Summary Minutes

Finance and Audit Committee Meeting
October 19, 2023

Call to order

The meeting was called to order at 3:02 p.m. by Committee Chair Nancy Backus.

The meeting was recorded and can be found at https://www.soundtransit.org/get-to-know-us/board-directors/livestream-video.

Roll call of members

Chair	Vice Chair
(P) Nancy Backus, Auburn Mayor	(P) Bruce Dammeier, Pierce County Executive

Board Members	
(P) Dow Constantine, King County Executive (A) Christine Frizzell, Lynnwood Mayor	(A) Joe McDermott, King County Councilmember (P) Ed Prince, Renton Councilmember (P) Kristina Walker, Tacoma Councilmember

Josephine Gamboa, Board Relations Specialist, announced a quorum of the Committee was present at roll call.

Report of the Chair

None.

CEO Report

CEO Julie Timm provided the CEO report.

2024 Proposed Budget and Financial Plan update

CEO Timm noted Chief Financial Officer (CFO) Henry and his team continued to make improvements to their presentations to provide more transparency and clarity on Sound Transit's complex financial data and position as well as to make sure the agency's annual budget and long-range financial direction remained aligned with the Board's policies and priorities. The forecasts had been updated based upon the macroeconomic environment and challenges that the agency was facing. CFO Henry's presentation at this meeting would provide updates on revenue projections, which included an update to fare revenue collection assumptions. There would also be updates on expense projections which continued to create pressure on the affordability of the long-range financial plan. CFO Henry would also highlight headwinds and tailwinds on the financial plans that the team had been assessing, as well as recent actions that helped improve financial standing and to improve other revenue streams.

Fares

Over the past few months, staff presented to the Executive and Rider Experience and Operations Committees a series of updates outlining the agency's fare policy, rates, parking fees, its impact of current policies on the financial plan, and public outreach regarding an upcoming Board consideration of possible changes to Sound Transit Fare Policy and rates in 2024. Not only were fares and parking rates critical parts of the passenger experience, but fare revenue was a significant component of the finance plan particularly as the system continued to expand in the next few years. CEO Timm noted an online open house was open until October 22, 2023, which included detailed information about the proposed changes and the potential impacts to riders. Staff was planning to bring a broad update on these topics, that had been discussed in committees and through public engagement, to the full Board in advance of a possible Board action later this year and early next year on fares and parking rates.

2024 Finance and Audit Committee Meeting Schedule

CEO Timm mentioned Chair Backus and committee members had expressed interest in expanding the frequency of Finance and Audit Committee meetings in 2024. Options were being reviewed with staff and Board members on scheduling and there would be more to share at the next Finance and Audit Committee meeting in December 2023.

Build America Bureau Grant for Joint Development

The US Department of Transportation announced earlier this month that Sound Transit was awarded a Regional Infrastructure Accelerator grant from the Build America Bureau to support Joint Development planning for West Seattle and Ballard Link extensions. The $1.75 million grant would assist the agency in planning potential projects that integrated future stations with Transit-Oriented Development, similar to what was currently happening at the U-District Station. This type of development, known as Joint Development, required significant upfront planning and coordination, which this grant would support. CEO Timm thanked Senator Murray and the Puget Sound delegation members for their work to secure funding for the program.

Update on Clean Fuels Standard

On January 1, 2023, the Washington Department of Ecology implemented the Clean Fuels Standard which provided credits for a range of low-carbon fuel alternatives that improved air quality and stimulated economic growth. Transportation was the largest source of greenhouse gas emissions in both Washington and in the United States. Reducing emissions from transportation is critical to meeting any state and national emission reduction targets.

This was especially important in Washington where transportation accounted for a disproportionate share of greenhouse gas emissions compared to the national average. Public and private entities, such as Sound Transit, opted into this program by generating credits from clean transportation activities that were sold to fuel producers who were responsible for lowering their emissions. Despite early volatility in the clean fuels marketplace, the agency projected the Clean Fuel Standard would provide an ongoing source of revenue.

Currently, Sound Transit was on track to generate nearly one million dollars in the first year of Clean Fuel Standard credit sales. The agency generated $367,000 in revenue from the first quarter of credit sales and expected to generate between $220,000 to $240,000 in the second quarter. The credit value had dipped in value recently, it was $104 per credit in the first quarter, but recently dropped to $68-70 per credit. Agency consultants predicted this lower price to remain steady, as it matched the current credit rate in California.

