OCTA

November 13, 2019

To: Finance and Administration Committee

From: Darrell E. Johnson, Chief Executive Officer

Subject: Reserve Policy

Overview

The Orange County Transportation Authority is committed to prudent fiscal management and maintaining the ability to fund its programs and services during times of economic uncertainty. Orange County Transportation Authority has a history of maintaining reserves to mitigate the impacts of financial risks to the programs operated by the Orange County Transportation Authority. The goal of this policy is to formalize the existing reserve policy for those programs and include them in one document for clarity and transparency.

Recommendation

Adopt the Reserve Policy and implement the policy in current and future financial plans.

Background

The Orange County Transportation Authority (OCTA) operates programs whose revenues can be greatly impacted during times of economic uncertainty or recession. These decreases in revenue can stem from reduced sales tax revenue, reduced fare or toll revenue, or less support from Federal or State sources. As a result, OCTA has a history of maintaining reserves implemented through its Comprehensive Business Plan (CBP) and annual budget process.

Discussion

OCTA operates three programs: Bus, 91 Express Lanes (91 EL), and Motorist Services, that are reliant on stable revenue sources and are most immediately impacted during periods of economic uncertainty. Decreases in revenue can produce immediate impacts to their ability to fund operating and capital requirements. As a result, operating and capital reserves can help mitigate the impacts to service levels and the funding of capital projects during times of economic uncertainty.

The current economic cycle has exceeded ten years, which is twice the typical expansion phase following a recession. Though it is unclear when the next recession will occur, it is important that OCTA be prepared for the downturn in order to lessen the impact to operations for the Bus, 91 EL, and Motorist Services programs. OCTA has historically maintained reserves for these programs. However, in preparation for the next economic downturn, OCTA has formalized a reserve policy for the three programs. The Reserve Policy will address three reserve categories within each of the programs. The three reserve categories are: operating, capital, and debt.

Bus Program

Reserve	Target
Operating	60 days
Capital	Fully fund capital expenditures through Capital Replacement Fund
Debt Requirements	Not applicable

OCTA has a longstanding practice of maintaining a fully-funded operating reserve for the Bus Program. The Bus Program has traditionally maintained a 45-day working capital balance to accommodate for unexpected fluctuations in revenue and expenditures. OCTA is recommending increasing the 45-day operating reserve to 60 days. This would increase the reserve from $37.9 million to $50.5 million for fiscal year (FY) 2019-20. The reason for the recommendation is that the primary revenues supporting the Bus Program, such as sales tax, State Transit Assistance, and fare revenue are highly susceptible to the negative impacts of a recession. In addition, in June of this year, the Government Finance Officers Association (GFOA) made a recommendation to local governments to maintain General Fund reserve balances of 60 days. Though the Bus Program is not a General Fund, given its strong reliance on multiple funding sources, which is similar to a General Fund, the recommendation from the GFOA provides an additional reason to take a more conservative approach to the level of operating reserves maintained to support the Bus Program. The increase to a 60-day operating reserve can be accommodated financially without impacting bus operations.

OCTA has also traditionally maintained a Capital Replacement Fund (CRF) for the Bus Program, which is used to fund the rehabilitation and replacement of its capital assets. The CRF enables OCTA to pay for the rehabilitation and replacement of capital assets without the need for debt financing, which allows OCTA to avoid debt service expenditures and instead maximize the amount of revenue available for service. Funding for the CRF is determined through OCTA's CBP and executed through the annual budget. Currently OCTA sets aside approximately $25 million annually to ensure the timely replacement of its bus capital assets.

In addition to eliminating the cost associated with debt financing, the CRF also provides OCTA flexibility during periods of economic recession. During the Great Recession, the significant decrease in revenues for the Bus Program necessitated a reduction in service. Due to the planned reductions in ongoing service levels, there was a corresponding decrease in the number of buses that would need to be replaced within the fleet. As a result, the funds that had been saved in the CRF for buses that would no longer be replaced were used to gradually reduce service instead of making large, immediate reductions.

91 Express Lanes

Reserve	Target
Operating	None
Capital	Fully fund capital expenditures through Capital Replacement Fund
Excess Revenue Policy	Freeway – 80 percent, Transit – 20 percent
Debt Requirements	
Debt Service Reserve	$10,800,000
Operating	$3,000,000
Capital	$10,000,000

The 91 EL has five reserve accounts which include two reserve accounts internal to OCTA and three reserve accounts required as part of the 91 EL outstanding debt. The two reserve accounts internal to OCTA are Board of Directors (Board)-approved and include a 91 EL CRF and a 91EL Excess Revenue Fund (ERF). The 91 EL CRF is fully funded and used to fund the rehabilitation and replacement of the 91 EL capital assets without the need for additional debt financing. Similar to the Bus Program, funding for the 91 EL CRF is determined through OCTA's CBP on an annual basis.

