Strategies to Mitigate Local Financial Commitment Risks of a New Starts Project

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INTRODUCTION

The St. Paul-Minneapolis Central Corridor Light Rail Transit project (CCLRT), is a 9.8 mile LRT line linking the downtowns of St. Paul and Minneapolis, Minnesota scheduled to open in 2014. The Metropolitan Council is the project sponsor and Federal Grantee, and will eventually own and operate the new system through its transit operating division Metro Transit. The Metropolitan Council is a mature government entity, with an estimated Transportation Capital Improvement Program of over $200 million per year on average from 2010 to 2014, and proven access to debt markets. At the time of the Fiscal Year 2011 New Starts submission (September 2009), the Central Corridor Light Rail Transit project (CCLRT) was completing Preliminary Engineering and undergoing Final Design designation review.

FTA's Annual Report on Funding Recommendations for Fiscal Year 2011 assigned the CCLRT project with Medium-High ratings for the capital finance plan, the operating finance plan, and the overall Local Financial Commitment, the only project in Preliminary or Final Design to achieve financial ratings this high.

The CCLRT capital and operation plan mitigated the local financial commitment risks through resilient financial structure of the Metropolitan Council Transportation Division and the unique CCLRT project partnering approach. The Transportation Division has not taken on capital or operating funding responsibility for rail projects. Rather, it has become the operator of both Hiawatha LRT and Northstar Commuter Rail through agreement with counties, Railroad Authorities with property tax revenues, and the State. Similarly, the CCLRT project's non-Federal capital share is funded by multiple local partners and the state who have agreed to the percentage proportions and timing through a series of funding agreements, creating a degree of assurance that reduces the capital risk of sufficient funding to complete the project.

The Metropolitan Council's operating fund is also insulated from risk, due to the approach of establishing CCLRT funding agreements with local and state jurisdictions. Furthermore, the Metropolitan Council's policy requirement that transit fares will be increased based on the farebox recovery ratio provides a cushion under the circumstances of increased O&M costs or general weakness in transit ridership.

CCLRT LOCAL FINANCIAL COMMITMENT ASSESSMENT WITH FTA PERSPECTIVES

FTA evaluates New Starts projects within a multi-criteria analysis framework which provides a structured approach for developing a project summary rating, based on the sub - ratings of project justification and local financial commitment. The framework is illustrated in Exhibit 1.

