Adopted 5/17/06

FINANCIAL FRAMEWORK
For
MEASURE J IMPLEMENTATION

SUMMARY OF POLICIES

1. **Divide Measure J Annual Revenues** in the budget into major capital project and operating program accounts, on an aggregated, *pro rata* basis as follows (See Exhibit 1 for Measure J element classifications):

    a. **Major Capital Project Expenses** would be approximately 35 to 40 percent of the annual revenues, consistent with the proportion of the *Transportation Expenditure Plan (*TEP) devoted to major capital projects. That percentage of revenues would be set aside annually to cover debt service, pay-go funding, and establishment of a prudent reserve for contingencies;

    b. **Operating and Grant Program Expenses** would constitute approximately 34 percent of annual sales tax receipts. This would provide such programs with relatively stable, continuing revenues to sustain on-going operations;

    c. **Hybrid Elements.** The above levels would be adjusted as appropriate depending on decisions made regarding "hybrid" Measure J elements – approximately 21 percent of Measure J – that potentially have both operating and capital components (See Attachment A);

2. **Hybrid TEP Category Funding Assignments.** Sponsors, with the concurrence of the relevant RTPC, should identify the portion - if any - of each hybrid Measure J element that should be dedicated to capital projects to be funded from the bond issue(s), and the portion for on going operating programs, prior to the start of Measure J implementation, no later than July 1, 2009.

3. **Operating Programs** should receive an annual revenue stream generally based on either the percentage already specified for each in Measure J, or a modified percentage as set under (2) above, in order to sustain their operations.

4. **Capital Components of Hybrid and Flexible Elements** should be segregated into those which should be part of the larger capital projects pool (and hence be eligible for advancement through the bond issue(s)), and those for which annual or periodic capital funding would be best accomplished through the budget process or accumulation of reserves over some period of time.

5. **Sponsor Advance of Funds for Operational Planning.** A prospective sponsor of a Measure J operating program may undertake an early planning effort for it at its own cost, without reimbursement from Measure J funds. Retroactive reimbursements from Measure J will not be provided for planning efforts undertaken without prior approval from CCTA.

6. **Sponsor Request for Reimbursement of Advance Planning Efforts for Measure J Operating Programs.** Prior to incurring any expense, a sponsor may request in advance that the Authority agree to future reimbursement, after July 1, 2009, for local funds expended in the planning effort for operating programs, subject to the following conditions:

   a. The sponsor(s) obtain formal concurrence for the funding advance from the respective policy board(s);

   b. The sponsor has taken the request, and supporting information, to the relevant RTPC and received its support for the advance;

   c. The costs to be reimbursed do not exceed one-quarter (1/4) of the estimated first year's annual revenues for the subregion's share of the program from which reimbursement will be drawn;

   d. The costs are solely for consultant or service provider activities necessary to better define overall feasibility and the parameters of the proposed service(s), including, but not limited to: (1) routing; (2) capital needs; (3) operating budget, including sources and uses of revenue, capital and operating costs; (4) a consolidated financing plan; and (5) benefits to be gained from the service(s);

   e. Sponsor's staff costs for oversight of the planning effort shall not be reimbursed, but consistent with current policy, costs for sponsors conducting in-house studies and/or tasks clearly related to the study and completed in-house could be reimbursed at actual salary plus a mark-up for benefits, not to exceed 50% of the hourly wage (1.5 x hourly salary); indirect costs (such as office rent, copier lease, etc.) and ongoing routine activities not related to the study shall not be reimbursed; and

   f. Sponsor, the Authority, and the RTPC agree upon the reimbursement schedule, and how it might affect future operations, with such repayment to occur over a mutually agreed upon time frame after July 1, 2009; and

   g. After considering all of the above factors, the Authority determines that the request for future repayment is consistent with the intent of Measure J and the advance planning is necessary prior to July 1, 2009 for timely implementation of the proposed program, and that future reimbursement schedule is consistent with the anticipated Measure J cashflow; and

   h. The Authority and the sponsor enter into an agreement that spells out the conditions, requirements and timing for future reimbursement – including strict accounting of the eligible expenses for which future reimbursement will be requested, including anticipated staff costs for in-house studies.

