PROPOSED FINANCING OF $6.8 BILLION PROJECT
SOUTHERN CALIFORNIA RAPID TRANSIT DISTRICT

NOVEMBER 1973

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November 13, 1973

Honorable Alan Sieroty, Chairman
Assembly Subcommittee on Los Angeles
Regional Transportation
Room 5136, State Capitol
Sacramento, California 95814

Dear Alan:

Transmitted herewith is a report in response to your request for an examination on the financing base, the amounts of future operating deficits contemplated, and how these deficits might be met for the mass rapid transit system proposed by the consultant to the Southern California Rapid Transit District (SCRTD).

The July 1973 consultant's report on the feasibility of SCRTD does not contain the estimated amount by which projected operating deficits would exceed sales tax revenues beginning in 1987, the year following the project's 12-year construction period. Based on the assumptions at the time the report was prepared, the consultant's estimate of such deficits for just the first four years following construction totaled $210.3 million.

The operating deficits anticipated once the 12-year construction period is over might be funded by increasing fares. However, this could result in decreased patronage, thus producing greater deficits.

Other alternatives used by transit districts to finance their operations include increased sales taxes, ad valorem real estate tax, gasoline tax, automobile in-lieu tax just to mention a few. Senate Constitutional Amendment 15, which will be on the June 1974 statewide ballot, proposes the use of state gasoline taxes for transportation purposes other than highway. If this amendment is approved, SCRTD's consultant estimates that up to $30 million could be available annually to the district for construction and maintenance purposes.

Approximately $2 billion could be collected from an existing one-quarter sales tax in Los Angeles County during the 30-year period from 1975 through 2004. An additional $4.9 billion in tax revenues could be raised from a proposed one-half percent sales tax authorized by Assembly Bill 1727 provided it is approved by the voters. These projections are based on 1972 taxable sales in Los Angeles County increased at an assumed annual rate of three percent over the stated period. These projected revenues, if realized, could be used to finance about 65 percent of the project's current estimated cost.

In assuming the availability of $4.5 billion in federal Urban Mass Transportation Administration (UMTA) funds for construction of the system, the consultant overstated such funds by at least $1.9 billion. The consultant's report states that the federal grant "...is expected...(and) would amount to $4.5 billion...". Even assuming the maximum possible share of the anticipated $10 billion federal funds that would be made available to California, and even assuming the entire California share would be made available exclusively to SCRTD, the UMTA grant would be limited to $2.6 billion.

The inclusion in the consultant's report of the amount of estimated future operating deficits and of the facts pertaining to the uncertainty of SCRTD receiving the entire $4.5 billion is necessary for full disclosure.

With my warm best wishes,

Sincerely,

Vince

VINCENT THOMAS, Chairman
Joint Legislative Audit Committee

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INTRODUCTION

In July 1973, the Southern California Rapid Transit District (SCRTD) released a consultant's report recommending construction of an eight-corridor mass rapid transit system and containing a financial plan for its construction and operation over a 12-year period.

Our review was made in response to a legislative request for an examination of the financial plan including specifically the amount of projected future operating deficits and how these deficits might be met.

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BACKGROUND

The 71-page consultant's report released by SCRTD in July 1973 was compiled by Peat, Marwick, Mitchell and Co., under the general direction of a three-man committee from the SCRTD staff, and was based on technical reports written by the following firms over an eight-month period beginning October 1972:

Engineering and Planning:
Kaiser Engineers
Daniel, Mann, Johnson and Mendenhall

Patronage, Revenue and Bus Plans:
Alan M. Voorhees and Associates

Socio-economic and Environmental:
Wallace, McHarg, Roberts and Todd/Kennard and Silvers

Financing:
Stone and Youngberg Municipal Financing Consultants, Inc.

The consultants were paid $600,000 for this study, $400,000 of which was from a planning grant from UMTA and $200,000 of which was from SCRTD funds.

A 12-page summary of the 71-page consultant's report, also dated July 1973, was prepared by SCRTD for distribution "to the people of the Los Angeles region".