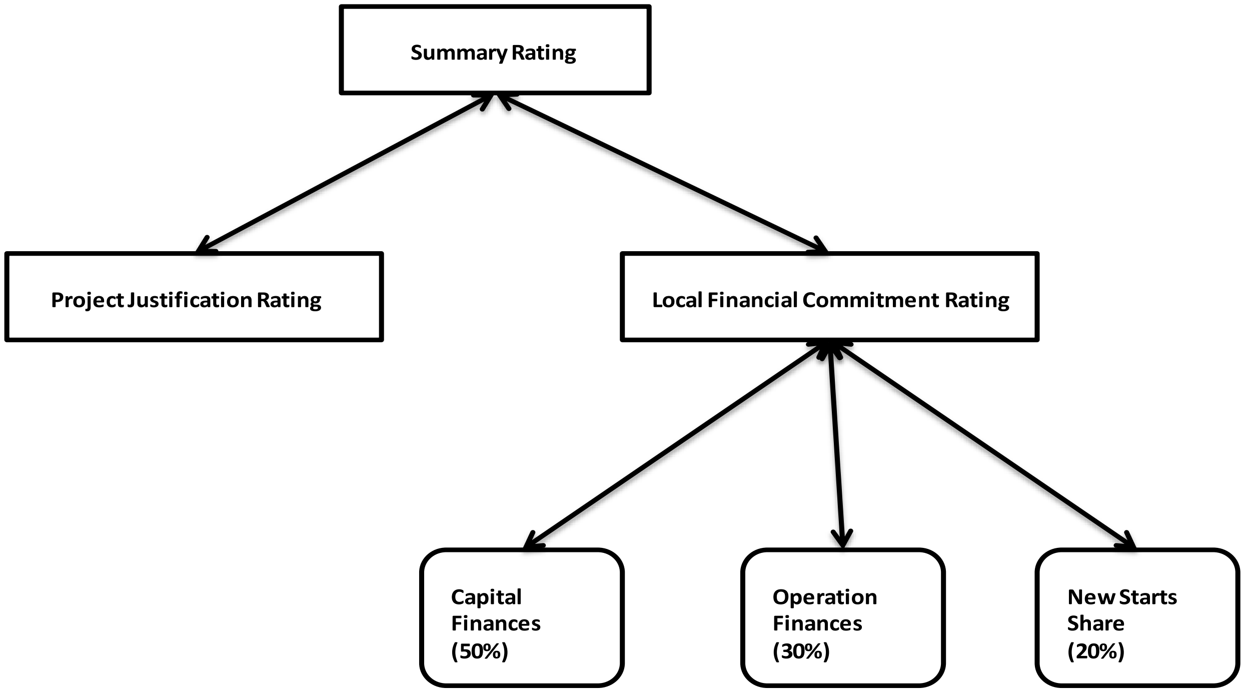

Exhibit 1: New Starts Multi-Criteria Rating Framework

The local financial commitment rating is based on weighted average of the ratings assigned to each of the following criteria: 1) the strength of the capital finance plan 50 percent, 2) the strength of the operating plan 30 percent, and 3) the New Starts share of project costs 20 percent.[1]

CCLRT Capital Finance Plan

Non-Section 5309 capital funding of the CCLRT project was 99% committed at the time of the Fiscal Year 2011 New Starts submission (September 2009), exceeding FTA's requirement of 50 percent of the non-New Starts capital funding committed before approval to enter final design. Early in the project development, the project sponsor Metropolitan Council established funding agreements with the State and local funding partners. The State will contribute up to 10% of the capital cost, Counties Transit Improvement Board (CTIB) 30% and the Regional Rail Authorities 10%. CTIB was created in 2008 to provide a dedicated source for capital and operating funds for transit projects through a regional quarter percent sales tax. Those funding agreements created a degree of assurance that reduces the capital risk to complete the project.

FTA also requires the capital finance plan should demonstrate the financial capacity to cover capital costs of new investments and costs of rehabilitation and replacement for the existing system. In addition to the funding commitment to the CCLRT project, Metro Council's capital plan presents the agency's CIP program funds meeting the majority of State-of-Good-Repair (SGR) needs.

The CCLRT finance plan includes details of issuing Grant Anticipation Note (GANs) and internal borrowing to finance the project funding shortfalls should federal funding be delayed. Because Minnesota law limits the issuance of GANS to a maximum for which the Federal funding provides 150% coverage of debt service, any unmet funding needs will be financed by internal loans from the Metropolitan Council. Those financing mechanisms guarantee the daily cash flow of the project construction. Internal policies of Metropolitan Council provide for the use of internal inter-fund borrowing. [2] The

[1] FTA's Annual Report on Funding Recommendations Fiscal Year 2011

[2] Metropolitan Council: POLICY - Finance and Asset Management: Section/Number: 3, Effective Date: 9/11/98

internal loan program in the CCLRT New Starts financial plan at any time requires less than 50% of the Council's unrestricted cash and investments. The Council has approved the loan program and will be intentionally timing some cash flows so that the maximum cash can be made available to the pool when the CCLRT project needs it.

CCLRT Operation Finance Plan

According to FTA guidelines, the operating finance plan of a proposed New Starts project should show the financial capacity to operate and maintain all proposed, existing and planned transit services of the transit system. The State of Minnesota and CTIB agreed to a shared responsibility for the additional O&M Cost of the CCLRT early in the project development. Those agreements insulated the Metropolitan Council from the operation risk of the additional O&M cost of CCLRT. Both the State and CTIB have taxation and bonding authority allowing them to meet future capacity needs.

MN Sessions Laws (2009) Section 473.4051 subd. 2. states that after operating revenue and federal money have been used to pay for LRT operations, 50% of the remaining balance must be paid by the State of Minnesota. Counties Transit Improvement Board (CTIB) Resolution #17 dated August 20th 2008 committed 50% of the operating subsidy for the Central Corridor LRT project. CTIB also passed similar resolutions to pay 50% of the operation balance for the existing LRT and commuter rail projects.