INTRODUCTION

At its February 3, 2006 meeting, the Administration and Projects Committee (APC) asked staff to prepare a policy framework regarding the implementation of Measure J programs. This direction came in response to a local jurisdiction's request to be reimbursed in 2009 for expenses incurred in conducting a preliminary study for implementation of a Measure J operating program. The APC deferred action on the request because it was concerned about setting a precedent without such a policy framework.

At a previous APC meeting the Committee directed staff to develop a financial plan that would allow early – before July 1, 2009 – project development work for Measure J capital projects. Although operating and capital project financing are interrelated, the Authority can advance only *capital* projects through the use of sales tax revenue bonds. Staff is independently preparing a draft financial plan to address pre-2009 Measure J project work. That focused plan will include options for short-term financing such as commercial paper (CP), borrowing from Measure C project funds, and application of Measure C funds to eligible projects (e.g., Route 4, east, Commuterway or I-680 categories).

Consequently, this issue paper proposes that the Authority: (i) establish an overall "Policy Framework" for both capital and operating programs; (ii) for those Measure J Transportation Expenditure Plan (TEP) elements[1] that could have either or both aspects, collaboratively clarify how the element's funding would be divided between capital and operations prior to July 1, 2009; and (iii) adopt a specific policy regarding Measure J reimbursement of locally funded, pre-2009 planning studies for eligible operating programs.

KEY ISSUES

To establish a framework and financial policies for Measure J projects and operating programs, the key issues that need to be addressed are:

- **Cash Flow**: availability, management, and relative commitments to the various components of Measure J's transportation expenditure plan (TEP);

- **Financing Strategies for Capital Projects**: including the percentage of annual revenues set aside for debt service and for pay-as-you go ("pay-go") project funding; allocating the cost of debt financing; the degree to which projects are accelerated compared to pay-go; and reserves for project funding contingencies; and

- **Priorities for Implementation**: including whether or not project and operating program priorities can be intermixed, or need to be separated; priorities among Measure J capital projects; and potential trade-offs between capital and operating components of "hybrid" Measure J elements that contain both.

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[1] For clarity, line items in Measure J will be referred to here as "elements," to distinguish them from their components that could either be capital projects or operating programs. The term "program" will generally refer to functions such as planning or transportation demand management, operating programs such as bus transit or paratransit services, or grants such as the 18 percent local streets and roads funding.

FACTORS IN SETTING FINANCIAL POLICY FRAMEWORK

There are three primary factors in setting financial policy for Measure J:

- **Requirements for Sales Tax Revenue Bond Debt Service.** The Authority has committed to a $300 million bond issue in September 2009, with the possibility of additional bond issue(s). Debt service, which will have the first call against sales tax revenues under the bond covenants, is structured to increase over time, generally as a relatively fixed proportion of the projected annual sales tax revenues times the percentage of Measure J assigned to major capital projects. A significant margin above projected debt service will remain to address revenue uncertainty and for "pay-as-you-go" (pay-go) project financing.[2] (See Figure 1.)

- **Operating Programs Require On-Going Stable or Growing Subsidies.** New transit operating programs generally require a significant subsidy in addition to passenger fare revenues.[3] While growing patronage over time might reduce the percentage subsidy required to sustain service, history shows that on-going stable or growing subsidies are necessary to support transit operations. In addition, ongoing transportation demand management programs, such as 511 Contra Costa, require a stable and continuing base of support.

- **Revenue Uncertainties.** Despite relatively conservative assumptions, forecasting sales tax revenues 30 years into the future is inherently uncertain. This uncertainty must be considered in formulating financial policies. For example, in 1988 dollars Measure C revenues to date are approximately 15 percent below original estimates. (See Figure 2.)