The consultant's report proposes a 12-year "initial construction program" to construct a six-corridor, 116-mile mass rapid transit system together with 24 additional miles of exclusive-lane busways in two other corridors. The existing fleet of 1600 buses would be gradually expanded to 2700 buses by the end of the 12-year period.

The six-corridor system and the new buses were estimated by the consultants to cost \$3.5 billion in 1973 dollars, increased to \$6.8 billion after including a nine percent per year escalation factor for the 12-year construction period. The consultants anticipated that two-thirds of this amount - \$4.5 billion - would come from federal UMTA funds, and the remaining one-third - \$2.3 billion - would be financed locally. The exclusive busways for the other two corridors were estimated to cost an additional \$135 million in 1973 dollars, which was assumed to be available from highway construction funds.

As an illustration of the size of the proposed 12-year "initial construction program", the cost in 1973 dollars of the existing 459 miles of freeways in Los Angeles County is estimated by the Division of Highways to be \$4.2 billion. Also for comparison, the construction cost to date of the California Water Project has been \$2.3 billion in historical dollars and the total anticipated construction cost of the Water Project through the year 2035 is estimated by the Department of Water Resources to be \$3.6 billion.

FINDINGS

UNDISCLOSED OPERATING DEFICITS

THE CONSULTANT'S REPORT DOES NOT CONTAIN THE ESTIMATED AMOUNT BY WHICH PROJECTED OPERATING DEFICITS WOULD EXCEED SALES TAX REVENUES BEGINNING IN 1987, THE YEAR FOLLOWING THE 12-YEAR CONSTRUCTION PERIOD. BASED ON THE ASSUMPTIONS AT THE TIME THE REPORT WAS PREPARED, THE CONSULTANT'S ESTIMATE OF SUCH DEFICITS FOR JUST FOUR YEARS TOTALED $210.3 MILLION.

The consultant's report projects that the district's fare revenues will be about $55 million less than operating costs at the start of construction in 1975. By the end of the construction period in 1986, the operating deficit is projected at about $287 million.

The consultant's financial plan provides for meeting these operating deficits until the end of the 12-year construction period assuming a 3/4 percent sales tax could be levied by the district to be used for either construction or operation as necessary and that the average fare would remain at 35 cents through the end of the construction period.

Technical reports were prepared by the consultants to support the published report and were presented to SCRTD. These technical reports show that the large operating deficits during the later years of the 12-year construction period were to be met largely by a surplus of sales tax revenues collected during the early part of the construction period when operating costs were low. However, this surplus would be fully expended in 1986. During 1987, the first year following the end of the construction period, the operating deficit would exceed projected sales tax revenues by $69 million. This deficit assumes an average fare of 50 cents beginning in 1987 which represents approximately a 43 percent fare increase from 1986.

The following schedule developed from information in Stone and Youngberg's working papers discloses the unmet deficit following completion of construction.

Operating Deficits Not Covered
By Sales Tax Revenues
Based on Consultant's Data
(In Millions)

Year	Sales Tax Revenues a/	Operating Deficit And Bond Service Requirements b/	Operating Deficit Not Covered By Sales Tax Revenues
1987	$283.4	$352.3	$ 68.9
1988	291.9	316.5	24.6
1989	300.7	347.1	46.4
1990	309.7	380.1	70.4
Total			$210.3

a/ Based on assumed 3/4 percent sales tax to be authorized and district share of the presently authorized 1/4 percent sales tax revenues under Chapter 1400, Statutes of 1971 (SB 325).

b/ Includes excess of operating costs over fare revenues and bond service requirements.

The only mention made in the final report of the sizable unmet operating deficit anticipated immediately following the construction period is as follows:

> "Beyond the 12-year period, continued rates of inflation will have a substantial impact on District finances. In 1987, the first year of full operation of the initial system, revenues from fares and from the sales tax and SB 325 have been compared with capital needs to continue bus replacement, bond service requirements, and operations and maintenance costs. This comparison shows that, while there will be no difficulty in meeting the bond service requirements, increased inflation will necessitate covering a net deficiency in funds."