The regional bus system historically seeks to recover approximately 30 percent of its operating cost via farebox revenue. Metropolitan Council's policy is to increase fares by 10% whenever inflating O&M costs cause the bus recovery ratio to drop to 28.5%. The fare increase policy of the Metropolitan Council provides a cushion under the stress test of higher O&M costs due to higher inflation or other factors. The policy in effect results in the design year (2030) bus average fare before inflation consistent with the bus average fare in 2001when the policy was implemented.[3] The projected fare is also consistent with the fare assumptions in travel demand projections. The operation deficit of bus system was subsidized by motor vehicle sales tax, federal formula funding and other local sources.

Assumptions of the Capital and Operation Finance Plan

In the capital and operation finance plan developed for the CCLRT project, the estimated revenues and expenses in future years are consistent with historical trends. Up to 10 year historical data of major revenues and expenses were required by FTA's Financial Management Oversight Contractor (FMOC).

Exhibit 2 summarizes major strategies to mitigate local financial commitment risks of the CCLRT project.

[3] Metropolitan Council: POLICY - Transit Fare Policy Changes: Section/Number: 3-2-6, Effective date on 01/10/2001

The Capital Finance Plan
CCLRT Project • Funding agreements with the State and local partners on proportional contributions to the project capital cost established in early stage of the project development with 99% of the non-Section 5309 capital funding already committed • Grant Anticipation Notes (GANs) issuance programmed to reduce the project's funding shortfall during construction period • Ability of Metropolitan Council to provide large amounts of short-term internal financing Transportation Division of the Metropolitan Council • The majority of State-of-Good-Repair (SGR) needs funded as part of the overall Capital Improvement Program (CIP)
The Operation Finance Plan
CCLRT Project • CCLRT O&M deficits funded equally by CTIB and the State of Minnesota Transportation Division of the Metropolitan Council • The existing LRT and Commuter Rail O&M deficits funded equally by CTIB and the State of Minnesota • Fare increase policy to increase fares by 10% whenever inflating O&M costs cause the bus recovery ratio to drop to 28.5%
Assumptions of the Capital and Operation Finance Plan
• Assumptions of major revenues and expenses forecast are in line with historical data

Exhibit 2: CCLRT Strategies to Mitigate Local Financial Commitment Risks

LOCAL FINANCIAL AND INSTITUTIONAL ISSUES INSTIGATED AS RISK MITIGATING STRATEGIES

The basic funding structure did not call for the Metropolitan Council to contribute any capital or operating funding to the project, other than construction bridge loans, [4] but to manage the construction and operation. The Council could therefore act as a neutral broker among the financial stakeholders, as the network of agreements described below demonstrates.

Cooperation Agreement

Under Minnesota law, both the Metropolitan Council, a public corporation and political subdivision of the State of Minnesota, and the State of Minnesota's Department of Transportation acting through its Commissioner, have the authority to plan, design, acquire, construct and equip light rail transit in the Twin Cities Metropolitan area.[5]

To clarify the respective roles and responsibilities, in December 2006 a Cooperation Agreement was negotiated and signed by both parties that created a partnership between the agencies to plan, design and construct the CCLRT. The Cooperation agreement spelled out the

[4] As described below under "d) Summary," Metropolitan Council did agree to fund less than 3% of the project cost in order to broker an agreement for additional stations in January, 2010.

[5] Metro Council: Minnesota Statutes sections 473.399 to 473.3997 and section 473.405 subdivision 4. MnDOT: Minnesota Statutes section 174.35 and sections 473.399 to 473.3887.

primarily responsibilities for the Metropolitan Council (Lead Agency, Grantee, Owner and Overall Manager, Operator) and MnDOT (Design review and approval, right-of-way, utility clearance, and environmental work).

The Cooperation Agreement was the first in what will eventually become a series of dozens of interlocking agency agreements between the Metropolitan Council and various government agencies defining the funding, cost participation and responsibilities. For the purposes of this paper, we will focus on the Metropolitan Councils specific responsibility as defined in Section 2.02 of the Cooperation Agreement to provide "Fiscal Management" for the project.

