BUDGET AND RESERVE POLICY
BOARD OF DIRECTORS
APRIL 15, 2020
OVERVIEW

- Budget impacts of the failure of Measure I
- Setting a minimum reserve policy
- The financial impact of the COVID-19 shut-downs
- Budget timetable and process
BUDGET OUTLOOK FOLLOWING ELECTION

- Measure I would have allowed refinancing of debt for construction of the SMART system

- Average reduction of $12 million per year in debt service cannot be achieved

- Long-term stability will require expenditure reductions of $9 million as shown during the strategic planning process in 2019
BUDGET OUTLOOK FOLLOWING ELECTION

- Budget problem identified in 2019, IF NOTHING CHANGES:

<table>
<thead>
<tr>
<th></th>
<th>CURRENT YR</th>
<th>PROJECTIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2019-20</td>
<td>2020-21</td>
</tr>
<tr>
<td>Operations Revenue</td>
<td>$51.0</td>
<td>$56.5</td>
</tr>
<tr>
<td>Operations Expense</td>
<td>-$41.3</td>
<td>-$43.2</td>
</tr>
<tr>
<td>Debt Service</td>
<td>-$16.7</td>
<td>-$17.4</td>
</tr>
<tr>
<td>Capital Expenses Not Covered by Grants</td>
<td>-$12.2</td>
<td>-$0.3</td>
</tr>
<tr>
<td>Subtotal (Needs Reserves/Annual Deficit)</td>
<td>-$19.2</td>
<td>-$4.4</td>
</tr>
<tr>
<td>Starting Unrestricted Reserves</td>
<td>$26.5</td>
<td>$7.3</td>
</tr>
<tr>
<td>Ending Unrestricted Reserves/Cumulative Deficit</td>
<td>$7.3</td>
<td>$2.9</td>
</tr>
<tr>
<td>Agency Reserve</td>
<td>$17.0</td>
<td>$17.0</td>
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</table>

- Original budget challenge to reduce expenditures, original estimates to address would have meant $3 million in reductions in EACH of the next three Fiscal Years
- Total of $9 million in reductions would have solved for future imbalance that would have eliminated reserves if nothing were done.
REFINANCING AS COST SAVING STRATEGY

- Without Measure I and additional years to spread the construction debt, the significant $12 million per year reduction in debt service we had hoped to achieve cannot be realized.

- Prior to 2020 we did not project significant benefits to refinancing within the existing bond term because rates were much higher.

- Decline in interest rates in recent weeks, potential for opportunities to refinance the outstanding Measure Q Sales Tax Revenue Bonds to generate some debt service savings does exist.

- In conjunction with SMART’s expert Municipal Advisor, PFM Financial Advisors LLC, we are monitoring the municipal bond market for an opportunity to lower our payments.
REFINANCING AS COST SAVING STRATEGY

- Using rates that existed on April 3, a taxable advance refunding could generate between **$1.1 and $2.5 million** of annual cashflow savings through FY2029 depending on the structure, terms and other factors. This is far below the $12 million Measure I sought to achieve.

- A number of things could affect that pricing, including the willingness of investors to participate, a change in rates or credit ratings, and continued economic uncertainty, along with the ability to call the bonds earlier than 2029.

- We are evaluating two structures:
  - A negotiated public offering
  - A “private” or direct placement of debt

- Public Offering
  - Longer process that might result in no savings to SMART due to the time involved, volatility in the market, credit process and other factor.

- A Direct Placement
  - Approved by the Board
  - Places debt directly with a financing entity
  - Saves time, allowing us to capture potential savings before they disappear
MINIMUM RESERVES

- Currently benefitting from our reserves which allow us time to address the fiscal crises
- Reserve policies adopted by other entities are as follows:

<table>
<thead>
<tr>
<th>Agency</th>
<th>Published Reserve Policy</th>
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<tbody>
<tr>
<td>City of Santa Rosa</td>
<td>15-17% of Annual Expenditures</td>
</tr>
<tr>
<td>City of San Rafael</td>
<td>10% of Annual Expense</td>
</tr>
<tr>
<td>City of Novato</td>
<td>15% of Annual Expense</td>
</tr>
<tr>
<td>County of Sonoma</td>
<td>8.3% of Annual Revenues (One Month)</td>
</tr>
<tr>
<td>County of Marin</td>
<td>5% of Annual Expense</td>
</tr>
<tr>
<td>Golden Gate BH&amp;TD</td>
<td>7.5% Annual Operations, 3.5% Emergency</td>
</tr>
<tr>
<td>SF MTA (Muni)</td>
<td>10% Annual Operating Expenses</td>
</tr>
<tr>
<td>Utah Transit</td>
<td>9.33% of Annual Expense</td>
</tr>
<tr>
<td>Trimet, Portland</td>
<td>2.5 Months Operating Expense (21%)</td>
</tr>
<tr>
<td>VTA (Santa Clara)</td>
<td>15% of Expense, Sales Tax stabilization fund $35 M (10%)</td>
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- Minimum reserves should be large enough to weather a TYPICAL financial challenge, without putting too much capital aside that is needed for other operating challenges
MINIMUM RESERVES

- SMART’s challenge is to recognize the significant role that sales tax plays in funding our budget.

- We recommend a minimum reserve policy that preserves $10 million as your minimum for Fiscal Year 2021 and beyond.

- This calculation is 25% of our Fiscal Year 2020 ongoing operations expenditures (excluding capital project and debt costs). This is higher than most entities carry but necessary given the uncertainty we continue to face.

- $10 million should be a minimum dollar amount despite our plans to reduce expenditures in the coming months.

- Further, we recommend that your Board adopt a policy that states the use of SMART’s reserve should require a 2/3 vote so that the use of the funds is preserved.
NEW BUDGET CHALLENGE: COVID-19

- The COVID-19 shelter-in-place order presents a giant new challenge
  - Loss of Fare revenue immediate $90,000
  - Staff vacancies, new leave mandates (unfunded)
  - Unknown but significant sales tax revenue impacts

- Challenge of anticipating sales tax impact when receipts lag 2-4 months behind transactions

- Further challenge of anticipating impacts of Governor’s order allowing businesses 90-day extensions, and, in some cases, up to 1 year to submit their tax receipts
  - Small businesses (with taxable sales of $5 million or less) can defer remittance of their sales and use taxes for up to one year to July 2021.
  - Approximately 360,000 filers will be eligible for deferral of up to $50,000 in what is essentially an interest-free loan from state and local agencies.
NEW BUDGET CHALLENGE

- Our initial projection:
  - Loss of 20% sales tax related revenue in Fiscal Year 2019-20 which ends in June.
  - Loss of 30% in budgeted fare revenue for Fiscal Year 2019-20.
- Total losses of $11 million in Fiscal Year 2019-20 as shown in red

<table>
<thead>
<tr>
<th>FISCAL YEAR 2019-20 IMPACTS OF SHELTER-IN-PLACE</th>
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<tbody>
<tr>
<td>Measure Q - Sales Tax</td>
</tr>
<tr>
<td>Original $39,312,541.0</td>
</tr>
<tr>
<td>Revised $31,450,033</td>
</tr>
<tr>
<td>(loss) $(7,862,508)</td>
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<tr>
<td>State Rail/Transit Funding</td>
</tr>
<tr>
<td>Original State $7,786,239</td>
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<tr>
<td>Revised State $6,228,991</td>
</tr>
<tr>
<td>(loss) $(1,557,248)</td>
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<tr>
<td>Fare Revenue</td>
</tr>
<tr>
<td>Original $4,137,000</td>
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<tr>
<td>Revised $2,482,200</td>
</tr>
<tr>
<td>(loss) $(1,654,800)</td>
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<tr>
<td>Total Loss (Projection) $ (11,074,556)</td>
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“CARES” ACT RELIEF

Coronavirus Aid, Relief, and Economic Security (CARES) Act

- CARES Act provided $25 billion to public transportation systems
- $1.3 Billion to the Bay Area
- Funds have been allocated for the specific use of maintaining transit staff and a reasonable level of service by backfilling for both the loss of revenues and the reimbursement for expenses as a direct result of COVID-19.
- 27 Bay Area General Managers and Metropolitan Transportation Commission (MTC) Executive staff have been negotiating since Congress settled on an amount
- Subject to MTC approval on April 22 and then Federal Transit Agency (FTA) grant approval
- SMART’s initial allocation is estimated to be $10 million
- May be additional funds forthcoming in the coming months as only 60% of the funds are being proposed to be allocated at this time.
“CARES” ACT RELIEF

Initial $10 million grant will partially address our estimated Fiscal Year 2019-20 loss.