However, the consultant's report contains no estimated amounts by which the projected operating deficits would exceed sales tax or other local revenues beginning in 1987. However, such deficits while not incorporated in the final report were in fact estimated by the financial consultant annually from 1987 through 1990.

The financial consultant told us that amounts of operating deficits after construction was completed in 1986 were not included in the report because this "would take super crystal-balling" and that the estimates get foggier and foggier for future years.

The SCRTD manager stated that 1986 is about as far into the future as operating deficits can be projected with any reasonable certainty. Therefore, deficits for 1987 and beyond were not included in the consultant's report.

In our opinion, the inclusion in the consultant's report of the estimated amounts of future operating deficits is necessary for full disclosure.

Further, in our judgment, if the assumptions used were valid to project an operating deficit for 1986, these same assumptions should be valid for estimating a deficit for 1987.

OVERSTATEMENT OF AVAILABILITY OF FEDERAL FUNDS

THE CONSULTANT'S REPORT, IN ASSUMING THE AVAILABILITY OF $4.5 BILLION IN FEDERAL URBAN MASS TRANSPORTATION ADMINISTRATION (UMTA) FUNDS FOR CONSTRUCTION OF THE SYSTEM, HAS OVERSTATED SUCH FUNDS BY AT LEAST $1.9 BILLION.

In developing the proposed method of financing the new transit system, the consultants assumed that UMTA would provide two-thirds of the $6.8 billion estimated construction and bus acquisition cost, or $4.5 billion while the $2.3 billion remainder would be provided by local taxpayers.

The U.S. Department of Transportation has acknowledged a $10 billion, 12-year federal commitment to rapid transit development. At the time the consultant's report was prepared the Congress had authorized only $3.1 billion for such grants. This amount was increased to $6.1 billion in August 1973.

Federal law limits the amount of UMTA commitments to any one state. The U.S. Secretary of Transportation has discretionary authority to issue grants out of a 15 percent portion of the UMTA budget without respect to other limitations. However, no one state can receive commitments in excess of 12.5 percent of the remaining 85 percent of the budget. Even assuming the maximum possible share of the anticipated $10 billion program would be made available to California, and even assuming the entire California share would be made available exclusively to SCRTD, the UMTA grant would be limited to $2.6 billion.

Therefore, in our judgment based on the current known facts and based on the known facts at the time the consultant's report was released, the consultant's assumption of the availability of $4.5 billion of UMTA funds was overstated by at least $1.9 billion.

The financial consultant and SCRTD manager stated that while the consultant's report does not comment specifically on the uncertainty of the $4.5 billion anticipated federal grant, this uncertainty has been discussed at numerous public meetings.

The SCRTD manager also stated that it is not unreasonable to expect more federal assistance for rapid transit construction than is available under present conditions and that the federal commitments are constantly changing. He said that other systems throughout the country are having problems similar to those of SCRTD, and they fully believe the federal commitment in this area will increase greatly. He also said that additional reports will be obtained from the consultants with regard to alternative financial planning.

The consultant's report states:

> "...To undertake a project of this magnitude, two-thirds Federal grant participation <u>is expected</u> under the Urban Mass Transportation Act of 1970 and/or subsequent legislation...The grant <u>would amount</u> to $4.5 billion. The remaining one-third must be raised locally..." (emphasis added).

We believe the inclusion in the consultant's report of the facts pertaining to the uncertainty of SCRTD receiving the entire $4.5 billion is necessary for full disclosure.

EFFECT OF RECENT LEGISLATION

Assembly Bill 1727 (Chapter 1060, Statutes of 1973) was signed by the Governor on October 2, 1973, after the consultant's report was issued. This bill authorizes the imposition of two separate 1/2 percent sales tax levies upon separate votes of a majority of the district's voters.

Revenue from one 1/2 percent levy could only be used for capital financing, on either a pay-as-you-go basis or with limited tax bonds.

