**REPORT OF THE**
**DEPARTMENT OF RAIL AND PUBLIC TRANSPORTATION and TRANSIT SERVICE DELIVERY ADVISORY COMMITTEE**

# CAPITAL ASSISTANCE ALLOCATION METHODOLOGY USING A TIERED APPROACH

**DRAFT**
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**ADOPTED:**
**Commonwealth Transportation Board**
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## A. Overview

The Transit Service Delivery Advisory Committee (TSDAC), along with the Director of the Department of Rail and Public Transportation (DRPT), has been charged with evaluating a tiered approach to distributing Mass Transit Trust Funds for capital purposes based on asset needs and available revenues. The purpose of the tiered approach is to assign higher priority to assets that the Commonwealth Transportation Board (CTB) views as the most important to transit in Virginia. The specific charge of the Committee with respect to transit capital funding in Chapter 639 of the 2013 Acts of Assembly (SB1140) is as follows:

> *(d) Of the funds pursuant to this section, 25 percent shall be allocated and distributed utilizing a tiered approach evaluated by the Transit Service Delivery Advisory Committee along with the Director of Rail and Public Transportation and established by the Commonwealth Transportation Board for capital purposes based on asset need and anticipated state participation level and revenues. The tier distribution measures may be evaluated by the Transit Service Delivery Advisory Committee along with the Director of Rail and Public Transportation every three years and, if redefined by the Board, shall be published at least one year in advance of being applied. Funds allocated for debt service payments shall be included in the tier that applies to the capital asset that is leveraged.*

As part of its evaluation process TSDAC has addressed the need to provide predictable funding streams, particularly for large capital projects that feature significant costs for several years at a time. However, this must be balanced with the need to maintain some flexibility in the event that revenues substantially decline or capital needs substantially exceed funding based on percentages that are in place. The legislation provides some guidance to the Department with respect to establishing a reserve to allow for state participation percentages that can be held constant for at least a three-year period. Specifically, the Code states:

> *(f) The Department of Rail and Public Transportation may reserve a balance of up to five percent of the Commonwealth Mass Transit Fund revenues under this subsection in order to assure better stability in providing operating and capital funding to transit entities from year to year.*

At the request of TSDAC, DRPT staff prepared a list of proposed capital asset tiers and definitions of each tier. In defining the capital tiers, DRPT and TSDAC considered how funds should be prioritized based on funding needs identified in the state's six-year improvement plan (SYIP). DRPT and TSDAC also considered the ability of transit systems to determine whether a capital project is needed to meet state of good repair needs versus expansion needs, particularly for facilities that will serve both purposes.

DRPT also prepared numerous capital allocation scenarios using both actual capital projects from FY 2012 through FY 2014 as well as planned capital projects for FY 2015 through FY 2019. The different scenarios serve to compare forecasted capital funding needs, by tier, to estimated future revenues. Additionally, DRPT applied the tiered approach to FY 2012 through FY 2014 to provide a sense of the impact of the proposed policy changes. Further scenarios were produced to show the impact of altering the base used to calculate state participation, i.e., total project cost vs. the non-federal share of the project cost.

In accordance with §58.1-638 of the Code of Virginia, the TSDAC has made decisions regarding the total number of capital tiers (three) and the definition of each, the tier percentages and relationship to each other, as well as the need for and use of a reserve fund. In addition, the TSDAC has made recommendations regarding the use of multi-year funding agreements, the pursuit of more rigorous six year capital improvement program practices, and the proposed funding allocation process.

In determining the recommended approach, the TSDAC considered:

- Need for transit agencies to have predictable funding streams, particularly for major capital projects;
- Ability for agencies of diverse sizes to meet state of good repair needs;
- Regional equity; and
- Funding needs forecasted for system expansion projects in future years, as compared to other capital projects.

## B. Capital Asset Tiers

The TSDAC recognizes that the tiers and their definitions, as well as the state matching percentages will evolve over time as transit asset needs and available revenues change. This concept is highlighted in the Code section that stipulates provisions around changing the tiers that require a one year advance publication of changes as well as a three year window for review. At its meeting on Monday, July 29, 2013, TSDAC approved three tiers which comprise categories of capital needs. Capital funds would be allocated to each tier based on a matching percentage that reflects the priorities of the Commonwealth Transportation Board (CTB). The tiers are defined as follows:

1. **Replacement and Expansion Vehicles**: Activities eligible for funding under this tier include the acquisition of rolling stock for either replacement or expansion purposes. Other eligible activities include items that would be installed on a vehicle as part of a major fleet wide conversion/upgrade or considered a part of the initial acquisition, including but not limited to:
    - Assembly line inspection
    - Fare collection equipment
    - Automated passenger counters
    - On-vehicle radios and communication equipment
    - Surveillance cameras
    - Aftermarket installation of farebox, radios, and surveillance cameras
    - Vehicle tracking hardware and software
    - Rebuilds and mid-life repower of rolling stock