Measure C policy addressed the on-going needs of operating programs by committing an "off-the-top" percentage of annual revenues to each. For Measure J, the paratransit and bus transit operating programs are expected to continue to follow this model. As noted above, the recently approved Measure J project financing is based on a *pro rata* share of annual revenues flowing to capital projects. Consequently, staff recommends that this approach be formalized: the Authority should segregate Measure J annual revenues earmarked for capital projects from those dedicated to operating programs, as described below.

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[2] For Measure J, staff estimates that approximately 10 percent of project capacity (in 2004 dollars) should be set aside for financing costs and to mitigate against revenue uncertainties, which will be factored into each major capital project's allowable costs. In adopting the TEP, the Authority agreed that each project advanced would pay for the cost of debt financing that enabled the acceleration. The more that interest rates on bond debt exceed the growth rate of sales tax revenues, the higher will be the net borrowing cost in 2004 dollars. The 10% net cost of borrowing was derived assuming that the bond interest rate exceeds long run sales tax revenue growth rate (including inflation) by 0.7 %. (An effective interest rate of 3.9% has already been secured for the first bond issue of $300 million scheduled for 2009.)

[3] Commuter rail services typically require subsidies of from 40 to 60 percent of operating costs; bus services can range from 50 to 90 percent subsidies; paratransit services can require up to approximately 95 percent.

SEGREGATION OF PROJECT AND OPERATING REVENUES

In order to reduce conflicts and enhance predictability, staff recommends that the Authority:

1. **Divide Measure J Annual Revenues** in the budget into major capital project and operating program accounts, on an aggregated, *pro rata* basis as follows:

    a. **Major Capital Project Expenses** would be approximately 35 to 40 percent of the annual budget, consistent with the proportion of the TEP devoted to major capital projects. That percentage of revenues would be set aside annually to cover debt service, pay-go funding, and establishment of a prudent reserve for contingencies;
    b. **Operating and Grant Program Expenses** would constitute approximately 34 percent of annual funding. This would provide such programs with relatively stable, continuing revenues to sustain on-going operations;
    c. **Hybrid Elements.**[4] The above levels would be adjusted as appropriate depending on decisions made regarding "hybrid" Measure J elements – approximately 21 percent of Measure J – that potentially have both operating and capital components (see Attachment A);

Perhaps the most significant challenges to fully segregating project and program revenues arise from elements that: (1) envision both capital and operating expenditures; (2) are either flexible or undefined; and/or (3) might have periodic significant cash flow needs above their annual percentages – for example, development of the countywide transportation plan (CTP). These "hybrid" (or flexible) elements warrant further discussion relative to what percentage, if any, of the element should be considered for capital expenses, and how periodic cash flow "spikes" would be accommodated.

Staff suggests that for such elements, sponsors should decide on the capital/operating split before any operating funding is allocated, in order to promote the long-term sustainability of subsequent operations. Where capital needs are significant, and sponsors wish to accelerate them through bond financing, the agreed-upon capital percentage of the element should be accumulated with the proportion of annual revenues dedicated to major capital projects. Then the cumulative total percentage times the annual revenue level would be set aside for debt service and pay-go funding. In the same vein, sponsors (and the Authority) that may have periodic cash flow "spikes" for planning, limited capital replacement, etc. should identify such requirements as early as feasible so they can be addressed.

Accordingly, relative to detailed capital project and programming for hybrid Measure J program elements, staff recommends the following steps be taken:

[4] Capital, Operating and potential "Hybrid" Elements of Measure J are identified in Exhibit 1 in a matrix showing all elements of the Measure J program (on an aggregated basis). The Operating and Hybrid Elements are further described in Attachment A.

2. **Hybrid TEP Category Funding Assignments.** Sponsors, with the concurrence of the relevant RTPC, should identify the portion - if any - of each hybrid Measure J element that should be dedicated to capital projects to be funded from the bond issue(s), and the portion for on going operating programs, prior to the start of Measure J implementation, no later than July 1, 2009.
3. **Operating Programs** should receive an annual revenue stream generally based on either the percentage already specified for each in Measure J, or a percentage set under (2) above, in order to sustain their operations.
4. **Capital Components of Hybrid Elements** should be segregated into those which should be part of the larger capital projects pool (and hence be eligible for advancement through the bond issue(s)), and those for which annual or periodic capital funding would be best accomplished through the budget process or accumulation of reserves over some period of time.