Over the next few years, Sound Transit would reap further benefits from the Clean Fuel Standard as the agency continued to expand light rail and electrified Bus Rapid Transit services. Additionally, any projects coming on-line after the launch of the Clean Fuel Standard program would have a higher credit value, which translated into greater revenue. As the Clean Fuel Standard market matured and stabilized, staff would continue to revise its long-term revenue projections as inputs to the agency’s Finance Plan.

Public comment

Chair Backus announced that public comment would be accepted via email to meetingcomments@soundtransit.org and would also be accepted virtually and in person.

There were no written, in-person, or virtual public comments received.

Business Items

Item for Final Committee Action

July 20, 2023 and September 8, 2023 Finance and Audit Committee meeting minutes

It was moved by Board member Walker, seconded by Committee Vice Chair Dammeier, and carried by unanimous vote of the committee members present that the minutes of the July 20, 2023 and September 8, 2023 Finance and Audit Committee meetings be approved as presented.

For Recommendation to the Board

Resolution No. R2023-33: Increasing the 2023 annual tax collection and fees budget by $3,165,000, from $23,062,638 to $26,227,638 to pay for additional sales and use tax offset fees.

John Henry, Chief Financial Officer, Ryan Fisher, Deputy Executive Director of Financial Planning, Analysis and Budget, and Stephanie Ball, Director of Financial Planning, Analysis and Budget, provided the presentation.

Committee Vice Chair Dammeier took a moment to acknowledge this action was not an increase in taxes and that it was an increase in budget authority reflecting what was seen as increased tax collections and this money would ultimately go back to the community through the Puget Sound taxpayer account.

It was moved by Committee Vice Chair Dammeier, seconded by Board member Constantine, and carried by the unanimous vote of all committee members present that Resolution No. R2023-33 be forwarded to the Board with a do-pass recommendation.

Motion No. M2023-92: Authorizing the chief executive officer to execute an eight-year contract with Crowe, LLP to provide independent financial and federal audit services, agreed upon procedures, and ORCA financial audits and system and organizational control reports, for a total authorized contract amount not to exceed $6,500,000.

Jeff Clark, Deputy Executive Director of Financial Operations, provided the presentation.

Board member Walker asked if staff knew how this action compared to previous cycles or years. Mr. Clark replied the fees were in line with the previous auditor.

It was moved by Committee Vice Chair Dammeier, seconded by Board member Walker, and carried by the unanimous vote of all committee members present that Motion No. M2023-92 be forwarded to the Board with a do-pass recommendation.

Chief Financial Officer Report

Board member Prince joined at this time.

John Henry, Chief Financial Officer (CFO), Ryan Fisher, Deputy Executive Director of Financial Planning, Analysis and Budget, and Jeff Clark, Deputy Executive Director of Financial Operations, provided the presentation.

Beginning with August Year-to-Date (YTD) performance, tax revenues were 102 percent above budget and other revenues and financing were 517 percent above budget. The agency was at 86 percent of budget for expenditures, with a majority coming from system expansion and non-system expansion projects. As for August YTD revenue and other financing, TIFIA was drawn down by $994.6 million associated with East Link. Tax revenues was $34.6 million higher and there was a slight decrease in grants and contributions and staff believe this would pick up before year end. Investment income was $74 million higher also due to drawing down early and taking advantage of current market rates.

August YTD transit operations were $31 million, or 10 percent lower than planned due to lower spending for Link and Sounder. Tacoma Link was $4.7 million over budget due. The 3.2 percent salaries and benefits underspend was driven by higher than budgeted vacancies partially offset by accounting adjustment for benefits accrual. CFO Henry explained how agency vacancies for full time employees (FTEs) were being carefully examined and methodically planned for 2024.

