MEMORANDUM

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SUBJECT: **SFMTA Contingency Reserve Policy Proposal**

Summary

This memo provides an overview of the Financial Analysis Office (FAO) proposed Contingency Reserve Policy for SFMTA, including the share of annual operating expenditures that shall be budgeted per fiscal year to fund reserves. The intent of the Contingency Reserve policy is to maintain regular service during an emergency event or economic recession, and to reduce immediate downsizing.

The SFMTA implemented a Contingency Reserve Policy in 2007 to mitigate the impact of one-time emergencies. The current target reserve funding level is 10 percent of annually budgeted operating expenditures, with 1 percent of each budget placed into the fund annually plus any end-of-year budget surpluses. Due to these surpluses, the Contingency Reserve currently contains 17 percent of fiscal year 2019-20 operating expenditures.

The FAO has developed recommendations and requests direction from the Policy and Governance Committee (PAG) on several key decision points:

- Shall the Contingency Reserve be divided into two separate reserves, one for General Reserve and another for Budget Stabilization Reserves?
    - The FAO recommends dividing the Contingency Reserve into A) a General Reserve for emergencies, totaling 5 percent of annual operating expenditures and, B) a Budget Stabilization Reserve for significant declines in revenue, totaling 10 percent of annual operating expenditures. This will allow the agency to better utilize the funds for their intended purposes.

- What is an appropriate rate at which to replenish Contingency Reserve funds after funds have been spent in a prior year?
    - The FAO recommends Reserves be replenished with at least two percent of annually budgeted operating expenditures and any surplus available operating fund balance (remaining funds available to deposit into a reserve at fiscal year close). The recommended rate is less than inflation and this strategy would leverage periods of economic expansion to replenish reserves.
- What authority and documentation should be required to disperse Contingency Reserve funds?
    - The FAO recommends emergency, non-budgeted use of the General and Stabilization Reserves be accessible at the sole discretion of the Director of Transportation (DOT), and the DOT must immediately report on such uses to the Municipal Transportation Agency Board (MTAB) via memo at the subsequent MTAB meeting. However, any budgeted uses of the reserves must be approved by the MTAB. This will allow for timely and responsive use of funds during unforeseen situations, while preserving authority and accountability for the MTAB and DOT.
- Shall General and Budget Stabilization Reserves be budgeted as continuing or annual projects in each two-year budget?
    - The FAO proposes that SFMTA regularly appropriate the General Reserve as an annual project, and appropriate the Budget Stabilization Reserve as a continuing project in each two-year budget. The General Reserve could be spent in a single fiscal year, and annual appropriation will allow the agency to better account for it. However, less than half of the Budget Stabilization Reserve could be spent in a single fiscal year, making a continuing project more appropriate for planning and implementation.

Background

Previous SFMTA analyses have highlighted the unprecedented duration of the current period of economic expansion since 2009, the growth of SFMTA expenditures, and the agency's increased dependence on City and County of San Francisco General Fund transfers as a proportion of total revenue. In the event of an unforeseen emergency or economic recession, the SFMTA will take necessary actions to ensure maintenance of service levels.

The SFMTA implemented a Contingency Reserve Policy in 2007 to mitigate the financial impact of one-time emergencies. The target reserve funding level is 10 percent of annually budgeted operating expenditures, with 1 percent of each budget placed into the fund as required. The Contingency Reserve currently contains $203 million, or approximately 17 percent of fiscal year 2019-20 operating expenditures. This amount exceeds the target level because of past fiscal years' available operating fund balance surpluses that have been deposited into the fund at fiscal year-end. In the past two fiscal years, funds from the Contingency Reserve have been used to balance the agency's operating budget, and to fund one-time capital and non-capital projects.

Since the creation of the original SFMTA Contingency Reserve Policy, the City and County of San Francisco created a City reserve policy in 2010, and peer agencies have refined their conditions for reserve withdrawals. These developments provided the impetus for the FAO to evaluate the Agency's current policy and identify opportunities for improvement, with the goal of maintaining service levels during and after financial emergencies or economic downturns. Additionally, reevaluating the policy presents an opportunity to formalize the agency's approach to using excess reserve funds and available operating fund balance surpluses at fiscal year-end.

Peer Benchmarking and Key Considerations

To inform the proposed Contingency Reserve Policy, FAO reviewed policies and best practices of peer transit and government agencies in the Bay Area and nationally. This research provided the following key reserve policy attributes contained in this proposal:

- Requirements for when, why, and how funds will be used should be specific.
- Plans for initial and ongoing funding of the reserves should be outlined in the policy.
- Conditions for withdrawal should ideally leave sufficient funds for reserves to be effective in subsequent years.
- Flexibility to account for changing circumstances.

