operating Budget; however, it did not recognize $16.3 million in operating surplus from FY 2009-10.

2. In addition, VTA has set Workers’ Compensation reserves at levels that are higher than expected liabilities, resulting in excess reserves of $18.5 million as of June 30, 2010.

3. VTA also had a $21.6 million reserve for compensated absences, as of June 30, 2010, which is unnecessary and counter to prevailing practice.
Reserve Funding

Operating Reserve

The VTA Operating Reserve is funded at 15% of the Adopted Operating Budget in FY 2010-11, but did not recognize $16.3 million in operating surplus in the August Update.

1. VTA’s 15% Operating Reserve Policy has been set at the high-end of levels recommended by the Government Finance Officers Association

2. However, at the time the reserve was established and the budget was adopted, the VTA was unaware and did not recognize that budget surplus of $16.3 million would result from operations in FY 2009-10.

3. These additional resources appear to have been recognized in the October Update, postponing the projected operating deficit from FY 2011 to FY 2012, and reducing the FY 2019 negative Operating Reserve Balance from a negative $328.86 million to a negative $126.15 million.
Reserve Funding

**Surplus ISF Cash Reserves**

The VTA operates three internal service funds that hold $40.1 million in cash resources that can be considered surplus.

1. Workers’ Compensation reserves are funded at the 90% confidence level, which states that there is a nine in ten chance that the reserves will be sufficient to fund liabilities.

2. In many other jurisdictions, such reserves are set at the 50%, or expected confidence level, or at lower levels.

3. If VTA were to set its reserves at expected levels, $18.5 million in excess reserves could be returned to the contributing funds.

4. In addition, VTA has established a $21.6 million reserve to fund $22.1 million in obligations to pay for compensated absences of current employees (e.g., vacation and sick leave), counter to prevailing practice in other large California jurisdictions and transit operations.
Workers’ Compensation Cash Reserves

Workers’ Compensation & General Liability
Table Showing Annual Funding Versus Actual Expenses

<table>
<thead>
<tr>
<th></th>
<th>FY 2008</th>
<th>FY 2009</th>
<th>FY 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Contributions</td>
<td>13,224,000</td>
<td>12,543,000</td>
<td>11,638,000</td>
</tr>
<tr>
<td>Beginning Fund Balance</td>
<td>39,462,000</td>
<td>41,968,000</td>
<td>45,963,000</td>
</tr>
<tr>
<td>Available Assets (Excludes Interest)</td>
<td>52,686,000</td>
<td>54,511,000</td>
<td>57,601,000</td>
</tr>
<tr>
<td>Annual Expenses</td>
<td>13,027,000</td>
<td>12,058,000</td>
<td>11,911,000</td>
</tr>
<tr>
<td>Available Balance</td>
<td>39,659,000</td>
<td>42,453,000</td>
<td>45,690,000</td>
</tr>
</tbody>
</table>
## Reserve Funding

### Compensated Absence Reserve Policies

Compensated Absence Liabilities and Funding
Most Populous California Counties

<table>
<thead>
<tr>
<th>County</th>
<th>Compensated Absence Liability</th>
<th>Amount Funded</th>
</tr>
</thead>
<tbody>
<tr>
<td>Los Angeles</td>
<td>$946,304,000</td>
<td>$0</td>
</tr>
<tr>
<td>San Francisco</td>
<td>233,628,000</td>
<td>0</td>
</tr>
<tr>
<td>Santa Clara</td>
<td>191,353,000</td>
<td>0</td>
</tr>
<tr>
<td>Orange</td>
<td>170,495,000</td>
<td>0</td>
</tr>
<tr>
<td>Riverside</td>
<td>163,417,000</td>
<td>0</td>
</tr>
<tr>
<td>San Bernardino</td>
<td>160,361,000</td>
<td>0</td>
</tr>
<tr>
<td>Sacramento</td>
<td>105,540,000</td>
<td>0</td>
</tr>
<tr>
<td>San Diego</td>
<td>101,325,000</td>
<td>0</td>
</tr>
<tr>
<td>Contra Costa</td>
<td>51,441,000</td>
<td>0</td>
</tr>
<tr>
<td>Alameda</td>
<td>32,713,000</td>
<td>0</td>
</tr>
<tr>
<td>Fresno</td>
<td>26,095,000</td>
<td>0</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>$218,267,200</strong></td>
<td><strong>$0</strong></td>
</tr>
<tr>
<td><strong>Avg Excl Los Angeles</strong></td>
<td><strong>$137,374,222</strong></td>
<td><strong>$0</strong></td>
</tr>
</tbody>
</table>
**Reserve Funding**