2. **Infrastructure/Facilities:** Activities eligible for funding under this tier include the construction of infrastructure or facilities for transit purposes, such as maintenance facilities, bus shelters, administrative buildings, or guideway infrastructure. Other eligible activities under this tier include:
    - Real estate used for a transit purpose
    - Signage
    - Surveillance/security equipment for facilities
    - Rehabilitation or renovation of infrastructure and facilities
    - Major capital projects

3. **Other**: Activities eligible under this category include, but may not be limited to the following:
    - All support vehicles
    - Shop equipment
    - Spare parts
    - Hardware and software not installed on a vehicle
    - Project development expenses for capital projects
    - Office furniture and other equipment
    - Handheld radios
    - Landscaping
    - Other transit-related capital items

Funds allocated for debt service and lease payments will be included in the tier that applies to the underlying capital asset that is being financed.

It is expected that each agency will designate the appropriate tier for each project in its annual grant applications. DRPT will review and confirm these designations as part of the grant approval process. Any capital needs that are not addressed above will be allocated by DRPT to the most appropriate category.

## C. Multi-Year Funding of Capital Projects

The TSDAC agreed that Major Capital Projects would be placed into the appropriate category (most likely Tier 2) based on the nature of the capital item, and that associated rolling stock would be broken out and funded in Tier 1. This decision obviated the need to define 'Major Capital Projects'.

The TSDAC unanimously agreed to multi-year funding of qualifying projects in order to spread the funding requirements over several years, and leverage the available transit capital funding. To qualify for consideration for a multi-year funding agreement, the total cost of the capital project should exceed 15% of the transit providers' annual operating expenses **or** the project should be for new construction. DRPT and the transit provider will determine the need for a multi-year funding agreement on a case-by-case basis for all qualifying projects. Interest cost may be included in the cost of the project as per existing DRPT regulations, and the state will provide the agreed upon share of the interest expense.

The TSDAC recommends that qualifying projects be funded over several years while maintaining the state participation rate for all years based on the applicable tier percentage from the initial year of grant award (this percentage would be the base percentage – not an adjusted percentage as discussed in Section D. of this memorandum). Project sponsors could enter into an agreement with DRPT that would outline the annual amount and matching percentage of funding for a qualifying project. DRPT would meet these multi-year funding commitments by taking the funds for these projects off-the-top of each year's available capital funding.

## D. Annual Revenues and Reserve Fund

TSDAC recognizes that the CTB must have the ability to adjust state participation in projects in the event that capital funding requests far exceed available funding despite an overarching goal to provide consistent state matching rates for capital projects. The TSDAC agreed to:

<u>Establishment, Use and Funding of Reserve Fund for Revenue Shortfalls</u>

- Establish a reserve balance capped initially at $10 million to cover shortfalls up to 15% of the annual estimated revenues. The reserve will be established over 2 to 3 years using the Code language allowing a 5% hold-back of revenues that exceed $160 million in a given year. For FY 2014, this 5% reserve amount is $3.667 million. Additionally, in all years the capital projects allocations will not completely consume the available revenues because funds will only be allocated in whole percentage points for all three tiers. These excess funds would be allocated to the capital reserve account. The reserve was capped at $10 million by TSDAC – not 15% of annual revenues. The 15% or greater shortfall of annual revenues is the threshold set for decreasing the tier percentages. For example, if annual revenues are only 14% short, we will use the reserve to make up the difference and keep the percentages at the set level. If the reserve is not sufficient, DRPT may have unobligated balances that the CTB could allocate to preserve the set percentages or as a last resort, we would roll forward any remaining amount that could not be covered to offset the next year's revenues. The reason for this approach was to try to maintain the percentages at the stated levels unless a significant (15%) shortfall occurred. Should that shortfall indicate the likelihood of revenue falling more than 15% in the next year, transit providers would have notice of a likely reduction in percentages and time to adjust. This process is similar to the way DRPT's current allocation processes already work as DRPT uses estimates of revenues that ultimately either exceed or fall short when compared to actual collections. In either case, DRPT rolls those minor variances forward to the next allocation process.

- For shortfalls that exceed 15% of the available revenues (including any shortfall carried over from the prior year as described in the previous bullet) in a given year, the TSDAC agreed that DRPT should adjust funding for all Tier 2 and Tier 3 capital projects **only** by decreasing the percentage match for each tier by one percentage point until there are sufficient funds (including reserve funds) to cover the approved capital requests. The objective of this approach is to preserve Tier 1 match percentages.