PROPOSED POLICIES FOR ADVANCEMENT OF PLANNING EFFORTS

Some advanced planning efforts will be requested prior to 2009. It should be noted that the Authority may borrow against future Measure J revenues for implementing *capital projects*, but generally cannot do so for *operating costs*. Therefore, defraying the cost of advance planning studies for operating and grant programs must be addressed in other ways. There are two primary ways in which such requests could be accommodated:

- If a particular program is determined by the Authority to have benefits and significance for *all* of Contra Costa, and warrants further policy deliberations and guidance prior to 2009, the Authority could develop the relevant policies within the framework of its 2008 update to the Countywide Transportation Plan (CTP). In staff's view, the most likely such programs are the TLC program and the Express Bus Program, given their countywide implications;
- For programs of high local focus and interest, the RTPCs, transit operators, and/or other affected parties could initiate studies of relevance to the Measure J funding affecting their areas by:
    - Providing local agency or private funds for the study at their cost; or
    - Providing local funds in advance of Measure J subject to future reimbursement from the eligible category after July 1, 2009, if the Authority has agreed to do so ahead of time. The time frame for each such reimbursement would be subject to negotiations in the context of the overall financial plan.

POLICY REGARDING FUNDING OF PLANNING STUDIES FOR PROGRAMS

Accordingly, the following policies are recommended:

5. **Sponsor Advance of Funds for Operational Planning.** A prospective sponsor of a program may undertake a planning effort relative to a Measure J program at its own cost without reimbursement from Measure J funds. Retroactive reimbursements from Measure J will not be provided for planning efforts undertaken without prior approval from CCTA.

6. **Sponsor Request for Reimbursement of Advance Planning Efforts for Measure J Operating Programs.** Prior to incurring any expense, a sponsor may request in advance that the Authority agree to future reimbursement, after July 1, 2009, for local funds expended in the planning effort for operating programs, subject to the following conditions:

   a. The sponsor(s) obtain formal concurrence for the funding advance from the respective policy board(s);

   b. The sponsor has taken the request, and supporting information, to the relevant RTPC and received its support for the advance;

   c. The costs to be reimbursed do not exceed one-quarter (1/4) of the estimated first year's annual revenues for the subregion's share of the program from which reimbursement will be drawn;

   d. The costs are solely for consultant or service provider activities necessary to better define overall feasibility and the parameters of the proposed service(s), including, but not limited to: (1) routing; (2) capital needs; (3) operating budget, including sources and uses of revenue, capital and operating costs; (4) a consolidated financing plan; and (5) benefits to be gained from the service(s);

   e. Sponsor's staff costs for oversight of the planning effort shall not be reimbursed, but, consistent with current policy, costs for sponsors conducting in-house studies and/or tasks clearly related to the study and completed in-house could be reimbursed at actual salary plus a mark-up for benefits, not to exceed 50% of the hourly wage (1.5 x hourly salary); indirect costs (such as office rent, copier lease, etc.) and ongoing routine activities not related to the study shall not be reimbursed; and

   f. Sponsor, the Authority, and the RTPC agree upon the reimbursement schedule, and how it might affect future operations, with such repayment to occur over a mutually agreed upon time frame after July 1, 2009; and

   g. After considering all of the above factors, the Authority determines that the request for future repayment is consistent with the intent of Measure J and the advance planning is necessary prior to July 1, 2009 for timely implementation of the proposed program, and that the future reimbursement schedule is consistent with the anticipated Measure J cashflow; and

   h. The Authority and the sponsor enter into an agreement that spells out the conditions, requirements and timing for future reimbursement – including strict accounting of the eligible expenses for which future reimbursement will be requested, including anticipated staff costs for in-house studies.