In January 2014, OCTA's Board approved a policy for the use of 91 EL ERF. The 91 EL ERF is to be used to fund future 91 corridor improvements. The 91 EL excess revenues, defined as revenues available after debt service, operations, maintenance, capital, and administration costs are paid, are to be allocated 80 percent for freeway projects and 20 percent for transit projects or services. The 80/20 allocation is to be achieved by 2030. The Board has already set aside $14.3 million of excess revenues to help fund the Placentia Metrolink Station. In November 2017, the Board approved the Next 10 Plan which included the utilization of up to $748.7 million in excess revenues to be used on a pay-as-you-go basis for two Measure M2 (M2) freeway projects in the 91 corridor. As of today, $56 million has been set aside for the two projects.

Three reserve accounts are required as part of the 91 EL outstanding debt to protect bondholders. The three reserve accounts are held in trust for the benefit of the repayment of the bonds and include a debt service reserve fund ($10.8 million), an operating reserve ($3.0 million), and a capital reserve ($10 million). Each of the reserve accounts is fully funded and will remain so until the debt is retired.

Motorist Services Program

Reserve	Target
Operating	60 days
Capital	None
Debt Requirements	Not applicable

The Motorist Services Program supports the Freeway Service Patrol (FSP), Freeway Callbox, and 511 Programs. Revenue to support the three programs comes primarily from vehicle registration fees and funding from the State Highway Account (SHA). In addition to those funding sources, the FSP does receive additional funding from the M2 Program and the Road Repair and Accountability Act (RRAA). Both the SHA and RRAA funds are received annually on a reimbursement basis.

The FSP is the largest operating program of the Motorist Services Programs and is used to fund private tow truck companies that patrol freeways to assist stranded motorists. OCTA maintains a 60-day operating reserve to ensure adequate reserves to cover unforeseen impacts to FSP revenue or expenses and to allow for fluctuations in the timing of the revenue reimbursement for the SHA and RRAA revenues. A 60-day operating reserve for FY 2019-20 is $1.4 million. Due to the small nature of the capital expenditures for the three programs, a capital reserve is not deemed necessary to support ongoing capital requirements.

Future Reserve Accounts

OCTA has two projects under construction that will lead to operating programs in the future. The two operating programs will be the 405 Express Lanes and the OC Streetcar. It is anticipated that the 405 Express Lanes will have up to five reserve accounts including internal reserve accounts, as well as reserves required due to outstanding debt. It is anticipated that the OC Streetcar will have up to two internal reserve accounts.

405 Express Lanes

Reserve	Target	Required
Operating	To be determined	Not applicable
Capital	To be determined	Not applicable
Debt Requirements		
Debt Service Reserve Fund	Fluctuates annually: formula based with annual calculation	2025
Operations & Maintenance	Fluctuates annually: formula based with annual calculation	2023
Major Maintenance	Fluctuates annually: formula based with annual calculation	2027

OCTA anticipates the 405 Express Lanes will have up to two internal reserve accounts (established and held by the OCTA), as well as three reserve accounts required due to outstanding debt to be held by the trustee. The type and amount of the internal reserve accounts will be determined at a future date as OCTA evaluates the available revenue to fund the accounts based on first satisfying the loan requirements from the outstanding debt. As an example, OCTA is required to deposit all excess revenue, after satisfying the requirements of the other reserve funds, into a Distribution Lock-Up fund for the first five years of operations. The internal reserve accounts will be included within this policy and brought to the Board for consideration.

The 405 Express Lanes has a Transportation Infrastructure Finance and Innovation Act loan with the United States Department of Transportation that is being used to finance the construction of the 405 Express Lanes. The loan will require three reserve accounts to be created within set time periods following substantial completion of the project. The three accounts include a debt service reserve fund, operations and maintenance reserve, and a major maintenance reserve. Each reserve account has a formula defined within the loan agreement for the amount required on an annual basis. The debt service reserve fund is required to be established in 2025, the major maintenance reserve account is required to be established in 2027, and the operations and maintenance reserve account is required to be established in 2023. The amounts required in the first year of establishment for each account will be determined in the future based on the requirements of the loan agreement and will be funded with toll revenues collected from the 405 Express Lanes.

OC Streetcar

Reserve	Target
Operating	To be determined
Capital	To be determined
Debt Requirements	Not applicable

OCTA also anticipates the OC Streetcar will have internal reserve accounts that will be established and held by the OCTA similar to the Bus Program. The type and amount of the internal reserve accounts will be determined in the future and will be included within this policy and brought to the Board for consideration. It is estimated a 60-day reserve for the OC Streetcar would be approximately $1.5 million.

Future Updates to the Reserve Policy

Reserve targets are reviewed during OCTA’s annual process of updating and analyzing the cash flows for each of OCTA’s programs and services. OCTA will bring any future recommended changes to this policy to the Board for consideration.

Summary

OCTA has a history of maintaining reserves to mitigate the impacts of financial risks to the programs operated by the OCTA. OCTA has formalized the reserve policies historically implemented through the CBP and bond indentures into a Reserve Policy for clarity and transparency for Board of Directors consideration.

Attachment

None.

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