- The reserve fund may also be used '*to assure better stability in providing operating funding to transit entities from year to year'* as per the §58.1-638.A.4.b.(2)(f) of the Code of Virginia. It is the TSDAC's intent that the reserve balance be available if needed for operating purposes, in addition to capital needs.

Annual Revenues Exceed Needs

- In years in which available revenues exceed the needs required to meet the stated state matching share for each tier and the reserve account is funded at the stated cap, the TSDAC recommends that the state match percentages be increased in increments of a 4/2/1 ratio among Tier 1, Tier 2, and Tier 3, respectively. Funds will only be allocated in whole percentage points at the stated ratio for each Tier starting with Tier 1 until current-year revenues for transit capital are allocated. For example, if there are enough excess funds to add 4% to Tier 1 and 1.7% to Tier 2, then the addition will be made to Tier 1 and the remaining funds will be rolled forward to the next allocation process or used for off-cycle grant requests. Adjustments to the participation rates as described here are applicable to the year in question, and would need to be reassessed in ensuing years.

## E. Project Cost Basis, Tier Rates, and Process Used for Calculating Funding Allocations

Three major components of the actual calculation of the state allocation for an approved capital project were analyzed and debated by the TSDAC at great length. These components involved the rates to apply to the specified cost basis by Tier, the cost basis of the capital asset, and the application of calculated state funding to the funding plan of the capital project. The actual allocations made by the CTB for capital projects are impacted by all of these components and decisions about any one of the components impact the others.

Tier Rates

The TSDAC considered the percentages applied to each tier relative to the other tiers – what level of importance does the TSDAC want to place in differentiating one tier versus another. For example, a 60/40/20 tiering would yield significantly different allocation results from a 70/35/17 tiering. This concept is demonstrated above in the data analysis below in the 2nd column of Table 1a. Because the Hampton Roads district had a high concentration of vehicles (tier 1 assets) that had no federal funding, this district benefits the most from a non-federal share approach using 70/53/31 tiering because these assets received 55% funding in the actual FY 2014 plan using non-federal share while receiving 70% funding in the scenario. The TSDAC decided by unanimous vote that the tiers should be related to each other in a 4:2:1 ratio. For example if Tier 1 is 60%, then Tier 2 should be 30%, and Tier 3 should be 15%.

The actual percentages set as the base calculated for FY 2014 are 68% for Tier 1, 34% for Tier 2, and 17% for Tier 3. These percentages are slightly higher than the scenario analysis had indicated due to the discovery of a double counted asset by the City of Alexandria totaling $31.9 million. The removal of this large duplicative capital project allowed Tier 1 to increase by 4% and Tier 2 to increase by 1% from the data in the Total Cost approach in Table 2b (found later in this document). These new percentages match the prescribed ratio of 4:2:1.

The tier participation rates appear to matter very little outside of the NOVA district because both proposals limit the combined federal and state participation to 96% of the project cost. As a result, transit agencies outside of NOVA end up with a state share of the cost of the project that is significantly lower than most of the NOVA transit agencies capital projects.

Project Cost Basis

This issue involves the dollar value to which the tier percentages should be applied to determine the state allocation amount. The Code of Virginia does not dictate a cost basis to be used for the state capital funding allocation process. Prior to the passage of SB1140, the Code did stipulate using non-federal share so it is evident that the General Assembly was open to a change from that basis as signified by the removal of that language.

TSDAC considered allocating funds to each capital project or activity based on the total cost of the project or based on the total cost less federal revenues for the project. The debate over the basis centered on a perceived loss of funding to the various providers depending on which basis was utilized. Under the total cost approach, the NOVA district providers perceived that they would lose capital funding as compared to the existing process. The other districts thought they would lose funding if cost was reduced by federal revenues. The TSDAC discussed at length the merits of both views and asked the consultant to perform various scenario analyses for both the FY 2012 – FY 2014 timeframe using actual capital projects funded, as well as the FY 2015 – FY 2019 period using the projected capital projects as provided by the transit providers to DRPT.

