STAFF REPORT

MEETING DATE: 9/8/2021 **Staff Report No.** 21-140d

TO: **AC Transit Board of Directors**

FROM: **Michael A. Hursh, General Manager**

SUBJECT: **FY 2021-22 Budget Adjustment with ARP Act funds**

ACTION ITEM

RECOMMENDED ACTION(S):

Consider adoption of Resolution 21-035 amending the General Fund FY 2021-22 Operating Budget.

STRATEGIC IMPORTANCE:

Goal - Financial Stability and Resiliency
Initiative - Financial Efficiency and Revenue Maximization

The Board adopted a balanced FY 2021-22 budget in June and requested staff return with adjustments to the budget based on American Rescue Plan (ARP) Act funding availability.

BUDGETARY/FISCAL IMPACT:

If adopted as shown, the revised FY 2021-22 Operating Budget will be balanced and include a projected operating revenue and subsidy budget of $499.0 million and an operating expense budget of $499.0 million. These figures are outlined in Attachment 2. The $499.0 million budget represents an increase of $19.3 million over the original Recommended Budget adopted by the Board on June 09, 2021. There are no changes to the FY 2021-22 Capital Budget.

BACKGROUND/RATIONALE:

On June 9, 2021, the AC Transit Board approved the FY 2021-22 budget of $479.7 million which included $55.5 million Coronavirus Response & Relief Supplemental Appropriations (CRRSA) funding to balance the budget at the 85% service level. The American Rescue Plan (ARP) Act funding amount was unknown at the time and was not included in the budget. Staff was instructed to revise the budget when the ARP Act funding amount became known. In addition, staff was instructed to create a list of items the ARP Act funds could be used to pay for.

After the original budget adoption, the District was allocated $66.1 million in ARP Act funding on July 28, 2021, by the Metropolitan Transportation Commission (MTC). The first allocation of funds to all regional transit agencies was roughly 60% of the total ARP Act funds. MTC does not expect to allocate the remainder of the funds until at least the end of the calendar year. There have been some preliminary discussions of how the remaining ARP Act funds will be distributed, and staff is not at all certain that the District will get a similar proportion of the remaining funds. Due to this uncertainty, staff is conservatively assuming only $66.1 million is available in the revised budget and in future year projections.

Operating and Financial Challenges
The challenge for the District continues to be increasing service at a rate that makes sense given operational resources and its financial outlook. Operationally, the District must recruit, train, and retain Bus Operators at levels that exceed attrition and meet the requirements to increase service. The District is currently budgeted to reach 85% of service in FY 2021-22. Increasing service to 90% will require the district to increase the active operator count from approximately 1201 to 1268, a net increase of 67. Reaching this goal in FY 2021-22 is far from certain given an average attrition rate of seven operators per month. The proposed budget revision includes a Bus Operator hiring incentive on the spending list that will hopefully help to increase monthly training totals. Even under optimistic scenarios, reaching an Operator count that can accommodate 90% of prior service levels is unlikely until FY 2022-23.

While the District has the revenues to increase service to 90% in FY 2021-22 with the use of ARP Act funding, the real challenge is sustaining these higher levels of service after the ARP Act funding is used up. The projections included in this report show that the District is unlikely to be able to continue higher service levels without significantly increased or new revenues. Staff has clearly heard the call for increasing service to pre-pandemic levels, but at this point does not yet have a financial plan to support these sustained service levels beyond the next two fiscal years.

Expense Adjustments
A list of new spending totaling $19.3 million in FY 2021-22, including $16.2 million on-going and $3.1 million one-time expenses is included in Attachment 4. In looking at new expenses, staff relied on a few criteria:

1. Rebuild ridership and service
2. One-time expenses
3. Critical initiatives

This criteria was combined with the desires expressed by the Board and staff in discussion of major issues: service increases and the needed operator increases; continued protection of staff and riders from COVID; better information on our riders and their preferences; and finding the best way to ensure the safety of staff and riders in service. In addition to the expense increases associated with these initiatives, fare revenue is reduced by $388,000 due to prior Board approval of fare-free Fridays in September 2021 to try and boost ridership.

