Metro

FINANCE AND BUDGET COMMITTEE
JUNE 14, 2006

SUBJECT: **FY07 BUDGET**

ACTION: **AMEND THE FY07 BUDGET TO LOWER EXPENDITURES AND ESTABLISH AN OPERATING RESERVE POLICY**

RECOMMENDATION

A. Amend the FY07 budget to lower expenditures by $16.3 million for the following projects or programs:

   1. Reduce the sheriff's contract by $1.5 million to take advantage of projected vacancy savings;
   2. Reduce insurance expense by $800,000 to reflect savings realized on renewal of property policies;
   3. Reduce pension expense by $1.0 million to reflect updated actuarial assessment;
   4. Reduce the tire lease contract by $2 million by substituting lower-cost acceptable tires;
   5. Defer $1.0 million of expenses for the Union Division capital project (CP#202001) to FY08; and
   6. Reduce the annual cash flow projection by $10 million for the Light Rail Vehicle Fleet Enhancement project (CP#800151).

B. Direct staff to develop a proposal for an operating reserve policy for the region of 5% of the total monies subject to the formula allocation procedure beginning in FY08.

ISSUE

During budget adoption the board requested that staff return to the board with additional recommendations for potential budget reductions and to provide the board with a recommendation to adopt an operating reserve policy.

DISCUSSION

Budget Reductions

The board adopted the FY07 budget at the May 23, 2006 board meeting with an amendment to the proposed budget to reduce the budget as follows:

- $1.3 million for reduction of 13 FTE's (in addition to the four FTE's reduced in the budget)
- $1.1 million to defer the purchase of 40 hybrid sedans

These cuts were in addition to $15 million that was reduced in the original budget proposal. At the May meeting, the Board directed staff to return in June with an additional $10 million of reductions. Staff met with Board staff and discussed each program and project included in the FY07 budget. A list that totaled $10 million was developed at that meeting. Subsequent to that meeting staff continued to review expenditures and identified three additional projects for reduction. The recommended reductions total $16.3 million and have been negotiated or confirmed with all involved parties.

- The Sheriff's department agreed to reduce the contract based on their anticipated vacancy rate. The service level will be maintained at the FY06 actual level.
- The property insurance policies recently awarded were less than the proposed budget. Earthquake coverage was deleted in order to stay within budget parameters.
- Final pension costs on our self-insured plans were approved in June by each of the unions at the actuary's recommended amounts which were slightly less than preliminary estimates made during the budget preparation cycle.
- The tire lease contract was pending award at the time of budget development. A subsequent review of the bidders products convinced Metro operations staff that a lower-cost tire would be an acceptable substitution resulting in a $2 million savings to the FY07 budget.
- The Union Division project will be proceeding with environmental approvals and preliminary engineering next year. The Project Manager has determined that the cash flow can be reduced by $1 million in FY07 without negatively impacting progress on the project.
- The Light Rail Vehicle procurement project is proceeding on schedule and within budget. The initial cash flow of $49 million was based on a prior cash flow that has since been reevaluated. The Project Manager determined that the cash flow can be reduced by $10 million in FY07 to $39 million without negatively impacting progress on the project.

Other potential reductions totaling $5.8 million discussed with Board staff but not recommended due to the severity of the impacts to bus and rail operations include the following capital projects:

- Defer $1.2 million of the Underground Storage Tank Replacement project (CP#202026). Metro is required to replace the underground tanks as they age or develop leaks. The total project is budgeted at $2.4 million for replacement of about 10 tanks; this deferral will result in about 4 tanks being removed. The rest of the budget is used for complying with regulatory requirements. The deferral carries an amount of risk of environmental sanctions, so although possible, it is not recommended at this time.

- Defer $1.0 million from the project to Replace the Unitload Crane Controllers at the RRC (CP#209032). The crane controllers were first installed at the RRC in 1984 to assist staff to reach inventory items in the warehouse. The crane controllers have outlived their expected useful life and require extensive maintenance each year to keep them operational. The project has been on the deferred capital list for the past five years. The deferral could compromise material support to Transit Operations should the cranes break down, therefore, it is not recommended at this time.