For system expansion projects, actuals were $165 million, or 13 percent, under budget. Link was $95 million below budget due to Lynnwood Link's roadway and utility work taking longer than planned. The light rail vehicle (LRV) fleet expansion was $35 million under budget due to delays in software installation and lower manufacturer production rate. Downtown Redmond Link was $30 million under budget due to contractor re-sequencing several work elements. Tacoma Dome Link was $21 million under budget due to the project addressing additional alternatives. Sounder was $18.7 below budget due to Sumner Kent and Auburn Parking Access and Improvements and Sounder fleet expansion. Regional Express was $8.3 million below budget due to RapidRide C and D invoicing delays, which were expected to level out by year end. Other projects were $1.3 million below budget due to Innovation and Technology program which was also expected to pick up by year end.

For August YTD agency projects, enhancements were $15.7 million below budget with $7 million for the Information Technology (IT) Digital Passenger Info System project, $3 million for programmatic work, and $1.6 million for IT Data Management Program project. State of Good Repair was $12 million below budget due to IT network redesign projects and Kinkisharyo LRV systems upgrades. Administrative was $24.6 million below budget with $20.4 million due to the previously mentioned high vacancy rates and $3.4 million for the IT program.

Mr. Clark provided an update to the portfolio actions that were approved at the July 2023 meeting. The first action was a request of $1 billion of TIFIA drawn on August 15, 2023 at an interest rate of 1.91 percent. The funds had been invested at an average yield of 4.99 percent. The action generated approximately $30 million of 2024 net interest income. The second portfolio action was the redemption of floating rate notes. The borrowers had ben notified and the notes would be redeemed on November 1, 2023.

Mr. Clark provided asset and liability management highlights stating there was no market consensus on future Federal actions, however, staff was continually monitoring the market and would appropriately adjust the portfolio to minimize risk and maximize returns. Investment balances remained favorable and there were no planned debt issues at this time.

Committee Vice Chair Dammeier wanted to confirm that the actuals noted for system expansion projects, which were lower than planned, were not savings but instead due to delayed executions of projects. CFO Henry confirmed that was accurate.

Committee Vice Chair Dammeier noted the portfolio actions related to borrowing money then reinvesting it and asked whether staff had any concerns about this. CFO Henry replied that the TIFIA loan was executed for East Link construction and the current market resulted in the agency's ability to take advantage of a higher investment rate. CFO Henry clarified the agency was not aware of the higher investment rates at the time of initial execution.

Audit Update

<u>2022 Accountability Audit Entrance</u>

Chair Backus noted the State Auditor's Office 2022 Accountability Audit Entrance report and related Engagement letter had been included in the committee's meeting packet for review. This annual audit focused on compliance with laws, regulations, and the agency's own policies in areas selected for testing, as well as determine if public assets were safeguarded against loss or misuse. The auditors had finished reviewing Moss Adams' financial statement audit and single audit workpapers and had no concerns with the documentation of those audits and related reports. Therefore, the State Auditor's Office accepted those audits as meeting Sound Transit's financial statements and single audit requirements under state law. The State Auditors were currently performing preliminary work and were in the planning phase of their Accountability audit. Communication would be sent to the committee when they select the areas for testing during this year's engagement. An Exit presentation was anticipated at the December 2023 Finance and Audit Committee meeting.

<u>2023 (Q3) Internal Audit Update</u>

Patrick Johnson, Audit Director, provided the presentation. The Federal Transit Administration (FTA) conducted a Triennial review of Sound Transit late last year and released their results last quarter. Mr. Johnson previously reported that the FTA's auditors found eight deficiencies in their final report. As of today, three of those eight deficiencies had been officially closed out with an additional two that had been requested to be closed by the agency to the FTA. Staff continued to work on the other three remaining open deficiencies and developed corrective actions to submit to the FTA. Those corrective actions were currently on track with submission timelines and the agency remained prepared to close out the FTA's deficiencies by the end of the year. Mr. Johnson would provide an update at the next committee meeting on the status of those remaining deficiencies.

For the Compliance audit group, Mr. Johnson noted these were primarily safety audits which were required to be completed annually by federal and state safety oversight requirements. These also included audits conducted as the agency maintained and pursued international accreditation for its Environmental, Safety Management, and Asset Management systems. The Sounder Commuter Rail Annual Internal Safety Audit resulted in no findings. The Safety Management Systems (SMS) Internal, Link Light Rail Annual Internal Safety, and Tacoma Link Annual Internal Safety audits were still in progress. Mr. Johnson postponed the internal audit of asset management systems because agency staff were still in progress of many critical items that would need to be verified as part of the entire management system. The next scheduled audit of that work was already scheduled for Q3 2024 and the teams' progress would be monitored over the coming months to synchronize the audit timing and resourcing.

