OCTA

***September 10, 2018***

***To:*** Members of the Board of Directors

***From:*** Darrell E. Johnson, Chief Executive Officer

***Subject:*** Measure M2 2018 Update: Next 10 Delivery Plan

### *Overview*

The Measure M2 Next 10 Delivery Plan was originally approved on November 14, 2016, incorporating the 2016 revenue forecast with a plan for continued acceleration of the delivery of Measure M2 freeway, streets and roads, transit, and environmental projects through the year 2026. With annual updates to the Measure M2 sales tax revenue forecasts, staff reviewed the Next 10 Delivery Plan in 2017, and made needed adjustments to confirm that it remained able to be delivered and has just completed the same review for 2018. The results of this effort are presented to the Board of Directors.

### *Recommendations*

A. Adopt the 2018 Measure M2 Next 10 Delivery Plan with revised financial assumptions.

B. Direct staff to continue to monitor revenue and project cost impacts that could affect the delivery plan and return to the Board of Directors with changes if necessary.

### *Background*

Expedited delivery of Measure M2 (M2) began in 2007 and has continued to date in an effort to bring transportation improvements to the public as early as possible. The 2008 Great Recession and changes in consumer spending habits, resulted in reductions to the M2 sales tax revenue forecast. In response, the Orange County Transportation Authority (OCTA) Board of Directors (Board) proactively revised the forecasting methodology and adjusted delivery plans to ensure the M2 plan of projects and programs are implemented as promised to the voters.

The initial strategy to overcome the drop in M2 revenues for the freeway program included reliance on external revenues rather than a self-sustaining approach, as originally designed. This strategy, combined with availability of one-time state and federal grants, and effective use of bonding, allowed OCTA to capitalize on competitive construction market conditions to continue expedited delivery of M2 Capital Program elements.

On November 14, 2016, with the adoption of the Next 10 Delivery Plan (Next 10), the Board directed staff to dedicate and set aside local revenues through the allocation of net excess 91 Express Lanes revenue, for eligible projects. The two eligible projects are on State Route 91: Project I, between State Route 55 (SR-55) and State Route 57, and Project J, between SR-55 and the Riverside County line. This approach was continued with the review and approval of the updated Next 10 on November 13, 2017. With the 2017 update, it included Project I designated as a priority project for advancement.

Staff continues to incorporate strategies to ensure the complete M2 program of projects is able to be delivered through tight project scope management including refinements as appropriate, adjusting schedules and aggressively seeking external revenue.

***Discussion***

On July 23, 2018, the Board received an early presentation on the 2018 sales tax revenue forecast of $13.1 billion. The 2018 forecast is $400 million lower than the 2017 forecast of $13.5 billion. Staff incorporated the new revenue forecast, as well as updated programmed external revenues, project costs, and schedules into the M2 cash flow for each of the M2 Program elements. While a reduction in revenues affects the M2 Program as a whole, in most areas of the M2 Plan programs can be scaled to available revenues. The area where this is not possible is in the freeway program, due to set scopes for project delivery.

Next 10 Cash Flow Update

The Next 10 cash flow incorporates the revised revenue forecast of $13.1 billion, as well as the contribution from the Transportation Infrastructure Finance and Innovation Act, in the amount of $153.9 million, which is a contribution to the M2 general purpose lane project. This amount is a direct benefit to the M2 portion of the Interstate 405 Improvement Project, as the loan will be repaid with toll revenues and not with M2. The cash flow also incorporates updated project cost estimates for all M2 Program elements, as well as committed programmed state and federal external revenues.

In addition to state and federal funding commitments, the cash flow also assumes the availability of a reasonable level of federal and/or state funds from 2017 to 2041 and makes specific assumptions about near term grants, such as the federal New Starts Program for OC Streetcar. Additionally, per the Board's direction, the cash flow also includes net excess 91 Express Lanes revenue within the freeway program for projects on the 91 corridor (as defined by the 91 Express Lanes governing legislation), in an amount not to exceed the total cost of Project I and Project J.