Project Cost Basis - Data Analysis

The results of a 4% local match requirement, removing assumptions related to the use of FTA 5307 funding, and capping funding at 96% are shown in the following tables. Table 1a shows the variance from the FY 2014 actual capital projects funding broken down by Commonwealth Transportation Board district compared to the new three-tier approach. The table shows the variance using both the total cost approach and the non-federal approach, as well as these scenarios with the addition of the $15.8 million (the new amount of funding for capital). It is necessary to point out that the variances shown in Table 1a are not solely caused by the change in the basis for applying percentages. The number of tiers and the applicable percentages has an equal or greater impact on the variances (the actual FY 2014 allocations were based on a two tiered approach with percentages at 80% state share of a project with federal participation and 55% state share of a project with no federal participation). The entire scenario analysis that supports Table 1a and Table 1b can be found at the following link:

http://www.drpt.virginia.gov/activities/files/Capital%20Budget%20Comparison%20Three%20Tiers%202012-2014%20-%20Update%20PB_10-7-13.xlsx

*Note: The results of this analysis are illustrative only, and do not constitute final funding allocations.*

**Table 1a: Summary of Capital Grants by Scenario by District, Variance to FY 2014 Actual Allocations**

| CTB District | Variance of FY14 Actual Compared to Total Cost, 3 Tier Proposal | Variance of FY14 Actual Compared to Non-Fed Share, 3 Tier Proposal | Variance of FY14 Actual Compared to Total Cost, 3 Tier Proposal + $15.8 M | Variance of FY14 Actual Compared to Non-Fed Share, 3 Tier Proposal + $15.8 M |
|---|---|---|---|---|
| Bristol | $13,115 | $(24,352) | $13,115 | $ (6,084) |
| Culpeper | 31,175 | (43,239) | 31,175 | 14,058 |
| Fredericksburg | 26,800 | (11,120) | 26,800 | 12,100 |
| Hampton Roads | 355,947 | 2,210,386 | 2,286,222 | 4,272,624 |
| Lynchburg | 30,786 | (28,226) | 30,786 | 2,683 |
| Northern Virginia | (1,298,502) | (2,025,193) | 12,574,440 | 11,130,863 |
| Richmond | 343,140 | (20,514) | 343,140 | 156,368 |
| Salem | 81,171 | (155,141) | 81,171 | (13,942) |
| Staunton | 441,975 | 9,195 | 441,975 | 189,519 |
| **Total** | **$25,608** | **($88,203)** | **$15,828,825** | **$15,758,190** |

The percentages applied to each tier in Table 1b were set to ensure that the funding provided under the four options presented in Table 1a remained relatively constant between the two basis options. This eliminated the dollar amount of funding as a variable causing the variances.

**Table 1b: Estimated Funding Percentages for Capital Tiers – FY 2014**

| Capital Tier | Estimated Percentage: Total Project Costs | Estimated Percentage: Non-Federal Costs | Estimated Percentage: Total Project Costs + $15.8M | Estimated Percentage: Non-Federal Costs + $15.8M |
|---|---|---|---|---|
| Tier 1: Vehicles | 60% | 70% | 70% | 80% |
| Tier 2: Infrastructure/Facilities | 35% | 53% | 45% | 62% |
| Tier 3: Other | 18% | 31% | 22% | 41% |

Table 2a shows total capital grants by scenario by district FY 2015 - FY 2019 based on data provided by transit providers regarding project cost and projected federal funding, comparing the total cost approach to the non-federal share approach. The entire scenario analysis that supports Table 1a and Table 1b can be found at the following link:

http://www.drpt.virginia.gov/activities/files/Capital%20Budget%20Comparison%202015-2019%20Other%20PB_10-7-13.xlsx

**Table 2a: Summary of Capital Grants by Scenario by District, FY 15 – FY 19 Total Cost vs. Non-Federal Share ($ in thousands)**

| CTB District | Estimated State Funding: Total Project Costs | Estimated State Funding: Non-Federal Costs | Variance |
|---|---|---|---|
| Bristol | $89 | $83 | $ (6) |
| Culpeper | 584 | 498 | (86) |
| Fredericksburg | 958 | 886 | (73) |
| Hampton Roads | 12,476 | 9,981 | (2,495) |
| Lynchburg | 8,012 | 6,143 | (1,869) |
| Northern Virginia | 483,390 | 492,219 | 8,829 |
| Richmond | 4,595 | 3,636 | (959) |
| Salem | 10,822 | 7,672 | (3,150) |
| Staunton | 1,919 | 1,771 | (148) |
| **Total** | **$522,845** | **$522,887** | **$43** |

The percentages applied to each tier in Table 2b were set to ensure that the funding provided under the two options presented in Table 2a remained relatively constant between the two basis options. This eliminated the dollar amount of funding as a variable causing the variances.