Attachment A
SUMMARY OF OPERATING PROGRAMS & HYBRID ELEMENTS

1. Measure J includes a number of programs that are presumed to be primarily operational in nature:

    a. Bus Services, 5.0% (1.2% Central, 2.6% West, 0.75% Southwest, 0.45% East)
    b. Paratransit, 5.0% (Annual Formula shares specified in Measure J – increases from 3.5% to 5.7%, by 0.1% each year)
    c. Express Bus, 4.3% (1% Central, 2% West, 1% Southwest, 0.3% East)
    d. Commute Alternatives, 1% (0.29% Central, 0.24% West, 0.18% Southwest, 0.29% East)
    e. Additional Bus Transit Enhancements, 3.4% (1.2% Central, 2.225% West)
    f. Additional Paratransit, 1.2% (0.5% Central, 0.65% West)
    g. Safe Transportation for Children, 4.5% (0.5% Central, 0.725% West, 3.32% Southwest)
    h. Ferry Service in West County, 2.3% -- potential hybrid component.

2. Subject to Authority confirmation, each of the above program sub-divisions would receive an annual allocation equal to the specified percentage of annual revenues.

3. Shifting funds from one or more of these categories from operations to capital improvements would have to be accomplished through:

    a. Annual set-asides to accumulate a capital reserve, and/or
    b. Deferral of operating expenses in lieu of capital investments early in the program, possibly combined with set-asides or debt payment for subsequent capital needs; and/or
    c. Diversion of an agreed-upon proportion of the annual revenue stream to support debt repayments for the bond issue(s). (*As with project categories, programs would need to absorb the cost of financing if bonds were used to advance capital projects.*)

MEASURE J PROGRAM SPECIFICS

4. For the above Measure J programs, the annual percentage allocations will apply, by sub-area, subject to the following additional considerations:

    a. **Paratransit.** Measure J explicitly states the percentage of annual revenues that each sub-area of the county will receive.

        i. Each sub-area's specified percentage of sales tax revenues increases by a specific increment each year.

ii. Existing operators will continue to receive their FY 2008-09 share of the "base" Measure C allocation to sustain existing Measure C-funded operations if desired.
iii. Accordingly, policy deliberations will likely be focused on the increments of new funding each year, and the specified sub-regional increments of 0.5% for Central and 0.65 % for West.
iv. Measure J provides for the percentage of revenues allocated to paratransit to increase over time. Such increases will need to be factored into the Strategic Plan. Staff suggests that either project funding levels provide the offset over time, or reserves be gradually accumulated, or some combination thereof.
v. Specifically allocated funding for the "core" program totals 4.7% of revenues, while 5.0% is committed in aggregate. The balance of 0.3% would be available to create a contingency reserve, and/or stabilize revenues in years when sales tax revenues do not grow at or above the rate of inflation. (In the current FY 2005-06, 0.3% would represent approximately $210,000 to $225,000.)

b. **Bus Transit.**

i. The base allocation for bus transit in Measure J is 5%, providing funding to continue existing services (the sub-allocation in the Measure is based on current allocation percentages), plus 0.1% for flexibility.
ii. Additional funding of 1.2%, Central, and 2.225%, West, is presumed to primarily be for operating expenses as well, and would be reserved for annual allocations unless re-directed per (3) above.

c. **Commute Alternatives.** This category is intended to provide and promote alternatives to single occupant vehicles. The Measure C program included some capital investments and also supports staff of the RTPCs. Any capital investments from this program would need to be funded consistent with (3) above.

d. **Express Bus.** Because this category includes funding for both operations and capital expenditures necessary to support them, the bus operators should develop a financial plan for consideration by the Authority. The plan should factor in other sources of revenue, such as the Regional Measure 2 program. The Measure language states explicitly "(r)eserves should be accumulated for periodic replacement of vehicles consistent with standard replacement policies."