Freeway Program Cash Flow

The net forecasted freeway program sales tax and interest revenues in the 2017 revenue forecast was $5.49 billion. The updated 2018 sales tax and interest revenue forecast is $5.36 billion. This results in a net freeway program loss in forecasted revenues of $127.1 million. OCTA has been successful in leveraging external funding in past years to offset reductions in sales tax revenues, and in the past year alone net external revenue for the freeway program increased by $291.9 million that was not available or programmed in the prior year cash flow. While sales tax revenue is down, the additional external revenue has resulted in a net positive revenue in the freeway program of $161.9 million.

With this 2018 update of Next 10, each project in the freeway program was reviewed and cost estimates updated. With the majority of the projects now either in the environmental phase or in design, project cost estimates have a higher level of engineering and are therefore better defined. While some project costs increased, others decreased and resulted in a net decrease of $280 million. This cost reduction, in tandem with the amount of external revenue captured and the resulting reduction in bonding need, results in an overall positive outlook for the M2 Freeway Program.

Freeway Program Revenue Cash Flow Comparison 2017 vs 2018

| Item | Influence | Impact on Cash Flow |
|---|---|---|
| Net Forecasted Sales Tax Revenue and Interest | Negative | - $127.1 million decrease |
| Net External Revenue | Positive | + $291.7 million increase |
| Net Freeway Project Cost | Positive | - $278.8 million decrease |
| Net Bonding Revenue | Positive | - 102.9 million decrease |
| Net Bonding Expense | Positive | + $205.6 million savings |
| Net Increase in FSP, EMP, Economic Uncertainty | Neutral | - $520.7 million added for safety |
| Total Difference in Ending Balance | Net Positive | + $25.6 million for financial safety |

FSP – Freeway Service Patrol / EMP – Environmental Mitigation Program

Key Financial Risks and Actions to Protect M2 Delivery

While the entire M2 Program continues to demonstrate financial viability and delivery of the complete M2 plan of projects and programs, risks continue to challenge the program. These include financial, organizational, and policy risks. Key financial risks and OCTA staff actions are highlighted below. A complete list of risks to be updated and tracked as part of the M2 quarterly progress reports to the Board is included on page 5 of the attached 2018 updated Next 10 document (Attachment A).

- Lower Sales Tax Revenues - In March of 2016, the Board adopted a new sales tax forecasting methodology. This year's revenue forecast came in lower than what was forecasted just one year ago. In addition, presentations by the expert economic forecast entities were far more conservative than in the past. Although, this points to the probability of a more accurate forecast going forward, there are no assurances and, hence, the revenue outlook continues to be a risk.

  OCTA staff will continue to monitor actuals to see how the forecast is performing and report to the Board quarterly.

- Repeal of SB 1 (Chapter 5, Statutes of 2017) Gas Tax - While the M2 cash flow includes only a small amount of direct SB 1 competitive funding, if Proposition 6, on the November 6, 2018 ballot is approved and the gas tax funding repealed, committed formula revenues may be impacted. Staff anticipates that up to $170 million of funding commitments programmed in the State Transportation Improvement Program for M2 projects could be deprogrammed or delayed, impacting M2 delivery schedules with state funding commitments.

  During the cash flow update of the Next 10, staff developed and analyzed two scenarios: one with current programmed commitments, which assumes current law with the gas tax in place, and a second scenario in the event of a repeal. While a total of $291.9 million was secured in state and federal funding since last year, if SB 1 is repealed the impact is conservatively estimated at $170.2 million. This remains a net positive. Attached are cash flow summary charts showing the difference between the cash flows with and without SB1 between now and 2041. Attachment B shows the cash flow with SB 1. Attachment C shows a comparison of the cash flow with and without SB 1. Attachment D shows a solvent cash flow with and without SB 1 but requires economic uncertainties to be lowered from 13 percent to seven percent if SB 1 is repealed. While both charts reflect a positive ending balance in all years and indicate that the full program (through 2041) is deliverable, the full impact of a repeal of the gas tax on programmed external revenues is unknown. More details will be available pending the outcome of Proposition 6, and action by the California Transportation Commission on how to demobilize approved projects.