The second 1/2 percent levy, if approved, must be used in two ways. Half the revenue, 1/4 percent, could only be used for maintenance and operation purposes. The other 1/4 percent could only be used to reduce fares and to eliminate transfer and zone charges among all transit operators in the district. If this second 1/2 percent levy is approved by the voters, a maximum flat fare of 25 cents must be established until 1981.

The following schedule shows that the projected operating deficits for the proposed system will increase when the consultant's financial plan is adjusted for the effects of AB 1727. We prepared the schedule by adjusting the consultant's cost and revenue data based on SCRTD projections that a fare reduction from an average of 35 cents to a flat 25 cents would result in a 22 percent increase in ridership and a 17 percent increase in operating expenses.

Projected Operating Deficits
After Adjusting the Consultant's Report
For the Effects of AB 1727 (CH 1060/73)
(In Millions)

Year	Estimated Operating Cost[a/]	Estimated Revenues: From Flat 25¢ Fare[b/]	Estimated Revenues: SCRTD Share Of 1/2 Percent Sales Tax[c/]	Estimated Net Operating Profit Or (Deficit) Not Covered By Sales Tax Revenues
1975	$ 124.9	$ 45.3	$ 86.2	$ 6.6
1976	137.9	49.4	88.7	.2
1977	152.1	54.7	91.4	(6.0)
1978	167.5	59.3	94.1	(14.1)
1979	184.1	64.1	96.9	(23.1)
1980	202.4	70.3	99.9	(32.2)
1981	221.9	75.6	102.8	(43.5)
1982	243.1	81.3	105.9	(55.9)
1983	266.1	88.3	109.1	(68.7)
1984	315.3	94.4	112.3	(108.6)
1985	404.9	105.8	115.7	(183.4)
1986	504.1	126.5	119.2	(258.4)
1987	599.2	145.1	122.8	(331.3)
1988	653.2	195.1	126.4	(331.7)
1989	710.2	206.2	130.2	(373.8)
1990	771.9	218.3	134.1	(419.5)
1991	838.4	230.9	138.1	(469.4)
1992	909.9	244.1	142.3	(523.5)
1993	986.8	257.8	146.5	(582.5)
1994	1,069.8	272.3	150.9	(646.6)
1995	1,159.3	287.2	155.5	(716.6)
1996	1,255.6	302.9	160.1	(792.6)
1997	1,359.3	319.3	164.9	(875.1)
1998	1,471.0	336.2	169.9	(964.9)
1999	1,591.0	354.0	175.0	(1,062.0)
2000	1,720.4	372.5	180.2	(1,167.7)
Total				($10,044.3)

a/ As estimated by consultant through 1990 and escalated through 2000 at the six percent rate projected by consultant; adjusted for a 17 percent increase due to additional ridership because of lower fares as estimated by SCRTD.

b/ As estimated by consultant through 1990 and escalated through 2000 at the three percent rate projected by consultant; adjusted as estimated by SCRTD: minus 28 percent for reduction of fare from 35 cents average to flat 25 cents, plus 22 percent for additional ridership because of lower fares.

c/ Los Angeles County estimated taxable sales calculated at three percent annual increase from 1972 actual, times 1/2 percent rate provided by AB 1727, times 83 percent estimated as SCRTD share based on FY 1972-73 allocations of transit funds under Chapter 1400, 1971 Regular Session (SB 325).

As shown by the above schedule, adjusting the consultant's financial plan for the effects of AB 1727 accelerates from 1987 to 1978 the time at which cumulative sales tax revenues will no longer cover operating deficits.

Since the consultant's report was issued, federal law was changed by the Federal-Aid Highway Act of 1973 [49 USCA 1603(a)] to increase the maximum federal share of projects constructed with UMTA funds to 80 percent from the previous 66-2/3 percent. However, this does not change the maximum UMTA commitments to any one state, as previously mentioned.

