OCTA

March 6, 2017

To: Executive Committee

From: Darrell Johnson, Chief Executive Officer

Subject: Delivering Transportation Solutions in a Changing Market

Overview

Since 2013, financial and market forces have combined to present numerous challenges to the Orange County Transportation Authority in successfully delivering on the agency's mission, including the core functions of implementing the Measure M2 Program and operating an effective, efficient, and affordable bus system. Bus ridership has steadily declined and the public's transit needs have shifted, while sales tax receipts continue to come in lower than expected. Despite these factors, the Orange County Transportation Authority has been able to realign the Measure M2 Program so that all promises will be kept, and steps have been taken to reduce costs and realign bus service with demand to better meet the needs of customers, avoid service reductions, and fare increases. This report details the major actions undertaken to keep all Orange County Transportation Authority programs on track in a financially constrained environment and changing market and identifies several upcoming challenges. These issues will need to be addressed in the development of the Long-Range Transportation Plan this year and will need to be incorporated into the annual budget and 20-year Comprehensive Business Plan.

Recommendations

A. Direct staff to continue delivery of the Measure M2 Next 10 Plan.

B. Direct staff to expand OC Bus 360° initiatives, focusing on the benefits and implementation of alternative transit service delivery models.

C. Direct staff to evaluate paratransit growth and cost-management strategies, and return to the Board of Directors with recommendations.

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Background

In fiscal year (FY) 2012-13, the Orange County Transportation Authority (OCTA) emerged from the Great Recession on solid financial footing and was well-positioned to deliver on the promises of Measure M2 (M2), successfully close out Measure M1, modestly grow bus and rail services, and continue the successful ongoing operation of the 91 Express Lanes. Getting to that point was difficult and included some major changes, including a 20 percent reduction in bus service, managing costs and schedules of freeway projects, securing external sources of revenue to keep projects on track, and the implementation of operational efficiencies.

In retrospect, FY 2012-13 was a watershed year. FY 2012-13 was the first year of a multi-year ridership slump on the bus system and was also the first year that sales tax collections started to noticeably underrun projections. The reduction in ridership and restoration of 68,000 vehicle service hours since 2013 have eroded system productivity. Furthermore, the impacts of reduced fare revenue and lower-than-expected sales tax receipts have hit the bus system particularly hard and make it difficult to sustain bus service levels despite the changes that have already been made. In addition, economic, demographic, and market forces have changed the demand for bus service, requiring OCTA to reinvent the delivery model to ensure system productivity and long-term sustainability.

Since FY 2012-13, actions have been taken each budget year to ensure sustainable programs and services despite lower-than-expected revenues. On March 28, 2016, the Board of Directors (Board) directed staff to modify the methodology used to forecast sales tax revenues. This change has proven to be more accurate than the previous methodology and has significantly reduced the amount of sales tax receipts forecast into the future, putting the long-term viability of the current operating model in question. While the Board has already addressed the lower sales tax forecast within the M2 Program by programming additional locally controlled revenues and modifying project delivery plans through the Next 10 Plan, the bus program requires additional adjustments to account for the lower forecast.

Discussion

Every four years, OCTA is required to submit a Long-Range Transportation Plan (LRTP) to the Southern California Association of Governments (SCAG) to ensure that the region is eligible for state and federal funds. The LRTP provides a 30-year vision for transportation investment in Orange County and the Southern California region. Decisions will need to be made regarding how OCTA plans to deal with the changing transportation landscape. These decisions will also need to be included in the upcoming OCTA budget and 20-year fiscally-constrained Comprehensive Business Plan. To determine where OCTA is headed, it is important to examine the current status of OCTA programs and actions already taken to address a changing marketplace and financial landscape.

Over the past four years, each of OCTA's programs has faced different challenges. As a result, the Board and management actions employed to address those challenges are unique to each program based on program characteristics, a changing business environment and funding sources. As it stands today, the M2 Program is reaching a peak with the recent award of the $1.2 billion design-build contract for the Interstate 405 (I-405) Improvement Project, the advancement of the OC Streetcar project, and the implementation of 17 other freeway projects in various stages of development, including three currently under construction. However, the bus program is at a crossroads where future funding is uncertain and ridership is falling due to affordable and convenient competition, a change in legislation regarding driver's licenses, and demographic shifts that are overwhelming OCTA's ability to attract and retain riders. The dichotomous nature of a growing capital program and a struggling bus program creates difficult management challenges for OCTA staff and difficult policy decisions for the Board.