For the Safety and Security Certification audit group, the Hilltop Link Operational Readiness Safety and Security, Downtown Redmond Link Design Conformance Safety and Security, and East Link E320 Construction Conformance Safety and Security audits were completed with only one audit that identified a finding that required a corrective action. That finding was identified in the Hilltop Link Operational Readiness Safety and Security Audit. The audit team found documentation of potential hazards, but not according to agency processes for hazard mitigation and resolution. Mr. Johnson explained that a hazard was any real or potential condition that could cause injury, illness, death, or damage. Those must be identified, tracked, and mitigated, by specific safety processes using either a preliminary hazard analysis, captured early in the design and construction stages, or in an operational hazard analysis, which captured items as they moved from capital project to revenue service. In this instance, the team found that the process tracked these potential items in a separate "punch list" log but were not transposed over to the agency's prescribed hazard analysis tracking mechanisms. This audit finding was merely a paperwork health check and did not impact the project as it had already moved into revenue service. Mr. Johnson reviewed the remaining planned audits for this group for the year.

For the Performance audit group, which identifies audit topics based on risk, had three audits currently in progress and one starting soon. The three audits in progress were SCADA Systems, Transit Systems Cybersecurity Preparedness, and State of Good Repair – Northgate Link Extension. The audit on Capital Project Closeout Process audit would begin soon. Results of these audits would be briefed in a future meeting.

Review of 2024 Proposed Budget and Financial Plan Update

John Henry, Chief Financial Officer (CFO), Ryan Fisher, Deputy Executive Director of Financial Planning, Analysis and Budget, provided the presentation on the proposed 2024 budget and transportation improvement plan (TIP), service growth, budget timeline and next steps, and the updated Fall 2023 financial plan projections. CFO Henry provided an overview of how the various pieces of agency projections and budget fit together. The long-range financial plan projections extended out through 2046, while the TIP went through 2029 and the Proposed Budget for the subsequent year, in this case 2024.

The 2024 budget was expected to grow over the 2023 budget by 8 percent, largely a result of strong investment income projected and a return of our assumed Build America Bonds subsidy. Tax revenues were the largest revenue source at 4.4 percent above 2023 budget and passenger fares had a slight increase of 13.5 percent. There would be a decrease in grants due to funds accelerated in 2023 originally assumed for 2024. Investment income increased due to the previously mentioned $994 million TIFIA draw. Miscellaneous revenues would increase by $16.7 million. The remaining $93.3 million TIFIA loan for Hilltop Link would be drawn down. CFO Henry shared a pie chart of revenue and financing sources by type. The largest share with $2.4 billion came from revenue.

CFO Henry shared the revenues and financing sources trends since 2021. Tax revenues had been growing steadily mostly driven by strong sales tax, passenger fare revenues had a slight increase throughout the years, there was a decrease in grants and local contributions which was a result in decreasing draw downs, investment income was beginning to increase, miscellaneous revenues remained steady, and bonds had a fluctuation due to draw executions. CFO Henry noted CEO Timm had asked staff to look at ways to increase margins and increase advertisement and marketing dollars.

For expenditures, the expected growth in expenses was due to the opening of the Starter Line 2, Lynnwood Link Extension, Hilltop Tacoma Link Extension operations after a year of service, annual increases in salaries and wages, escalating healthcare costs, insurance premiums, and additional security on the lines. There were headwinds anticipated for the Hilltop Tacoma Link Extension settlement and higher contracted labor rates. Proposed 2024 expenditures was $3 billion. The proposed budget for modal operating expenses grew from $495.3 million to $634.2 million primarily due to East Link Starter Line 2 and Lynnwood Link Extension starting revenue service and increase labor and material costs. System Expansion projects budget decreased with $197 million primarily due to winding down of projects in construction for Federal Way, Lynnwood, and Downtown Redmond Link extensions. Non-system expansion projects had slight increase. Debt service had a decrease due to retirement of variable rate debt. Contributions to partner agencies was lower as 2023 was the last year of the agreement with the City of Seattle to contribute towards the First Hill Streetcar. Leases were decreasing as expiring leases were examined and eliminated if they were no longer required for headcount. Agency contingency went from 2 percent to 3 percent for foreseeable labor costs.