- Potential for Cost Increases Impacting Freeway Delivery - As presented on September 11, 2017, the Next 10 Market Conditions Forecast and Risk Analysis Report, conducted by respected local economists Dr. Wallace Walrod and Dr. Marlon Boarnet, identified a strong potential that OCTA could experience an increasing-cost environment during delivery of Next 10. The Board directed staff to continue to work with the consultant to monitor and track key early warning indicators. Through this follow on effort, the consultant team created a cost pressure index providing a range of potential cost fluctuations. The index identified that OCTA may experience a cost increase of between six to 11 percent during the 2018 though 2020 time period of construction activity.

  In order to accommodate cost pressures, OCTA's Project Controls Department monitors and adjusts project cost escalation assumptions according to market trends. Project controls makes use of schedule control, cost control, progress reporting, and change management to effectively monitor and control project escalation and execution. Imbedded in the Next 10 are cost assumptions based on historical information, current trends in the market, as well as review of the California Department of Transportations' (Caltrans) Construction Cost Index. Higher cost assumptions are included on some elements of projects based on assessed potential risk. Additionally, to further protect against potential cost increases in our freeway capital program and conform to project controls' project estimating process, staff incorporated a 13 percent program level expense line item in the cash flow for economic uncertainties (without SB 1, the cash flow scenario includes seven percent). This is intended to safeguard the program and ensure that OCTA does not over commit delivery during this time of uncertainty.

- Project Alternative Selection - In addition to project cost increases as a result of market forces, the freeway program is also at risk of cost impacts during alternative selection in the environmental phase. OCTA is committed to funding projects promised to the voters, and ensuring community and business support, and staying generally within the existing ROW. A number of projects are currently moving through the environmental process and alternative selection is, or will be, underway soon. While OCTA provides the funding commitments for the projects, Caltrans ultimately makes the decision on alternative selection. One project in particular is of current concern. Interstate 5 between

SR-55 and Interstate 405 (Project B) is challenged with ROW constraints within the project area. Two alternatives are under study with both proving to have equal net traffic benefits. One alternative has greater community and business impacts; however, due to the need for the reconstruction of two bridges, resulting in a nearly $300 million higher cost. The second alternative relies on design exceptions to provide the same capacity and same ultimate traffic benefit while minimizing community and business impacts. Given the constraints of the M2 Freeway Program, the impacts and lack of community and business support, OCTA is not in support of the higher cost alternative.

Keeping project scopes contained is critical to successful delivery of the entire M2 Freeway Program. With the current risk of a cost-increasing environment, and due consideration for the impacts, the higher cost alternative was not included in the cash flow. Inclusion of the constrained alternative ensures the same capacity improvement, the same net traffic benefit, and supports community and business wishes.

Updated revenue assumptions and commitments, along with revised bonding assumptions (the bonding plan is based on the scenario without SB 1 to ensure a conservative approach), result in a delivery plan that remains solvent. A balanced plan not only allows OCTA to secure favorable bond ratings when financing, but also allows OCTA to weather reasonable changes to cost or revenues. With a solvent cash flow, the Next 10 deliverables remain as adopted and are included along with a progress report as Attachment E.

***Summary***

In response to the latest revenue forecast, staff reviewed the Next 10 and updated the revenues, bonding assumptions, project costs and schedules into the M2 cash flow. The result of the review and update demonstrates a delivery plan that remains solvent. To address the potential of higher cost in the near term as it relates to the freeway program, the cash flow assumes a 13 percent expense at the program level for economic uncertainties in the freeway program cash flow between now and 2028. The 2018 updated Next 10 is presented for Board review and approval.

***Attachments***

A. 2018 Update, Next 10 Delivery Plan, 2017-2026, Draft
B. 2018 Updated Next 10 Plan, M2 Program Cash Balance With SB 1 (Chapter 5, Statutes of 2017)
C. 2018 Updated Next 10 Plan, M2 Program Cash Balance Comparison With And Without SB 1 (Chapter 5, Statutes of 2017)
D. 2018 Updated Next 10 Plan, M2 Program Cash Balance With Adjusted Economic Uncertainty Allowance
E. 2018 Update, Next 10 Delivery Plan, Next 10 Progress Report on Deliverables

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