The management strategies and Board policy changes and directives that have been used for each program are described in detail below.

M2 Program

In September 2012, the Board approved the M2020 Plan. This plan was a roadmap to deliver on all the promises of M2 despite lower sales tax collections as a result of the Great Recession. While the plan is detailed in other reports, in general, the plan called for accelerated project delivery to take advantage of a favorable bidding environment and securing and utilizing $720 million in external funds to fill the freeway gap.

After adopting a more conservative sales tax forecast methodology that further decreased the expected future sales tax collections, the Board acted quickly and approved the Next 10 Plan in November 2016. The Next 10 Plan utilizes locally generated net excess toll revenues from the 91 Express Lanes to help fund the remaining M2 projects in the State Route 91 (SR-91) corridor to fill the freeway gap. Also, a Transportation Infrastructure Finance and Innovation Act (TIFIA) loan is assumed for the I-405 Improvement Project which would provide a significant financial benefit to the M2 freeway program. At the same time, there were across the board cuts in funding distributions to the programmatic elements of M2 transit, streets, and environmental elements to ensure the M2 program's viability and to ensure OCTA is operating within its financial means.

For the M2 Transit mode, the $297.9 million OC Streetcar project has entered into the engineering phase and is on track to receive a New Starts grant from the Federal Transit Administration, which would pay for half of the project. In addition, $92 million of other federal and state funds have been secured for the project, leaving only $57 million required from M2 to deliver the project. In 2015, following completion of the M2 Ten-Year Review, Project T – Metrolink Gateways – was officially completed and closed, and $150 million was reallocated to Project R for Metrolink service and $69 million to Project U for Fare Stabilization for Seniors and Persons with Disabilities. The reallocation to Project U was particularly notable because that solved a problem that was identified in 2010. In short, one percent of net M2 revenues was originally allocated for the Fare Stabilization Program. However, with the big drop in projected sales tax due to the recession, it was immediately evident that one percent of the net revenues would not be sufficient to stabilize fares for the 30-year life of M2. The transfer from Project T to Project U addressed this critical issue through 2041.

While much has been done to keep the M2 Program on track, serious challenges remain. Most notably, keeping $5.4 billion of freeway projects within scope and budget will be critical as we move forward, especially as the $1.9 billion I-405 Improvement Project advances. Keeping a close eye on sales tax forecasts and other external funding opportunities also will be an important element to keep the promises of M2. Lastly, with the passage of other local sales tax measures in the region, OCTA expects fierce competition for both internal and external human capital resources and for materials to deliver capital projects.

To address these issues, OCTA will continue to work with the state to ensure that state regulations do not impede our ability to deliver projects consistent with voter approval. For funding, OCTA will advocate strongly for the reinstatement of funds for freeway projects and expects to close the TIFIA loan in May 2017. To address the expected competition for resources, OCTA is undertaking a market analysis study to determine potential impacts and solutions. Lastly, in order to keep qualified personnel that can deliver large capital projects that are promised in M2, changes to the OCTA Personnel and Salary Resolution may be included in the upcoming budget submittal, along with the continued funding of OCTA's pay for performance system.

Bus Service

The bus program has been fraught with challenges over the last few years resulting in negative impacts to ridership in a way that has not been experienced by OCTA in its history. While significant cost-saving measures have been implemented and will continue to be an ongoing focus to sustain current service levels and mitigate inflationary factors, long-term sustainability will require redesigning service to improve productivity and provide market-driven solutions.

The multiple factors creating the current environment have been described in detail in other reports, but it is clear that the demand for the types of services that OCTA has historically provided are no longer effective in all areas of the county. In response, OCTA has launched an ambitious program, called OC Bus 360°, in an effort to curb declining ridership and provide customers a more efficient and user-friendly transit system.

OC Bus 360° is a multi-pronged effort, where one of the key strategies is to reallocate services from low-productivity areas to higher-productivity areas to increase bus ridership. OC Bus 360° is still in its infancy as the first major reallocation of services took place in October 2016.

The results of OC Bus 360° will take time to materialize; however, there are immediate financial implications of ridership declines due to much lower fare revenues being collected than assumed. In addition, similar to the M2 Program, sales tax receipts have not kept pace with projections.

Up to this point, multiple actions have been taken to address the financial realities without impacting the overall level of fixed-route bus service. Additional changes will need to be made after adopting the more conservative sales tax forecasting methodology that may require service reductions to ensure long-term fiscal sustainability.