**Table 2b: Estimated Funding Percentage by Tier by Scenario, FY 15 – FY 19**

| Capital Tier | Estimated Percentage: Total Project Costs | Estimated Percentage: Non-Federal Costs |
|---|---|---|
| Tier 1: Vehicles | 64% | 75% |
| Tier 2: Infrastructure/Facilities | 33% | 50% |
| Tier 3: Other | 17% | 25% |

***Note: Table 2b has not been adjusted for duplicative project discussed within this report.***

Table 3 shows the cumulative state share allocated to the transit providers in each CTB district for the last three years based on actual and based on the three tier approach and adding the new revenues. The chart also shows the cumulative share by CTB district share for the projected 2015 through 2019 timeframe.

**Table 3: Summary of State Percentage Share by CTB District**

| District | 2012-2014 (Cumulative) | | | 2015-2019 (Cumulative) | |
|---|---|---|---|---|---|
| | Actual Allocation | Total Cost + $15.8 M | Non-Fed Share + $15.8 M | Total | Non-Federal |
| **Bristol** | 0.3% | 0.2% | 0.2% | 0.0% | 0.0% |
| **Culpeper** | 0.6% | 0.6% | 0.5% | 0.1% | 0.1% |
| **Fredericksburg** | 0.8% | 0.7% | 0.6% | 0.2% | 0.2% |
| **Hampton Roads** | 5.7% | 5.9% | 6.4% | 2.4% | 1.9% |
| **Lynchburg** | 0.7% | 0.8% | 0.6% | 1.5% | 1.2% |
| **Northern Virginia** | 88.2% | 88.1% | 88.3% | 92.5% | 94.1% |
| **Richmond** | 1.4% | 1.3% | 1.2% | 0.9% | 0.7% |
| **Salem** | 1.4% | 1.3% | 1.2% | 2.1% | 1.5% |
| **Staunton** | 1.0% | 1.1% | 1.0% | 0.4% | 0.3% |
| **TOTAL** | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

Project Cost Basis - Data Analysis Observations:

In the only deviation from otherwise unanimous recommendations on both operational and capital funding processes, the TSDAC voted 6-2 in support of utilizing the total cost of the capital asset as the base for applying the tier percentages. A minority report authored by the two dissenting voters is attached to explain their position. The following bullets include the rationale accepted by the majority of the TSDAC members.

- The General Assembly provided the new funding for transit with clear direction for change. The non-federal share wording was removed from the Code language for a reason.
- The old capital allocation methodology is not a good basis for comparing allocation results to the current tier approach that TSDAC is evaluating because the old process did not use tiers of assets. The old approach blended two different funding sources with significantly different Code specified allocation processes in a manner that allowed the CTB to emphasize state of good repair for vehicle fleets as well as equity in state funding levels by only providing the higher state share to projects that included federal funding.
- The thought that the old process produced fair and equitable results is an assumption that should not be made. A review of the old approach was not a part of the TSDAC's efforts.
- The NOVA district (the one district that **appears** to be negatively impacted by using total cost as the basis) received 88.2% of the actual capital allocations in FY 2012 – FY 2014, but in the projected FY 2015 – FY 2019 allocations NOVA district would receive 92.5% of the allocations under the total cost approach and 94.1% under the non-federal share approach – these calculations are made before considering the impact of the $50 million a year of state funding dedicated to WMATA as match to the federal PRIIA program. That is **92.5% of the total state capital funds allocated, not just of the new funding being provided**.
- A 5-year and a 10-year hold harmless provision were debated by TSDAC. The 5-year average share of state capital funds for the NOVA district was 82.5% and the 10-year average was 80.2%. Clearly, the data indicates that the NOVA district (either 92.5% under the cost approach or 94.1% under cost less federal revenue approach) is receiving the majority of the new funding and significantly more than their historical share. Therefore, concerns of a loss are unfounded.
- The only impact on local budgets would be if for some reason the NVTC local jurisdictions used the 94.1% estimate of future allocations instead of the historical trend of 80.2% for 10-years, 82.5% for 5-years, or even the 83.0% received in FY 2014. Using an estimate that is higher than any of these three benchmarks would be speculative.
- The local share of the NOVA region is increasing as a percentage of the total cost of a capital project because the NOVA district is increasing its total capital projects dollar value by an average of 37% over the next 5 years AND the federal and state funding sources do not increase anywhere close to this rate during that timeframe. Therefore, the local share must increase to pay for this rapid expansion of capital spending. In fact, **if all of the state capital funds including the new revenues**

**were provided to the NOVA district in FY 2015 through FY 2017, the state would still have to come up with an additional $40 million to allow the local share of NOVA capital projects to remain at the 25% level.**