- Defer $800,000 from the ITS Telecommunications Transmission Replacement project (CP#207010). This project will provide improved communications with the operating divisions throughout the county. When completed the project is anticipated to save $800,000 each year in operating costs. The total project cost is $10 million with planned completion in FY10; the planning phase was started during FY06 and approximately $240,000 will be spent by year-end. The deferral will delay implementation of the project and eventual operating cost savings, therefore, it is not recommended at this time.

- Defer $2.5 million from the Bauchet Street Construction project (CP#202205). This project will provide an additional warehouse near the RRC on land that was purchased for this purpose during the FY06 budget year. Provision of the additional storage and maintenance space is required due to the impending closure of Metro's South Park facility. The warehouse will be constructed to provide bulk material storage space for bus and rail material, parts, supplies and will provide shop space for Facilities Maintenance personnel displaced from South Park. Furthermore, this project is proposed to be funded in the FY07 budget with bond funds which were programmed to Metro for another purpose and were not necessary. Therefore, deferring the project provides no positive benefit to the operating deficit. The deferral is not recommended at this time.

Staff also looked at the bus and rail operating budget to identify programs or projects that are being introduced in FY07. One area that is being improved in FY07 is field supervision for bus operations. Thirteen additional Transit Operations Supervisors FTE's were added to the FY07 budget at the South Bay Sector (5), Westside/Central Sector (5) and San Gabriel Valley Sector (3). These positions are currently being recruited for placement after July 1, 2006. Eliminating these thirteen positions would result in a $1.3 million reduction to the bus operating budget. This reduction is not recommended because field supervision is a critical element of providing safe and reliable bus service. Although we have expanded bus operations, we have not added field supervision (with the exception of the Orange Line supervisors added last year).

Many of the services contracts have increased in FY07 due to rising fuel prices, and the increasing cost of goods and services. As Metro rebids contracts that have reached their expiration dates, it is possible that many of the contracts will contain price increases. The FY07 budget includes some funding for potential cost increases to services contracts. A reduction of $500,000 could be made to the Transit Operations Facilities Maintenance budget if it is assumed that cost increases will not occur or will be mitigated by cost decreases in other areas. This reduction is not recommended at this time but will be monitored by staff throughout the year.

Metro continues to look at other options for reducing FY07 expenditures. Travel, training and miscellaneous costs have been reduced for the third year in a row but will continue to be closely managed by all supervisors. Services costs will be monitored throughout the fiscal year with the goal of making reductions whenever possible (as was achieved in the FY06 budget). Metro will continue to look into fuel purchasing methods to improve regional fuel prices. Reducing costs is an ongoing effort that will continue to be one of Metro's highest priorities.

Operating Reserve Policy

Transit agency board-approved reserve policies were difficult to find. Staff conducted a survey focused mainly on California transit agencies due to the similarities in funding sources. Smaller agencies seem somewhat more likely to adopt and attempt to follow a reserve policy. The Government Finance Officer's Association (GFOA) recommends operating budget reserve policies of 5%-15% percent for its members, and many smaller California cities adopt policies even greater than the GFOA's recommendation. The sources for the information were individual websites and/or telephone contacts at transit agencies listed as well as the California Society of Municipal Finance Officers article titled "Management of Public Funds: The Adoption of Reserve Policies in California Cities".

	Transit Agency	Reserve Policy	Notes
1	Valley Transportation Agency (VTA) Santa Clara, CA	Not less than 15% of the operating budget in any fiscal year.	Draw downs must be restored in the following year, and can result in budget and service reductions.
2	San Francisco County Transit Authority	Not less than 5% and up to 15% of estimated sales tax revenue	Must be shown as a separate line item in the annual budget.
3	San Francisco Municipal Railway (MUNI)	5% reserve in current proposed FY07 budget	Proposed only, no current policy.
4	Alameda County (AC Transit) Oakland, CA	Sets aside 1% annually to a max of 10% of operating budget	