The most financially impactful change that has been implemented for the bus system since 2013 is the continued effort to contract out a significant portion of the fixed-route service. In 2013, OCTA was contracting out 20 percent of the fixed-route service. Today, that figure has doubled to 40 percent of the fixed-route service. The savings of this action alone is $14.2 million on an annual basis. The majority of the savings was a direct result of favorable rates received when this contract was competitively bid in March 2015.

The contract for the provision of ACCESS paratransit service was awarded in March 2013. The cost for these services is expected to be $8.5 million less in next year's budget when compared to what OCTA was paying on the prior contract.

In regards to savings related to staffing costs, a major shift was approved by the Board in April 2013, that required all employees to pay the full amount of the employee share of pension costs. This action was approved in a phased approach that is now fully implemented. The annual savings of this action is estimated to be $5.8 million next fiscal year. Since the majority of the employees at OCTA work directly or indirectly for the bus program, the majority of the savings accrues to the bus program.

Also in 2013, staff negotiated a new lease for the administrative headquarters building. OCTA continues to reap the benefits of this new lease. In addition to providing tenant improvement funds for the buildout of the new Board room and conference center and other building improvements at no cost to OCTA, the lease approved by the Board saves OCTA $1.3 million annually. Most of those savings accrue to the bus program.

Last year, the Board approved a new contract for the purchase of renewable natural gas at a lower cost. In addition, OCTA has been able to monetize both state and federal credits, which generates a new revenue stream for OCTA. Between the lower cost of fuel and the new income stream, OCTA expects to save $3.4 million annually that directly supports the bus program.

A major portion of the costs associated with running a countywide bus system is the purchase of rolling stock. Recently, OCTA reduced an order by 40 buses which provided immediate cash savings of $23.2 million. OCTA has a conservative approach for paying for rolling stock and other capital by simply saving in a sinking fund and utilizing a pay-as-you-go method when capital needs arise. Since the long-term fleet plan has now been reduced by 40 buses, annual sinking fund contributions have been reduced by approximately $2 million. These funds are being used to help offset lower ongoing revenues.

There are a number of other changes that have been made throughout the normal budget process that have saved operating funds, including a budget amendment approved by the Board in March 2016 that aligned the budget with ongoing revenues. Changes included the cancellation of an order of 12 40-foot buses, lower fuel and lubricant costs, lower contracted-services costs, and savings related to insurances, professional services, and parts costs. Ongoing savings realized by these adjustments total $6.7 million, and annual sinking fund contributions have been reduced by approximately $600,000.

All of the aforementioned actions have saved a total of $42.5 million for the bus system on an annualized basis as compared to what costs would have been incurred had no action been taken. These proactive changes have allowed OCTA to moderately grow bus service by 68,000 hours, or four percent additional service since 2013, despite lower fare revenue and lower-than-expected sales tax receipts. Additionally, a planned fare increase in 2017 was cancelled. In fact, there have been no service hour reductions since March 2010 and no fare increases since February 2013.

The adoption of the more conservative forecasting methodology resulted in a major change in anticipated long-term revenues for the bus system and needs to be addressed. The ridership challenges afflicting Orange County suggest that the services OCTA is providing do not meet the needs of our customers, and reductions in certain areas may be necessary to maintain productivity.

There will be other challenges. Demographics are working against the bus program. Federal regulations will make it difficult to directly partner with transportation network companies. Growth in paratransit demand is expected to continue to consume a larger percentage of transit dollars. Lastly, the state-mandated 20 percent farebox recovery ratio will eventually become an issue again, even though we are allowed to now use other revenues to meet the requirement.

Looking forward, although OCTA may make changes to service levels because of lower demand, it is imperative to give OC Bus 360° time to succeed. OCTA will continue to look at providing service in different, innovative ways by exploring the use of technology to allow for on-demand services and possible partnering with transportation network companies and other providers to better serve our customers. A number of community-based circulators under Project V have been deployed. These projects are intended to fill the gap in areas that are not well-served by the OCTA bus system. Stationlink and express bus services will be revisited by either utilizing vanpools or simply letting the private sector serve those customers. To explore ways to meet the needs of seniors and persons with disabilities while controlling our costs, OCTA will hold a special Board workshop on paratransit services later this year. The workshop will highlight the services that are provided today and associated costs, and provide information regarding the specific requirements OCTA has to abide by under the Americans with Disabilities Act.