- Further, when looking at FY 2014 – FY 2012, the reason for a minor loss of 0.1% (88.1% vs. 88.2%) in this timeframe (approximately $85,000 a year) is the inclusion of a significant dollar value of non-federal participating capital projects by Hampton Roads Transit. The proposed approach by the NOVA district to provide for a 'hold harmless' provision would effectively preclude other providers from the same level of state funding as they receive, thereby hindering growth in transit in the rest of the Commonwealth.
- The 'loss' in FY 2014 is an **even greater 'loss' to the NOVA district using the cost less federal revenues approach**. This indicates that the perceived loss is resulting from the tiers, not the cost basis of the capital asset used in the calculation.
- No logical reason has been provided for removing federal revenues from the capital cost of the asset before applying the tier percentage. By applying the tier percentage to the total cost of the capital asset, every transit provider is afforded the same opportunity to get the maximum state share available. Under an approach that eliminates federal revenues from cost, the exact same bus purchased by two different transit providers would get different state shares of the cost of the capital asset. For instance, one transit provider could have a project with a funding agreement with DRPT at 68% state and 32% local while another buying the exact same bus might have 80% federal, 16% state and 4% local.

Based on the above reasons, the TSDAC voted (6-2) in support of utilizing the total cost of the capital asset as the base for applying the tier percentages. A Minority Report memorandum authored by the two dissenting voters is attached to explain their position.

<u>Other Allocation Process Issues</u>

The idea of allowing grantees to apply for a program of capital projects, receive allocations based on the specified state match, and then apply the funds through an agreed upon financial plan across all approved capital projects in the current year was discussed. This idea met with some resistance based on the grounds of fairness because it was perceived that a grantee could potentially "plan" for state funds to be applied to projects that are ready to proceed while allocating much of their local share to projects that are in conceptual stages and may take years to complete, if ever. Further, this approach would complicate the administrative process that has been established between DRPT and its grantees whereby each capital project is treated as a separate and distinct project. Additionally, verification of the actual use of federal funds would still have to occur at some point for all projects for each year's capital allocations. Without strict adherence to the financial plan (meaning the plan must be set within 90 days of SYIP adoption and **no changes from the plan will be allowed**) and verification of the federal funds, it has been suggested that some capital projects would be overfunded by state funds (i.e., receiving a state funding contribution that funded the project above 100%). Therefore, TSDAC did not accept the idea of "blending" current-year approved projects into one financial plan.

DRPT had recommended that under the total cost approach that the entity providing federal funds to a capital project be allowed to voluntarily supplant state funding with federal funding. This would allow DRPT to cap the total funding provided through the state sources and state-controlled federal programs to a 99% maximum share. After receiving feedback on this idea, two themes emerged – concerns regarding an overall reduction in the amount of local funding applied to projects funded 99% with state and federal funds, and the expectation that transit entities that receive federal funds directly could receive more than 99% funding for a capital project through state and federal funds combined.

On the local funding issue, the TSDAC approved a 96% maximum combined state and federal share or alternatively a 4% minimum local share. This was approved as a 6 – 2 vote, and the reasons for opposition can be found in the attached memorandum. The Committee voted to affirm its increase in local match at 4%. The TSDAC was responding to concerns that localities that had in many cases seen increased local share of funding to maintain services would be forced to increase local revenue at a time when they were being promised enhanced state support.

Finally, the state prescribed matching share for a tier would be reduced until this 96% maximum is reached. In this manner all transit providers would be eligible to receive the specified tier rate of state funding. The federal funding on each capital project would be confirmed by DRPT as it is today. This procedural step would ensure that capital projects would not be overfunded by state funds.

The TSDAC agreed to examine the results of the FY 2015 allocations using the recommended approach during the summer of 2014. This review would include consideration of a ‘hold harmless’ provision, as well as a more detailed analysis of the six year capital budgets of the transit providers. Before investing considerable resources analyzing the results of the first year of allocations under the adopted capital approach, an interpretation of the Code of Virginia is needed as soon as practicable to determine if the CTB may change the capital approach before the end of three years.

## F. Implementation of Proposed Approach

Based on this final recommendation of TSDAC, the Director of DRPT will recommend a tiered approach to the CTB for approval at its December 4, 2013 meeting. If adopted by the CTB, this approach will be applied to capital funding requests for FY 2015 (application period of December 2013 – February 3rd, 2014).

**Disclaimer: The TSDAC Majority report related to these issues can be found at http://www.drpt.virginia.gov/activities/SB1140.aspx.**

## TSDAC Capital Allocation Plan Adopted On 10-29-13 – Minority Report

### Overview

On October 29, 2013, the Transit Service Delivery Advisory Committee (TSDAC) adopted by a divided vote a set of recommendations regarding transit capital funding, with the undersigned dissenting. The divided vote was the only time TSDAC made a decision that was not unanimous and, because the issue leading to this result is a significant one, TSDAC concluded that a minority report was warranted to illuminate the difference of opinion.