Reserves are designed to provide protection in the event of adverse circumstances. Funding requirements should minimize impacts on agency service provision and operations in the present, as well as in the immediate aftermath of conditions that merit withdrawals. The target funding level of the reserves should be carefully selected to ensure alignment with estimated needs for emergency funds. Finally, procedures for withdrawing reserve funds should allow for effective and timely resource deployment.

The FAO found wide variations in the reserve policies of regional and national peer transit agencies. Combined reserves ranged from one percent of annual operating budget for the New York City Metropolitan Transportation Authority, to half a year's operating budget for the Marin Transit Department. Transit agencies with larger operating budgets generally reserved smaller proportions of their annual revenue.

The SFMTA's existing reserve of 17 percent matched the median of these peer reserve policies and is comparable with Seattle Sound Transit's 17 percent combined reserve policy. A proposed combined reserve policy of 15 percent of operating funds would also be comparable. However, the SFMTA's current actual reserve policy would limit contingency reserves to 10% if it were to be fully implemented.

The FAO recommends a contingency reserve policy that reflects the policy of the City and County of San Francisco Controller's Office. In 2010, Controller's Office separated its reserves into distinct Budget Stabilization and Rainy Day funds. San Francisco is one of five cities in the nation with separate funds. Marin Transit, BART, and the Transbay Joint Powers Authority also distinguish between general and stabilization reserves in their policies. The reserve policies for the New York City Metropolitan Transportation Authority, and Seattle Sound Transit do not distinguish between general reserve and stabilization reserve purposes, opting instead for a single combined reserve fund.

Table 1. Comparison of Reserve Policies Among Regional and National Agencies as a Percentage of Annual Operating Budget

Agency	Combined Reserve	General Reserve	Stabilization Reserve	FY19 Operating Budget (Millions)
NYC MTA	1%	N/A	N/A	$14,000
City and County of San Francisco	10%	~4%	~6%	$6,000
San Francisco MTA Current	10%	N/A	N/A	$1,214
San Francisco MTA Proposed	15%	5%	10%	$1,214
BART	15%	1%	Unclear	$922
Seattle Sound Transit	17%	N/A	N/A	$505
Transbay Joint Powers Authority	25%	1%	24%	$39
Marin Transit	50%	17%	33.30%	$30

SFMTA Revenue Response and Actions During the Prior Recession and Loma Prieta Earthquake

The previous recession negatively impacted the SFMTA's revenue. Total SFMTA revenues rose sharply between fiscal years 2004-05 and 2006-07, leveled-off in fiscal year 2007-08 as the recession began, declined by two percent in fiscal year 2008-09, and rose again starting in fiscal year 2009-10, continuing to the present. Transit fares as a subset of total revenue exhibited similar trends. Transit fares grew from fiscal year 2004-05 to fiscal year 2007-08, declined slightly in fiscal year 2008-09, grew from fiscal year 2009-10 through fiscal year 2013-14, and have declined slightly since then.

Figure 1. Total SFMTA Revenues and Transit Fare Revenues From Fiscal Years 2004-05 to 2011-12