	Transit Agency	Reserve Policy	Notes
5	Bay Area Rapid Transit (BART)	5% of the operating budget	Only set aside once. Was to be funded from revenue enhancements such as Lease/Leaseback. Separate Board adopted Financial Stability Policy with automatic fare increase triggers.
6	Cal Train Commuter Rail (Bay Area)	10% of annual operating expenditures	To be funded from surplus revenues as they are generated over time. Currently no surpluses to fund contingency.
7	San Mateo County Transit (SamTrans), CA	No current policy.	Staff would like board to adopt a policy, however, no surpluses to fund it with.
8	San Diego Transit Development Board, Metropolitan Transit System	5% of annual operating budget	Adopted as part of FY05-09 Financial Plan.
9	Riverside Transit Authority (RTA)	10% operating budget	Changes annually. Board adopts a policy during budget process, depends on allocations from Riverside County Transportation Commission.
10	Orange County Transportation Authority	No policy.	
11	Pierce Transit, Tacoma WA	Maintain a minimum 2 months operating expenditures (16.6%)	To offset unanticipated downturns in revenues and provide funds for emergency expenditures. Not always able to fund at level adopted in policy.

	Transit Agency	Reserve Policy	Notes
12	TriMet Portland, OR	8% of budgeted Passenger Revenues 25% of budgeted Diesel Fuel Costs	Different contingency levels adopted for certain line items. Policy also requires the agency to come up with a plan, which could include fare increases, whenever fuel prices increase at least 10 percent over the budgeted amount for two months.
13	Dallas Area Rapid Transit (DART), TX	Sets aside sales tax revenues in excess of budgeted amount into a Financial Reserve	Requires 2/3 vote by Board to utilize Financial Reserve.
14	Washington Area Metro (WAMTA), DC	1% of operating budget	For FY06 staff proposed increasing reserve to 2%, rejected by Board.
15	Chicago Regional Transportation Authority, IL	5% or more of annual operating budget	Board adopts a three year budget plan, must be at or above 5% by the end of the three year plan period
16	Greater Cleveland Regional Transit Authority, OH	Budget reserve equal to one month's (8.3%) operating expense	

One potential proposal is to establish a regional operating reserve fund that is equal to 5% of the total funds subject to formula allocation procedure (FAP), providing reserve contingencies for Metro as well as the Municipal operators. For the first year, the reserve fund would be funded 100%; in subsequent years only the incremental amount would need to be funded to bring the reserve fund to 5% of the total FAP. The purpose of this operating reserve would be to protect existing services from extraordinary revenue shortfalls or expense increases. Any draws from the reserve would require specific Board approval. The reserve balance would be required to be restored to 5% in the following budget year.

FINANCIAL IMPACT

The reduction of $16.3 million identified in the recommendation will result in the operating budget deficit being lowered in FY07 by $5.3 million. To achieve a $10 million reduction to the operating deficit would require all of the non-recommended reductions be approved. These reductions are not recommended because reducing or delaying them now may result in additional costs in the future as identified in the discussion for each proposed reduction.

The recommended reductions, combined with the Board action at the May meeting to reduce the deficit by $2.4 million, will reduce Metro's use of Proposition C40% reserves to fund the deficit from $112 million to $104.3 million. Some of the recommended reductions are funded by either bond funds or grant funds and will not lower the deficit but will better align the cash flows with the forecasted expenditure plans.

The Proposition C40% fund balance reported to the Board during budget adoption was estimated to be $19.8 million before the Board motion to program $6 million for the municipal operator's fuel increases which resulted in a revised fund balance of $13.8 million. Since $12.5 million is reserved for the Eastside Enhancements project, the projected fund balance at the time of budget adoption was $1.3 million. The recommended reductions will increase the available fund balance to $9 million.

There will be no impact of the regional operating reserve on the FY07 budget. In FY08, approximately $40 million would have to be set aside prior to allocation of the FAP.

NEXT STEPS

Monitor budget expenditures throughout FY07 to continue to identify areas for savings. Begin development of regional operating reserve.

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