**Compensated Absence Reserve Policies**

Compensated Absence Liabilities and Funding  
**Major California Transit Agencies**

<table>
<thead>
<tr>
<th>Transit Agency</th>
<th>Absence Liability</th>
<th>Amount Funded</th>
</tr>
</thead>
<tbody>
<tr>
<td>Golden Gate B.H.T.D.</td>
<td>7,894,000</td>
<td>0</td>
</tr>
<tr>
<td>Los Angeles Metro Tran Dist</td>
<td>77,168,000</td>
<td>0</td>
</tr>
<tr>
<td>Sacramento Reg Tran Dist</td>
<td>8,528,767</td>
<td>0</td>
</tr>
<tr>
<td>San Diego Metro Tran Sys</td>
<td>12,074,415</td>
<td>0</td>
</tr>
<tr>
<td>San Francisco Muni</td>
<td>24,912,092</td>
<td>0</td>
</tr>
<tr>
<td>San Mateo Co Tran Dist</td>
<td>7,339,204</td>
<td>0</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>$22,986,080</strong></td>
<td><strong>$0</strong></td>
</tr>
<tr>
<td><strong>Avg Excl L.A. Metro</strong></td>
<td><strong>$12,149,696</strong></td>
<td><strong>$0</strong></td>
</tr>
</tbody>
</table>
Reserve Funding

Recommendations

The Board of Directors should:

Direct the VTA General Manager to:

1. Immediately release $18.5 million in excess Workers’ Compensation and General Liability reserves to the contributing funds, including the Transit Operating Fund.

2. Immediately release $21.6 in reserves for compensated absences.

Revise its reserve policies to:

1. Fund Workers’ Compensation liabilities at the 50% confidence, or expected level.

2. Eliminate reserve funding for compensated absences.
Pension Costs

Finding 4:

VTA’s pension systems are comparable to those for other transit operators, but $749,000 in annual savings could be achieved by pre-paying VTA’s annual contribution. Savings from establishing a two-tiered system would be minimal until all current employees were replaced in 20 years.

1. VTA pays interest on unpaid portions of its annual pension contribution at rates of 8.00% (ATU) and 7.75% (CalPERS), while earning less than 1.00% interest on investments. If interest charges were avoided by prepaying the annual contribution, approximately $750,000 in annual interest expense could be avoided.

2. Creating a two-tier retirement system would save an estimated $112,671 in year one, increasing to only $3.3 million per year after 20-years.
Pension Costs

Prepaying Annual Pension Contribution

By prepaying its annual pension contribution of approximately $21.5 million to the ATU and CalPERS pension plans, VTA could avoid interest expense on unpaid balances through the year.

1. VTA must pay the ATU and CalPERS plans interest of 8.00% and 7.75% on unpaid balances through the year.

2. Yet the VTA maintains over $75 million in cash balances, with more than half of it earning investment returns of less than 1.00%.

3. By prepaying its annual contribution to these systems and avoiding the interest expense, VTA could realize net savings of approximately $749,000, based on prior fiscal year data.

4. Savings would be more as annual pension costs increase, provided the percentage return on investments doesn’t surpass the interest expense being charged by the plans.
Establishing a Two-Tiered Pension Plan

Savings from establishing a two-tiered system would be minimal until all current employees were replaced in 20 years.

1. Creating a second tier pension plan for new employees has achieved an average of 2.19% savings in 37-Act counties that have established such plans, once fully implemented.

2. However, full realization of these savings does not occur for many years until all of the current employees in the Tier 1 plan are replaced by the new employees in the Tier 2 plan.

3. Projections prepared for this report indicate that savings from implementing a two-tiered plan would be minimal in the initial years, amounting to only:

– $112,671 per year in Year 1; to,

– $3,282,797 per year in Year 20.
Pension Costs

Recommendations

The Board of Directors should:

Direct the VTA General Manager to:

1. Implement steps to prepay ATU and CalPERS annual retirement contributions to avoid interest expense charged to VTA by the plans for unpaid balances during the year.

Consider:

1. The minimal financial gains to be achieved from establishing a two-tiered pension system for new employees, when exploring alternatives for reducing operating costs.