91 Express Lanes

The 91 Express Lanes continues to meet all stated objectives. The congestion-pricing toll policy remains in effect and all adjustments have been made per Board policy. Utilization of net excess toll revenues will be dedicated to M2 projects in the SR-91 corridor, which was a major element of the M2 Next 10 plan.

The debt on the 91 Express Lanes was refinanced in 2013 and saved approximately $1.7 million per year when compared to the 2003 debt transaction. Both Standard and Poor's and Fitch have provided ratings upgrades for the 91 Express Lanes since the refinancing was finalized. The "AA-" rating provided by Standard and Poor's is one of the highest ratings assigned to a single-asset toll facility.

The Riverside County Transportation Commission (RCTC) will be extending the 91 Express Lanes into Riverside County this year. OCTA has worked in close partnership with RCTC on this extension and entered into a three-party agreement with RCTC and Cofiroute to provide seamless operation of the express lanes. The three-party agreement is expected to save OCTA $9.63 million over a four and a half year period. It is expected that OCTA's 91 Express Lanes operation and revenue will still meet stated goals once the RCTC extension is opened. Additionally, the Transportation Corridor Agencies (TCA) is designing a direct connector from the State Route 241 to the 91 Express Lanes. OCTA will continue to keep the Board apprised of any issues related to the RCTC project or the TCA project to the extent that they affect the ability of OCTA to improve throughput of the SR-91 corridor.

OCTAP

The Orange County Taxicab Administration Program has seen a major drop in revenues with the emergence of transportation network companies (TNCs). This program is administered by OCTA on behalf of Orange County's local jurisdictions and has always been a cost recoverable program, meaning the revenues generated from the taxi companies would cover OCTA's costs to administer the program. While OCTA has eliminated staff to reduce administrative expenses, the revenues are now so low that OCTA is unable to recover all of its costs while meeting the program objectives.

This industry has dramatically transformed with the advent of TNCs. A letter was sent from OCTA in July 2016, notifying local jurisdictions that OCTA could not provide this service in the future under the existing structure.

Local jurisdictions have convened a working group to determine their potential courses of action given the current circumstances. OCTA has received a letter requesting another year of OCTA administration as the local jurisdictions have a stated preference of not using their own general funds to support the taxicab program.

OCTA is not in a position to subsidize the taxicab program using general funds or transit funds on behalf of the local jurisdictions. Staff will keep the Board apprised of ongoing developments, but it is clearly not the intent for OCTA to provide these services long-term without a structured change to the program.

Metrolink

In 2013, OCTA was running 54 weekday trains per day. Today there are 60 weekday trains per day. Sustaining this higher level of service is made possible largely due to the transfer of $150 million from Project T to Project R as mentioned above. Additionally, staff continues to closely monitor costs provided by Metrolink each budget year and have offered help and provide guidance to Metrolink staff as they have dealt with staff turnover in their finance department.

Growth in Metrolink operating costs and capital rehab costs will likely be significant issues in the future. On February 24, 2017, Metrolink staff provided OCTA with their preliminary budget for FY 2017-18. Metrolink's request increases OCTA's annual operating contribution by 11 percent and also includes an unusually high request for capital rehab. These types of cost increases are unsustainable. Staff will continue to work collaboratively with Metrolink staff to keep costs at reasonable levels while also ensuring proper investment is made for the provision of safe and reliable service.

Summary

Over the next several months, OCTA will be developing a Long-Range Transportation Plan, an annual budget, and a 20-year Comprehensive Business Plan at a time when the transportation marketplace is rapidly evolving and the traditional methods for funding transportation services and projects are shifting. Since 2013, OCTA has focused its efforts on ensuring that all OCTA programs remain on track despite lower-than-expected sales tax revenue and declining bus ridership. Through various actions, $42.5 million in ongoing recurring savings for the bus program have been achieved to ensure fiscal sustainability without raising fares or reducing service levels. Lower revenues and reduced demand for traditional fixed-route service may require some service levels to be revised. In addition, OCTA is examining ways to deliver transit service that addresses a changing market. For the M2 Program, the approval of the Next 10 Plan puts the entire program in position to deliver on all the promises made to voters. The continued commitment to meet all of the promises included in the capital-intensive M2 program juxtaposed against a struggling bus system that needs to evolve to better meet the needs of our customers creates management challenges that will need to be addressed in the coming months.

Attachment

None.