The following quotation from a September 1973 address to the Southern California Association of Governments by the UMTA administrator, Frank C. Herringer, referred to the proposed SCRTD transit system as the largest public works endeavor ever proposed in an urban area and cautioned that obtaining UMTA funds for a full 80 percent of the project cost was at least somewhat speculative.

> "[I am]...unable to provide any guarantee that funding of the level required to build the proposed system...will be available. If you feel that you can count with certainty on the federal 80 percent share under these circumstances, you are far more optimistic than I would be in your situation.
>
> If I were you, I would consider the possibility that your citizens will have to provide more than 20 percent of the total cost of a massive project...".

The Federal-Aid Highway Act of 1973 also gives state and local officials some flexibility in deciding whether to use certain funds for mass transit or highways as solutions to urban transportation problems.

Specifically, the act provides that in 1975, the first year of the SCRTD system construction, up to $200 million out of the Highway Trust Fund will be available nation-wide for bus projects. In 1976, $800 million is available nation-wide from the Highway Trust Fund for any type of transit project. The act also provides that under certain conditions, cities and states are permitted to substitute in an urban area a mass transit project out of general funds for an interstate highway project.

Amounts which might be available under this act to the SCRTD for its system have not been determined. Therefore, at this time we cannot assess their potential impact on financing of the proposed system.

HOW THE OPERATING DEFICITS MIGHT BE MET

As mentioned earlier in this report, fare revenues and anticipated sales tax revenues will not be sufficient to finance the anticipated operating deficits of the proposed system once the 12-year construction period is over.

One obvious method to reduce operating deficits would be to increase fares. However, even when possible, the extent to which this may be done is limited since when fares are raised, patronage may decline resulting at some point in less total revenue.

There is growing concern throughout the nation about the need to subsidize the operating cost of urban mass transit systems. Indications are that the federal government will make some effort to give assistance in this area. However, the timing and amount of such action is speculative and can, by no means, be looked on as a certainty.

The following list shows some of the ways other transit districts throughout the country are financing their operations:

- Sales tax
- Ad valorem real estate tax
- Gasoline tax
- Auto in-lieu tax

- Surplus bridge tolls
- Cigarette tax
- Business and occupation tax
- City and county subsidies from general tax revenues
- Personal income tax.

Senate Constitutional Amendment 15, which will appear on the state-wide ballot in June 1974, would permit the use of state gasoline taxes for transportation purposes other than highways. If the amendment is approved by the voters, money could be used for transit construction or maintenance. SCRTD's financial consultants have estimated that up to $30 million per year may be available to the district to fund mass rapid transit if such an amendment is approved.

LOCAL SOURCES OF CONSTRUCTION FUNDS

Other than federal grants, SCRTD has two potential local sources of funds for construction of the proposed transit system.

The first, which is presently available, is the district's share of a 1/4 percent sales tax collected by Los Angeles County for transit development, as provided by Chapter 1400, Statutes of 1971 (SB 325). In 1972, the district was allocated about 83 percent of the total amount estimated to be collected in the county in fiscal year 1972-73.

The second, which must be approved by district voters, is the 1/2 percent sales tax for transit construction provided by AB 1727.

We estimate that, for the 30-year period starting in 1975, the district will receive about $2 billion from the existing 1/4 percent SB 325 sales tax, and about $4.9 billion from the 1/2 percent AB 1727 sales tax if it is approved by the voters. These two taxes will thus provide about $6.9 billion over the 30-year period. These estimates were based on actual 1972 taxable sales in Los Angeles County, increased at an assumed rate of three percent per year.

These tax revenues could be used to finance up to $4.4 billion, or about 65 percent, of the estimated $6.8 billion cost of the proposed transit system. This estimate is based on the assumption that the district could issue six percent tax revenue bonds as necessary up to the $4.4 billion, and that the bonds and interest would be repaid from the 30-year sales tax revenues.

Even though it would be possible under AB 1727 and SB 325 to finance $4.4 billion of the estimated construction costs, this legislation, as presently written, will not finance the projected operating deficits.

Harvey M. Rose
Auditor General

November 8, 1973

Staff: John H. McConnell
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