Marin Conservation League

January 11, 2008

Summary Comments and Context for MCL 2006 Report on

Analysis of
SMART'S FINANCIAL & PROJECT PERFORMANCE

1. The SMART Draft Environmental Impact Report (DEIR) released in the spring of 2006 made several statements relating to the cost of the proposed rail project. Two of the statements place into context MCL's motivation for undertaking its own analysis of the rail projects costs. The two statements were:
   - The Executive Summary stated that one of the primary objectives of the rail proposal is "to provide cost-effective rail service that links to bus and ferry services."
   - Chapter 2, (section 2.8) that "Following completion of the Final EIR, and the finalization of recommended project mitigations, new capital and operating cost estimates would be prepared and the SMART Expenditure Plan updated."
2. In the summer of 2006, SMART released updated capital costs and updated "direct" operating costs; the "direct" operating costs excluded any specification of debt service costs. SMART also issued a revised Expenditure Plan that it later placed in the sample ballots distributed to all registered voters in Marin and Sonoma counties. "Expenditure plans" are legally required documents to be prepared and circulated by a public agency proposing a sales tax increase. However, the law provides very little guidance on what these plans must include.
3. MCL reviewed the Expenditure Plan approved by the SMART Board on July 19, 2006 and concluded that the Expenditure Plan did not provide the public sufficient funding, revenue and cost detail to enable informed decisions. One concern about the SMART rail proposal was whether the project, as described in detail by SMART, would be fully funded and supported by a ¼ cent sales tax increment; and what other identifiable sources would be available for capital and operating needs. The Expenditure Plan did not answer these questions; it did not include any pro-forma financial analysis of the expected annual revenue and cost streams associated with the rail proposal.
4. The absence of adequate financial detail was noted by the MCL Board of Directors in the summer of 2006. Similarly, the financing uncertainty also was noted by the Metropolitan Transportation Commission's Executive Director Heminger who wrote in a summary memo to the MTC Legislation Committee (September 1, 2006)

   > "Because elements of the state and federal portions of SMART's financing plan are contingent upon future appropriations and allocations decisions, the SMART District is developing options to address revenue shortfalls, including extending the construction period or phasing implementation."

   More recently, TAM Executive Director Steinhauser commented in a letter to SMART General Manager Lillian Hames (October 22, 2007)

> "We continue to be concerned that the document adequately address cost, funding, and congestion impacts of the proposed project. Although your response in the original EIR correctly pointed out that "…a discussion of project costs in the environmental document is not required by CEQA," we believe that optimistic or incorrect cost estimates could result in less service and fewer riders than assumed, resulting in an optimistic assessment of the project's environmental benefits and creating a funding burden if revenue does not meet expected levels."

5. The MCL financial analysis had to address a number of technical issues. Two particular issues generated comments from reviewers. These were (a) the definition of direct operating expenses and (b) the treatment of depreciation of capital goods purchased in the early years of the project and their "residual value" at the end period of analysis.

    - SMART's Expenditure Plan stated it expected to issue bonds (valued at several hundred million dollars) to finance construction of the rail line and pathway during the first three years following approval of the sales tax. Bond funding was necessary because SMART's Expenditure Plan estimated US Department of Transportation funding for the SMART rail project to be insignificant. The bonds would be an obligation of local taxpayers; debt-service expense for the bonds was estimated to be about $10 million a year. However, SMART's literature excluded any reference to annual debt-service expense. The MCL analysis explicitly included debt service expense as a direct operating expense.

    - The "residual value" question arises for capital projects with long-life capital items, such as rail tracks and rolling stock, which retain value beyond the horizon of a financial analysis period. Economists answer this question in an economic analysis by present-valuing all cash flows over the horizon, including residual value in the analysis. The MCL analysis, however, was a funding analysis intended to identify whether the project that was described could be funded over the sales tax duration period. It was not an economic analysis. In a funding analysis, when expenses and revenues occur is relevant and residual value is not. A separate economic analysis would answer the question of whether the present value of the revenue streams was sufficient to cover the present value of the expense streams.

<u>Updating the SMART Analysis for 2008 Revised Cost Estimates</u>

Some time in 2008, SMART is expected to release revised capital cost estimates and revised operating expenses. It is also expected to issue a revised Expenditure Plan. However, SMART has not committed to prepare a projection of annual revenues and expenses over the 20-year sales tax funding period.