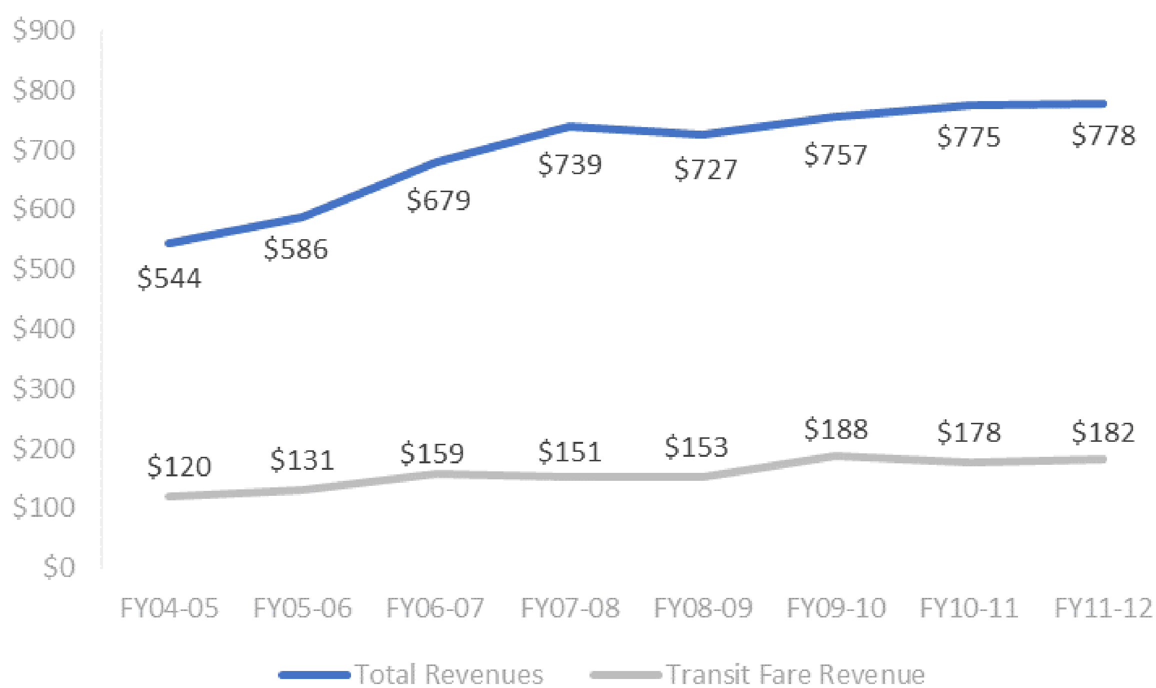
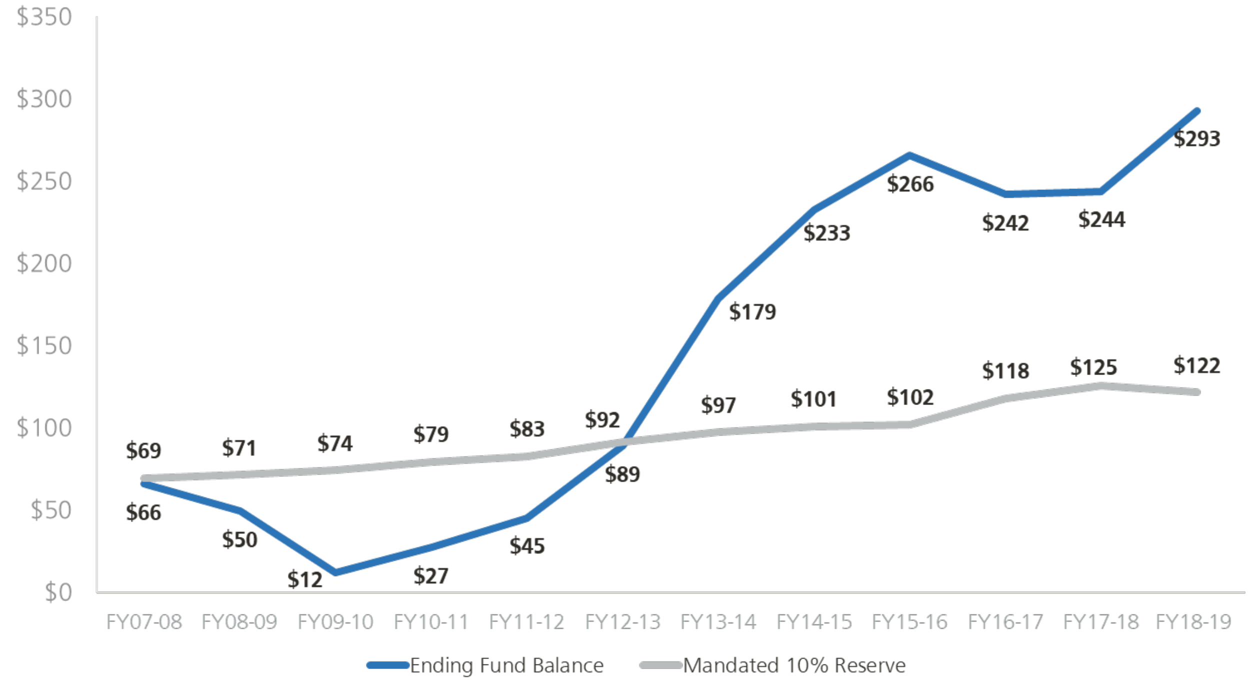


Figure 2 illustrates how the SFMTA's fiscal year-end available fund balance also declined during the recession and rebounded in the seven years after. The agency successfully reduced the fund balance by $54 million over the two years following the recession from fiscal year 2007-08 to fiscal year 2009-10 and grew the fund balance within the three following years of economic expansion. If the fund balance had not been available, the Contingency Reserve would have been necessary to reduce layoffs and maintain service during a period of greater instability and public need. In fiscal years 2016-17 and 2017-18 the agency has also used reserve funds to balance the budget.

Figure 2. SFMTA Fiscal Year-end Available Fund Balance From FY2008-FY2019



San Francisco has not experienced a major earthquake in over 100 years. The FAO cannot provide an accurate estimate of what the potential cost to the agency could be. The magnitude 6.9 Loma Prieta earthquake of 1989 caused deaths, injuries, and substantial damage to buildings and transportation infrastructure around the San Francisco Bay Area. However, SFMTA operations were only slightly impaired. There were no reported SFMTA-related injuries or fatalities, and no substantial damage to transit infrastructure. Muni metro lost its power supply for several hours, and all SFMTA service was shut down for twelve hours for inspection before returning to full service the following morning.