TSDAC was created by Senate Bill 1140 ("the bill") to work with VDRPT on a set of specified transit funding assistance issues identified by the bill, one of which pertained to capital assistance. The "capital assistance" issue cited by the bill directs TSDAC to formulate a "tiered approach" for allocating and distributing transit capital assistance ….. "based on asset need and anticipated state participation level and revenues". While that's the sole capital issue TSDAC was directed to address, the "transit capital funding" recommendations adopted on October 29th go beyond the formulation of a tiered approach, by incorporating a change in how the state participation rate for capital assistance is calculated. While there was unanimity among the TSDAC members on all but one of the elements of the capital recommendations (including the tiering structure, the definitions of project types qualifying for each tier, and the size differences in participation rates by tier), we strongly dissent on one element – the majority's preference for changing how the state capital assistance participation rate is calculated (aka the "basis for funding allocations").

Changing how the state participation rate for capital assistance is calculated as the majority favors is problematic in our view, because that change: (1) undermines the "tiered approach"; (2) is premised on assumptions about future federal funding that are highly conjectural; and (3) results in an outcome whereby Northern Virginia is the only area of the state that would have to increase local support in percentage terms to capture the increased state funding promised by HB 2313.

Before the vote, we made a counterproposal to mitigate the harm we foresee resulting from changing how the state participation rate is calculated. Despite our best efforts to seek common ground, the differences in opinion could not be surmounted and so we ended up having to dissent. The balance of the minority report details why.

### Issue

The one contentious issue pertains to how the state's capital funding participation is calculated. Simply stated, the alternatives TSDAC primarily examined were to:

1. <u>"No change" methodology</u>: Retain the current state capital participation methodology whereby the state's capital participation is calculated as a percentage of the project cost net of actual federal funds associated with the project; or

**Disclaimer: The TSDAC Majority report related to these issues can be found at http://www.drpt.virginia.gov/activities/SB1140.aspx.**

2. "Total Cost/Gross" methodology: Alter the state capital participation methodology so the state's capital participation is calculated as a percentage of the project's gross cost, with adjustments as necessary to cap the combined federal and state participation at 96% of the gross cost.

The majority voted in favor of the second alternative, while the two of us favored the first. Since the majority's preference constitutes a change from the current practice, the most straightforward way to explain why we disagree is to examine the aims cited by the VDRPT members of TSDAC during the TSDAC deliberations for contemplating a change to the current practice, and then examine how the alternative favored by the majority affects actual outcomes. As the ensuing discussion details, actual outcomes are at odds with the stated aims. That fact, coupled with our view that there is no compelling public policy reason for changing the current practice, are the reasons for our dissent.

The first stated aim for contemplating a change is that the current practice results in varying state participation rates for the same types of capital investments depending on whether a grantee does or doesn't have federal funding to apply towards the investment. This was perceived to be inequitable, and initial concepts suggested by the VDRPT members of TSDAC for changing participation rates to percentages of gross were formulated to make state participation rates for the same type of capital investment uniform. In the end, however, concepts conceived to meet that intent proved impractical, so the variations remain in the "gross" methodology approved the majority and the "inequity" concern has not been cured.

The second stated aim for contemplating a change is that the current practice lacks built in incentives to induce grantees to favor investment types seen as higher state priorities. By varying state participation rates according to investment type or "tier", TSDAC reasoned incentives of this sort could be incorporated into the capital assistance program. Consistent with that aim, the change approved by TSDAC was unanimous in its support for tiering with differing state participation rates for each tier, and thus this is an element of the allocation / distribution approach no matter how the state capital participation rate is calculated. However, the alternative favored by the majority leads to an outcome in which the varying "tier" rates are essentially irrelevant outside of Northern Virginia, because the levels of state assistance promised by the tiers is seldom necessary to fully fund the capital investment due to federal resources also dedicated to the investment. So the alternative favored by the majority fails to provide a meaningful incentive nearly everywhere.

The third stated aim for contemplating a change is to foster expanded transit services by using the increased state assistance to leverage increased local support (assistance) for transit statewide. In terms of outcomes, however, the change favored by the majority requires more local support in percentage terms only in Northern Virginia, where local transit support already dwarfs local support for transit elsewhere in the state in both absolute and percentage terms. While all the TSDAC members were in agreement that leveraging increased local support was (is) a desired aim, wariness about requiring too much local support ended up tempering what was recommended in terms of required local support -- only a "4% minimum" requirement.