e. **Safe Transportation for Children.** To the extent that operating programs are established for use of these funds, such programs would be assumed to require a fixed percentage of annual revenues each year to be sustained. This would apply to West County, the Lamorinda School Bus program, and the San Ramon School Bus program. Capital costs would be addressed consistent with

(3) above, on either a sub-area basis or an agreed-upon cash flow program from within the element's annual percentage of revenues.

f. **Ferry Service in West County.** West Contra Costa, working with the Water Transit Authority, will need to develop a plan for application of these funds. The funds can be used for capital and/or operations.

   i. Recognizing that the funds may not be sufficient to operate the desired level of service for 25 years, Measure J language states "Funding priority should be given to routes that demonstrate long-term sustainability."
   ii. If capital investments were desired, they would be subject to (3) above.

g. If any operator wished to receive more than its category's *pro rata* share of annual revenues to support operations, either the start of services would need to be delayed to accumulate additional funds, or other program or project allocation offsets would need to be identified (presumably within the same area of the County). The Authority should carefully evaluate the service's long-term financial stability before authorizing such an approach.

ESTABLISHING OPERATING RESERVES

Relative to transit and paratransit operations, some parties have expressed an interest in creating a "reserve" fund against significant economic downturns, to buffer potential operating service reductions that might otherwise result. Such a reserve could be created either by deferring the start of new services, and/or by setting aside a portion of annual revenues each year. For years in which sales tax revenues increase at or above the rate of inflation, the Measure does specify that the Authority will require each operator to retain up to 3 percent of its annual allocation to accumulate as a reserve for its operating programs as a contingency.

Specifically, the Measure J Expenditure Plan states:

> *"For the transit operating programs (bus services, transportation for seniors and people with disabilities, and express bus), for years in which sales tax revenues increase at or above the change in the CPI, the Authority will require that each recipient/operator retain up to 3% of its annual allocation to accumulate in a reserve. The reserve would be available as a contingency for application when 1 or more periods of decline in sales tax revenues, in inflation adjusted dollars, requires application of the funds to "smooth out" the flow of revenues. The reserves would be available to sustain operations in the event of such economic downturns."*

Using the reserves to smooth out the effects of business cycles could be beneficial to operators. Each of the transit operating programs would receive a certain percentage of annual sales tax revenues. However, the growth of sales tax revenues – both in current dollars, and inflation adjusted terms – varies from year to year. For example, during the

Measure C period to date, sales tax revenues increased by more than the CPI in 9 of 15 years. Conversely, inflation adjusted sales tax revenues declined in 6 of 15 years.

Presently, in the Bus Transit program, payments are made to the operators quarterly in advance. For example, the payment for the first quarter of a fiscal year is made on July 1. Quarterly payments are calculated on the basis of budgeted sales tax revenues for the upcoming year. When actual sales tax revenues are higher than the original budget estimate, funds accumulate in the Bus Transit program reserve. When actual sales tax revenues are lower than the original budget estimate, Bus Transit program reserves are drawn down. Reserves can also be drawn down as part of the allocation process. When a large Bus Transit program reserve accrued in FY 2000-01 because actual sales tax revenues were much larger than anticipated, the balance was drawn down over the subsequent "lean" years when the transit operators experienced a decline in TDA revenues.

In the Paratransit program, payments are also made quarterly in advance. For the Paratransit program, however, a reserve was deliberately built up to a level of about $2 million to ensure that: 1) paratransit service could continue to be provided under various economic circumstances, 2) special projects could be accommodated, and 3) the paratransit program could continue for a period beyond the end of Measure C. At the time of the economic downturn from 2001 to 2005, and later following passage of Measure J, the Paratransit Coordinating Council recommended a revision to the allocation policy to annually disburse $300,000 of the paratransit reserve according to an adopted formula.

Measure J establishes formula apportionments to bus and paratransit services. If 3% reserves are established initially, annual allocations can be determined as part of the annual budget in May. At that time, sales tax revenues and the CPI for the year ending June 30 would be known with a fairly high probability, and reserve drawdown / replenishment recommendations could be developed for the upcoming budget year.