To balance the budget, it will be necessary to include $19.3 million of ARP Act funding (see Attachment 2).

The new spending list of $19.3 million includes $13.4 million of labor related items and $5.9 million of non-labor items. These items are listed in Attachment 4 and summarized as follows:

1. Service level increase - $10 million to increase FY2021-22 service levels from the current planned 85% to the 90% service level.
2. Bus Operator Training and Incentives - $524,750 is included to help increase and retain operators so that service levels can be increased over time:

   a. New Operator hiring bonus $168,000
   b. New Operator referral bonus $56,000
   c. Operator recruitment advertising extension $300,750
3. COVID Protection - $2.0 million for COVID related expenses:
   a. Temperature Checkers $1.0 million
   b. Ongoing PPE $1.0 million
4. Personnel - $3.1 million
   a. Ten Non-Operator new positions $2.1 million (Attachment 5)
   b. Bus Operator Overtime $1.0 million
5. Operations $3.3 million
   a. Fuel Adjustment: $2.1million
   b. Departmental Requests: $930,736
   c. Mobile App 2.0 with Trip Planner: $200,000
   d. Contra Costa Sheriff Contract Audit: $60,000
6. Others $300,000
   a. Rider Survey/Customer Satisfaction Survey: $300,000

Staff has begun discussions with ATU leadership on hazard pay at the request of the Board. These discussions have not progressed far enough to enable an amount to be included in the budget, so they are listed as $TBD. Staff will make the necessary adjustments up to and including an additional budget amendment if warranted to accommodate any agreed upon hazard pay.

Revenue Adjustments
The adopted budget includes a $388,000 revenue reduction due to prior Board approval of fare-free Fridays in September 2021.

Other Potential Uses
There are a couple other potential uses of the ARP Act funds which would save the District money over the long term. These are presented to the Board to show the full breadth of the District's major obligations.

(1) Tempo Project Line of Credit
The District is in the close out phase the Tempo Bus Rapid Transit Project. In July 2019, the Board approved the opening of a $35 million temporary line of credit to fund the Tempo project through construction completion. The line of credit was part of an overall plan that included converting the short-term line of credit debt to long-term debt once the project was complete and the final costs known. At this point in the closeout, the total construction costs are relatively well known, although claims by the contractor are still pending. The line of credit sunsets in August of 2022 and staff will need to begin the process for conversion to long-term debt in December of this year if the original plan is still pursued.

However, instead of the original plan, the District can look at paying off the line of credit without taking out longer term debt. To date, the District has spent approximately $28 million of the $35 million from the line of credit. The District could decide to use ARP Act funds to supplement its current revenues which would allow payment of the line of credit debt. The significant benefit to paying off the debt now is avoiding the significant interest costs from a long-term borrowing. Even with current low interest rates, staff expects that a 15-year term borrowing will end up costing nearly $10 million in interest. The additional debt will also take a significant amount of staff time to implement and administer.

(2) Salesforce Transit Center Capital Commitment
In 2008, the District signed a Lease and Use Agreement (LUA) with the Transbay Joint Powers Authority, which specifies the details of the District's use and obligations to the construction and operations of the Salesforce Transit Center. The LUA includes a capital commitment of $57 million to be paid by 2050. The commitment is pegged to 2011 dollars at a 4.5% discount rate, which means that the longer the District takes to pay off this debt, the more it "costs" the District. In other words, a dollar paid in 2011 would lose value against the commitment at 4.5% per year, so in 2020 that dollar is only worth 66 cents against the original commitment.

The District has paid $34.2 million of the $57 million commitment, which leaves $22.8 million outstanding. The District could also choose to use some of the ARP Act funds to effectively pay off part or all of its capital commitment. If the Board is interested in paying off the capital commitment, staff at this time would recommend a partial payment of no more than $3 million at this time.

Financial Projections
Staff has updated its financial projection to show what impact the new spending items have on the FY 2021-22 budget and beyond in an effort to show what the District's financial status is after the ARP Act funds are used up. This projection is shown in Attachment 3.