However, impacts to SMART likely to continue--

- Rosy scenario:
  » Short-lived impact with quick revenue recovery
  » Unlikely given the broad economic shock we are experiencing

- More likely scenario:
  » Could take a year or more for sales tax to return to pre-COVID-19 levels.

- In the likely scenario: Preparing for second impact of an $11-14 million loss in Fiscal Year 2020-21 beginning July 1.

- A second negotiation with the Bay Area transit operators over remaining CARES Act allocations would assist with this impact

- Recovery likely to take much longer and impacts could be much higher.
Budget Composed of Three Different Parts: Capital+Administration+Operations
CAPITAL BUDGET

- FY 2019-20 current budget of $51 million

- Almost entirely grant funded, one time in nature

- Reductions will not significantly impact operating imbalance
ADMINISTRATION EXPENSES FY 2019-20
$29 MILLION

- Debt Service 58%--$17 M
- Salaries and Benefits 18% -- $5 M
  - 31 FTE
- Services and Supplies 24%--$7 M
  - (IT, Rent, Outreach, Insurance)
OPERATIONS EXPENSES FY 2019-20
$32 MILLION
NEW BUDGET CHALLENGE

First Challenge: Measure I failure eliminating significant debt service relief

Second Challenge: Predicting and absorbing sales tax losses until the economy recovers

- Originally planned to close the Fiscal Year with significant reserves, which allow us some cushion but will be quickly depleted without significant revenue and expenditure changes.
- Prior target of $3 million for Fiscal Year 2021 now increased
- Now looking for **targeted reductions of up to $6 million**
- $6 million chosen as an aggressive but potentially achievable amount in the coming year
- The sooner we can find reductions and implement them, the quicker we will be able to address both the immediate revenue crises and long-term structural problem.
NEW BUDGET CHALLENGE

- Three major strategies for budget reduction proposals for FY 2020-21.
  - One-time savings
  - Reduction in Ongoing Expense, Salary and Non-salary
  - Reduction in Ongoing Expense Due to Reductions in Service

1. One-time savings
   Expenditure reductions for planned items that will now be deferred, such as:
   - Deferral of machinery and equipment
   - Extended replacement cycles for vehicles
   - Deferral of mitigation measures and enhancements
   - Deferral of non-safety capital projects and matching funds
NEW BUDGET CHALLENGE

2: Reduction in Ongoing Expense, Salary and Non-salary:

Important but could be considered for reductions without a direct impact on the SMART train schedule. Items such as:

» Train WiFi service
» Information Technology upgrades and servicing
» Customer service contract with Golden Gate Bridge District
» Debt refinancing
» Federal and state advocacy services
» Communications/outreach contracts and activities
» North County bus service
» Elimination of non-critical vacant positions
» Discussing with our unions various means of reducing labor costs, including a possible wage reopener for the current July 1 increases.
NEW BUDGET CHALLENGE

3: Reduction in Ongoing Expense Due to Reductions in Service:  Such as

» Running fewer trains
  Fewer trains would mean a decrease full-time staff and related expenses
  Fewer trains would mean reductions in fuel, materials, other services

» There is a potential for loss in either direct fare revenue or related revenue from State and Federal sources and the savings would be reduced by these losses.

» Could impact our ability to compete for service expansion grants depending on the severity of the cuts.
NEW BUDGET CHALLENGE

- There will be significant impacts to our riders of reductions that could reach $9 million or more over time.

- There is no way to cushion the impact of such a change from our everyday operations functions. There is no other place to look for reductions.

- Length of time of the economic downturn will impact decision making.

- A larger, more long-lasting economic downturn would mean that this initial $6 million target could be followed by a new effort to reduce expenses shortly thereafter rather than waiting for the next budget cycle.
NEXT STEPS

- **April 15:** Briefing on targets and reduction categories
- **April 21:** Citizens Oversight Committee discussion of budget and refinancing
- **May 6:** Update on budget process and any follow-up from April
- **May 20:** Preliminary Budget Presentation and Discussion
- **June 3:** First opportunity for Board Approval of FY 20-21 Budget
- **June 17:** Final opportunity for Board Approval of FY 20-21 Budget