The FAO cautions against the use of these two examples as a direct proxy for future potential events. SFMTA transit infrastructure has changed since the 1989 earthquake. The economic and transportation opportunities in the region have also changed over the past ten years due to the national diversification of the technology industry and the emergence of Transportation Network Companies (TNCs) and shared micromobility platforms. San Francisco experienced a unique and rapid recovery from the prior recession due to the expansion of technology-related employment in the region. It is not clear whether these same circumstances would remain in a future recession.

Proposal

The FAO proposes segmenting the current Contingency Reserve into a separate General Reserve and a Budget Stabilization Reserve, each of which are detailed in Table 2 below. The proposal augments the overall target level of the reserves from 10 percent to 15 percent of each year's operating budget to prepare the SFMTA for a variety of fiscal pressures. Reserves are to be used at the discretion of the DOT with immediate reporting requirements to the MTAB and restrictions on use unless specifically waived by MTAB.

Table 2. Proposed Reserve Configuration

	General Reserve	Budget Stabilization Reserve
Purpose	Provide funding for emergencies, as determined by the Director of Transportation.	Mitigate the operational impacts of significant revenue decline and economic downturns.
Target Level	**5 percent of operating expenditures** ($60.2 million based on FY 2020 budget)	**10 percent of operating expenditures** ($120.3 million based on FY 2020 budget)
Initial Funding	Completely fund from the existing Contingency Reserve. The deposit will total $60.2 million.	Completely fund from the existing Contingency Reserve. The Budget Stabilization Reserve will receive all funds in excess of the target levels for the reserves. The deposit will total $142.8 million.
Ongoing Funding	Deposits shall equal a minimum of 2 percent for the General Reserve before budgeting any use of projected year-end available fund balance. To the extent that there is any projected year-end available fund available, a minimum of 50 percent of that available fund balance would be used toward restoring first the 5% General Reserve, and if there is leftover, then toward restoring the Budget Stabilization Reserve. The other 50 percent of available fund balance shall be used to support one-time needs in the upcoming budget.	Detailed under General Reserve.

	General Reserve	Budget Stabilization Reserve
Withdrawal Conditions	The General Reserve is for one-time, non-recurring emergencies, risks or losses related to civil legal liabilities, destruction of assets, natural disasters, and other one-time emergencies as determined by the DOT. Use must mitigate the impact of an unexpected revenue shortfall or unavoidable expenditure need. General Reserve funds exceeding the target funding level should be used for one-time investments that reduce operating costs; these must be approved by the MTAB.	The Budget Stabilization Reserve can be used for the current or subsequent year if there is a projected decline in revenue compared to the current fiscal year or any of the four fiscal years before the current one, adjusted by two percent per year for inflation.
Withdrawal Authority	The General Reserve will be appropriated as an annual project in each two-year budget and approved by MTAB during the budget process. The General Reserve may be used during a given fiscal year at the discretion of the DOT. The DOT must immediately report on such uses of the General Reserve to MTAB via memo. Budgeted uses of the General Reserve must be approved by MTAB.	The Budget Stabilization Reserve will be appropriated as a continuing project in each two-year budget and approved by the MTAB during the budget process. The Budget Stabilization Reserve may be used during a given fiscal year at the discretion of the DOT. The DOT must immediately report on such uses of the Budget Stabilization Reserve to MTAB via memo. Budgeted uses of the Budget Stabilization Reserve must be approved by MTAB.
Withdrawal Size	The entire General Reserve may be used in any given fiscal year.	No more than 50 percent of the balance of the Budget Stabilization Reserve can be withdrawn in any given fiscal year unless the MTAB waives the policy.

Reserve Budget Replenishment

The FAO recommends that reserves be replenished at a rate of two percent of annually budgeted operating expenditures and any surplus available operating fund balance. The surplus available operating fund balance are revenues that exceed expenditures at fiscal year close. A replenishment rate of two percent is less than inflation; this strategy would leverage periods of economic expansion to replenish reserves.

The key tradeoff in selecting a replenishment rate is minimizing pressure on the annual operating budget versus replenishing reserves in a timely manner, ensuring availability for when they are next needed.

Table 3. Proposed Contingency Reserve Replenishment

Performance Metrics Assuming 2 Percent of Operating Expenditures Deposited Annually	
Annual Deposit Amount For FY2020	$24.1 million
Replenishment Timetable: General Reserve	3 fiscal years
Replenishment Timetable: Budget Stabilization Reserve	5 fiscal years
Deposit when eligible to withdraw from Budget Stabilization Reserve	1 percent of operating expenditures to the General Reserve
Scale Comparison: How many staff* would the annual deposit employ?	186 Transit Operators (9163) or 111 Principal Administrative Analysts (1824)

*Using fully loaded rates