Metropolitan Council Fiscal Management Approach

The Metropolitan Council is responsible for coordinating and arranging for Project funding from all federal, state, and local government sources necessary to complete the project. With the Council's responsibilities under this agreement being wholly dependent on the availability of funding from sources other than the Council in order to carry out the activities. In effect, the Metropolitan Council was given the keys to the project, but would have to rely on the kindness of others to provide the gas money.

The Metropolitan Council also has the responsibility for ensuring funds are available for the design phases, construction and into operations. During design and construction, the Metropolitan Council essentially serves as the project's "bank", responsible for ensuring adequate daily cash flows, internal borrowing, and arranging Grant Anticipation Note (GAN) issuance. To reduce the uncertainty and limit the project financing costs, the Metropolitan Council established a framework of funding and cooperation agreements early in the process to both ensure issues are resolved ahead of time, and to demonstrate to the FTA that the project's funding commitment and availability of funds is secure.

The approach to the funding commitments also required the Metropolitan Council early on to recognize the effect of the anticipated lag in the Federal availability of funds, and plan a funding approach to limit financing costs and project risk. A conservative but realistic approach based on recent FTA experience with the Hiawatha LRT and Northstar Commuter Rail was made that Federal funds would not be made fully available until approximately one and a half years after the project opening.

The use of funding agreements and Memoranda of Understanding (MOU) provided a format to discuss and agree that the local funding partners would "advance fund" the project in its early construction stages. This early need recognition provided FTA with the assurances on the commitment and availability of local and state funding when reviewing the financial capacity and project's overall funding strategy.

Funding Agreement

To organize and manage the entire CCLRT project, the Metropolitan Council established the Central Corridor Project Office (CCPO). The CCPO is both an organizational reporting structure and a physical office that houses Metropolitan Council, MnDOT, and County, project personnel and design and environmental consultants.

As the State's largest construction project undertaken, funding agreements were approached by the the CCPO as a critical component to its business plan for success. To meet the State's direction that the Metropolitan Council fulfills it's obligation to provide "Fiscal Management" to the project, the Metropolitan Council entered into a Memorandum of Understanding (MOU) with the major funding partners for both the capital contributions and operating sources.

A formal series of policies and procedures was developed for the CCPO Project Director and Manager of Transitways Administration to create and negotiate funding agreements. The funding agreements also require internal coordination with the Metropolitan Council Board, General Counsel, Administration and Finance Departments, and within the guidelines established by the *Managing Federally Funded Projects* manual.[6]

The primary goals and rationale for the use of Funding Agreements include:

- **Formal and binding direction between government agencies**. Establishing the contractual and legal agreement between the agencies results in the ability to offer the funds as "committed" in the review by the FTA.
- **Enhanced discussion and understanding by staff and policy makers prior to the approval.** Brings early recognition to the project financial approach

[6] CCPO Procedures Manual 240-02 Rev 0

- **Clarify financial commitments** Allows agencies to plan funding needs, timing and requirements

- **Clarify schedule of major activities and decisions.** Identifies major elements of the project development and expected requirements.

- **Clarify project risk if project is abandoned.** Early acknowledgement of the potential risk of public monies spent and agency share if the project does not proceed.

The three general types of Funding Agreements used include: a) Subreceipient agreements, where CCPO project funds flow to a partner agency; b) Award Agreements, where CCPO receives funds or inkind services from a partner, and c) Cooperative Agreements, where CCPO and Agency Partners establish Memoranda of Understanding or Cooperation Agreements.

Specific types of funding agreements used by the Metropolitan Council include:

- **Memoranda of Understanding:** Defines the agreed to overall percentages for capital and operating funds to the project.

- **Grant Agreements and Cooperative Funding Agreements:** Generally defines agency responsibilities during a specific "stage" of project development (example – Final Design) and methods by which it shall be accomplished. Includes:
  - Roles and responsibilities
  - Reporting requirements
  - Mechanism for transferring funds
  - Scope of work
  - Review Responsibilities
  - Cash Flows
  - Conflict Resolution
  - Schedule
  - Sale and disposition of any Real Estate acquired or contributed
  - Liability

- **Master Funding Agreement:** Defines the contractual approach, requirements, and payment mechanisms to be used between funding agencies.