**<u>Disclaimer:</u> The TSDAC Majority report related to these issues can be found at http://www.drpt.virginia.gov/activities/SB1140.aspx.**

Much has been said about the shares of overall state assistance each district of the Commonwealth stands to realize in the FY 2015-2019 period as a result of the recommended changes, but those differences are in large measure an outgrowth byproduct of how ambitious the transit plans of the districts are. That is, the more ambitious a particular district's plan is for transit investment, the larger its share of state dollars. Thus Northern Virginia does stand to realize a larger share of the statewide transit assistance comparing past and future, but that's because Northern Virginia's transit plans are more ambitious than elsewhere in the state. The majority's favored recommendation is silent on the "local assistance" requirements attendant to the two above described alternatives, as well as the fact that the change recommended by the majority requires more local assistance in Northern Virginia and less in the other parts of the Commonwealth; these facts are the source of our concern. This can be seen by comparing local assistance shares in the FY 2012-FY 2014 period and the FY 2015-FY 2019 period in the attachment (the column labeled "total" is the alternative favored by the majority while the one labeled "non-federal" is the alternative we favored).

Stated more simply, none of the stated aims for making a change in how the state participation rate is calculated are achieved by the alternative the majority favors. That change would simply have the effect of compelling Northern Virginia's local jurisdictions to bear higher costs with local funds in both absolute and proportionate terms to realize increased state assistance (because to do otherwise would mean less proportionate state funding). That's a concern not only for Northern Virginia, but for the state as a whole since Northern Virginia is an economic engine for the entire state and since the presence of a robust transit network in Northern Virginia is one of the linchpins to Northern Virginia's economic health.

Mindful of these consequences, a counterproposal was made to mitigate the harm and account for the uncertainties (e.g., the current federal transportation funding authorization expires at the end of September 2014 and the Congress will be working on the successor legislation this coming year), namely:

1. <u>Delay the change to the calculation of the state participation rate for one year (i.e., to the FY 2016 funding cycle)</u> **or** <u>implement a "maintenance of effort" (MOE) provision to insure that all capital grant recipients receive no less state capital assistance than they did in FY 2014, in terms of only the existing state capital funding.</u>

2. <u>Increase the minimum local match requirement to 5% in FY 2016.</u> This was seen as a further nod towards the stated aim of using the increased state assistance as a means of leveraging additional local support.

A further counterproposal was made in the event the counterproposal summarized in (1) and (2) was not supported, as described below:

> Confining the change to the calculation of the state participation rate to only the first two years of capital assistance (i.e., FY 2014 and FY 2015), with a commitment to reassessment before the FY 2016 allocation.

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## The end result

Both of the counterproposals were discussed at some length at the meeting, but neither mustered sufficient support to be embraced by the majority. TSDAC did agree to consider the suggestions of these sorts as part of a research work program that could give rise to changes downstream but, because Northern Virginia stands to be negatively impacted by the majority recommendation, for years before a reassessment of this issue might lead to an amendment, we felt compelled to cast our dissenting vote.

Respectfully submitted:

Alfred H. Harf, Alfred H. Harf, VTA representative

Cindy L. Mester, Cindy L. Mester, VML representative

**ATTACHMENT**

**LOCAL TRANSIT ASSISTANCE SHARES, FISCAL YEAR 2013 AND 2014 VERSES FISCAL YEAR 2015 THROUGH 2019**

| | Approved SYIPs | | | FY15-19 Estimated | |
|---|---|---|---|---|---|
| | FY13 | FY14 | FY13-FY14 | Total Cost | Non-Federal |
| Northern Virginia | 26.1% | 24.7% | 25.3% | 30.4% | 29.8% |
| Bristol | 5.3% | 5.4% | 5.3% | 4.0% | 5.0% |
| Culpeper | 6.4% | 5.1% | 5.8% | 4.0% | 6.4% |
| Fredericksburg | 8.6% | 6.3% | 8.2% | 4.0% | 5.2% |
| Hampton Roads | 12.1% | 33.5% | 28.3% | 4.4% | 7.7% |
| Lynchburg | 7.8% | 6.0% | 7.1% | 4.0% | 7.7% |
| Richmond | 4.7% | 7.8% | 6.2% | 4.0% | 7.3% |
| Salem | 6.5% | 5.1% | 5.9% | 4.1% | 8.9% |
| Staunton | 8.9% | 8.6% | 8.7% | 4.0% | 5.2% |
| Rest of State | 7.8% | 19.2% | 14.0% | 4.2% | 7.8% |
| State-wide | 22.5% | 23.6% | 23.1% | 26.8% | 26.8% |

Excludes PRIIA funding paid directly to WMATA, since this funding is not part of the state participation rate calculations.