Under this projection, the District is expected to experience deficits totaling $154.8 million over the four projected years. The projection includes service levels gradually increasing to 100% by FY 2024-25 with expenses increasing to support these levels.

Before the pandemic, the District had been able to match revenues and expenses for several years. The pandemic has pushed the District into a structural imbalance as shown in the projection. The District is not alone in this predicament, for example the San Francisco Municipal Transportation Agency (SFMTA) has said they will be unable to restore to prior service levels without new revenues.

The primary reasons for the projected mismatch of revenues and expenses are as follows:

1. Significantly reduced farebox revenue - The approved FY 2021-22 budget includes farebox revenues around 50% of pre-pandemic levels. It will likely be a few years before farebox revenues reach prior levels.
2. Lost ground on sales tax revenues - the pandemic caused a temporary drop in sales tax revenues, which effectively means the District lost a couple years of growth in those revenues. The sustained growth in sales tax revenues was the main reason the District was able to balance revenues and expenses in the several years before the pandemic.
3. Uninterrupted expense growth - The District's expense drivers - primarily wages and fringe benefits - continued their steady growth despite the pandemic. The District also did not lay off or furlough any staff during the pandemic. While attrition and reduced service levels did temporarily reduce expenses, the current push to restore service quickly brings expenses back above prior levels.

The original adopted FY 2021-22 budget required $55.5 million of CRRSA funding to balance revenues and expenses at the 85% service level. It was previously projected that any ARP Act funding received would be used in future years to help reduce deficits. With the addition of $19.3 million in new spending and $388,000 revenue reduction, a corresponding $19.7 million of ARP Act funding must be added to FY 2021-22 to balance the budget. The remaining $46.4 million ARP funding is assumed to support FY 2022-23, but the projection shows that will likely not be enough funding to balance the budget and FY 2022-23 will be left with a $4.2 million deficit. Assuming service levels increase to 95% in FY 2023-24 and no additional COVID stimulus funding is available, the projected result will be a deficit of $53.2 million. Fiscal years 2024-25 and FY 2025-26 at 100% service levels will fare only slightly better with a $48.7 million deficit each.

This projection illustrates the challenges to reach and maintain 100% service levels after the ARP Act funding is used up. The ARP Act spending list requires more funding in earlier years, leaving less funding in later years resulting in higher deficits. Assuming the District receives some amount from the second tranche of ARP funding, staff expects that would be able to cover the deficit projected in FY 2022-23. It is highly unlikely that the District would receive enough additional ARP funds to cover the projected deficit in FY 2023-24, and that still leaves future years with significant deficits. Without significant increases in existing or new revenue sources, the District will be significantly challenged in the coming years. Farebox revenue is projected to increase as service levels increase but the pandemic has placed the District in a disadvantaged position that will be difficult to correct.

Conclusion

As the four-year projection illustrates, paying for increasing service levels will not be easy. The district may have the ability to increase service levels from 85% to 90% in FY 2021-22 but due to the short-term operational constraints and long-term financial uncertainty, even this small increase may not be possible to achieve or sustain. For the FY 2022-23 budget, assuming the pandemic is finally under control, more should be known about our farebox and subsidy revenue sources to properly assess how much service can be restored.

ADVANTAGES/DISADVANTAGES:

The advantage of this proposed budget revision is that it allows for service levels to increase and funds various critical initiatives. The spending items are drawn from prior Board and staff discussions. The disadvantage is mainly that the increased spending will draw on funding resources that could be applied to projected future deficits.

ALTERNATIVES ANALYSIS:

There is no alternative analysis.

PRIOR RELEVANT BOARD ACTION/POLICIES:

SR 21-140 FY 2021-22 Budget Goals and Objectives
SR 21-140a Draft FY 2021-22 Operating and Capital Budgets
SR 21-140b Proposed FY 2021-22 Operating and Capital Budgets
SR 21-140c Recommended FY 2021-22 Operating and Capital Budgets

ATTACHMENTS:

1. Resolution 21-035

2. Adjusted Budget
3. Budget Projections
4. ARP Spending List
5. Positions
6. Presentation

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