- **Subordinate Funding Agreement:** Used to define the scope, budget and schedule for yearly or short term funding authorizations from CCPO to another agency.

The use of Funding Agreements expands beyond those between the Metropolitan Council and other FTA project funding agencies, and includes multiple Utility Relocation Agreements, agreements with railroads, and with local municipalities funding elements of construction outside the Full Funding Grant Agreement (FFGA) amount. In each case, the CCPO is responsible for ensuring the work and responsibilities are clearly defined as part of the financial risk mitigation approach.

All of these agreements must be maintained and managed by the Metropolitan Council to ensure the $956.9 million in design, right-of-way, vehicle procurement and construction contracts "remain fiscally managed" as mandated by the State. Without the advanced planning and discussion that go into an agreement, delays in project definition and funding contributions would likely occur, increasing both the management capacity risk and financial capacity risk to the project.

Summary

The success of the agreement approach can be best measured when the best developed plans go astray, and the project must resolve the issue and move forward. For the CCLRT project, two major changes have occurred since the September 2009 New Starts Financial Plan was submitted to FTA.

The first occurred when the project took advantage of new FTA Cost Effectiveness Index (CEI) policy issued in January 2010 by adding in three new stations that had been planned for the future, but had not yet been funded. The goal of adding the three stations also required the funding commitment of Ramsey County and CTIB to be updated, and the addition of three new funding partner sources (City of St. Paul, Central Corridor Funding Collaborative, and the Metropolitan Council's Regional Transit Capital funds) to be developed and agreed. Appendix A presents a summary of the CCLRT capital funding sources.

The second occurred in March 2010 with the schedule for receiving the FFGA was extended to September 2010, which is beyond the date when the various design/bid/build construction contracts were to be reviewed, negotiated, selected, and notices to proceed authorized.

To avoid the potential construction season delay and an additional year of inflation, and to begin mobilizing the workforce while in a recessionary economic climate, the Metropolitan Council immediately began the process of establishing new funding agreements with local funding partners that tied together the contractors receiving limited notices to proceed, based solely on local funding and following FTA's Letter of No Prejudice (LONP) making the costs federally reimbursable if the FFGA is ultimately approved.

Without the ability to react so quickly, and the familiarity and trust the funding partners have with the process, these two changes would have had the possibility of significantly impacting the project's budget and schedule. Instead, the project was able to quickly provide FTA with funding assurance to allow the project to proceed into Final Design consideration, and lay a strong case for the eventual FFGA approval and project success.

CONCLUSION

This paper summarized the Metropolitan Council's strategies to mitigate local financial commitment risks in developing the CCLRT project and further analyzed the financial and institutional issues pertaining to risk mitigating strategies. This knowledge may be helpful to project sponsors to effectively develop a successful financial capacity plan for a New Starts project. The risk mitigating strategies and related discussion documented in this report should help make project sponsors, state DOT and transit agencies more aware of the FTA perspectives in assessing financial capacity of candidate New Starts projects.

There is not a "one-size-fits-all" solution for a financial capacity plan of a New Starts project. The primary purpose of this paper is to share the experiences of the FTA's financial management oversight and to promote effective approaches in addressing local financial commitment risks.

Appendix A

The Metropolitan Council, through the CCPO, receives funding from the following agencies and organizations for the CCLRT capital costs:

Local Funding	**$478,450,000**	**50.0%**
Counties Transit Improvement Board	**$283,950,000**	**29.67%**
State of Minnesota Bonding	**$91,548,000**	**9.57%**
Regional Rail Authorities	**$94,650,000**	**9.89%**
Ramsey County Regional Rail Authority	**$66,411,000**	**6.94%**
Hennepin County Regional Rail Authority	**$28,238,000**	**2.95%**
City of St. Paul	**$5,200,000**	**0.54%**
CCFC (Central Corridor Funding Collaborative)	**$520,000**	**0.05%**
Met Council RTC	**$2,582,000**	**0.27%**
FTA Funding	**$478,450,000**	**50.0%**
5309 New Starts	**$473,950,000**	**49.53%**
CMAQ	**$4,500,000**	**0.47%**
Total Funding	**$956,900,000**	