CFO Henry shared a pie graph of where the money was spent with a large portion, 61 percent, towards system expansion projects then modal operating expenses with 21 percent. Diving into the modal expenses by mode, 54 percent of total operating expense was to operate and maintain Link, 27 percent for Regional Express, 16 percent for Sounder, and 3 percent for Tacoma Link. For system expansion projects by mode, 77 percent of expenses were for Link, 15 percent for Stride, 5 percent for Sounder, and other projects just below 2 percent each. For agency projects by mode, 47 percent was funding the agency's general and administration expenses, 30 percent for systemwide projects and programs, 19 percent for Link non-system expansion projects, and under 1 percent for Tacoma Link and Regional Express.

The 2024 Proposed TIP was increased to $25 billion primarily due to the Stride baseline with $950 million and Tacoma Dome Link extension and Operations and Maintenance Facility South Preliminary Engineering and Right-of-Way work with $208 million. New projects included the South Warehouse Facility with $12 million and the Unified Control Center with $3 million. A few projects were closed out including the LRV Overhaul and the Convention Place retrofit projects. The largest components of the TIP was 70 percent for Link, 12 percent for systemwide projects, 9 percent for Stride, 5 percent for Sounder, 3 percent for Regional Express, and 1 percent for Hilltop Tacoma Link Extension.

CFO Henry reviewed the service platform hour growth by mode consisting of about 86,000 proposed hours for 2024 Link service due to East Link and Lynnwood Link openings. Sounder hours increased by 1,600 hours due to adding two daily north trips. Tacoma Link hours increased by 9,000 hours to include the full year of operations at Hilltop.

A few thoughts and concerns when reviewing the proposed 2024 budget included that the proposed 2024 budget was under original long-term forecast and target, expansion project delivery management remained critical, service openings and maintaining ST3 service levels continued to pressure costs, and resourcing (labor and materials) continued to be a headwind to supporting growth. CFO Henry shared many agencies across the nation were experiencing similar difficulties with resourcing.

Board member Walker thanked staff for highlighting the workforce conditions into their presentation.

CFO Henry reviewed that the Long-Range Financial Plan (LRFP) was a 30-year financial forecasting model and projects all agency revenues and expenditures required to build and operate Sound Move, ST2, and ST3. It identified when peak spending occurred and when Sound Transit needed to issue debt to fund system expansion and monitored Sound Transit's ability to build and operate the vote approved system while adhering to state financial laws and agency financial policies. The LRFP is used to monitor the affordability of the program, comply with Federal and State reporting requirements, and used for participating in the credit rating process.

The financial plan considered financial policies, project cost estimates and schedules, planning assumptions such as ridership, service levels, and fare compliance, independent economic forecasts, and most recent actuals and budgets.

Key takeaways included that debt capacity was lower and coverage was not materially improving, capital expenditures increased due to inflation and Stride baseline, there was a decrease in fare revenues from decreased boardings with fare media, and an increase in tax revenues to help offset the increase in expenditures. Elevated risks included costs to provide ST3 service levels and cost estimates for expansion projects in planning.

Net Debt Service Coverage Ratio (DSCR) measured the ability of the agency to pay back debt after paying for operating costs. The goal was to be above 2.00x and the current minimum net DSCR was 1.63x. The policy stated that Sound Transit must have 1.5x the amount of revenues needed to pay for debt service. Since realignment, net DSCR trended downward. Since the Spring 2023 plan, Stride baselined with an increased project cost which reduced net DSCR to 1.62x. The remainder of the updates made for the Fall 2023 plan did not materially improve this ratio. Debt capacity was the agency's ability to issue debt, constrained by assessed values in the district. The goal was to be above 15 percent. Spring 2023 showed improvement to debt capacity with 15.9 percent, since then Stride baselined with an increased project cost reducing capacity to 13.7 percent. The remainder of the updates made for the Fall 2023 plan pushed debt capacity down to 13.1 percent and was driven by increased inflation and decreased fare revenue forecasts.

Committee Vice Chair Dammeier asked if the net DSCR ratios and debt capacity was being imposed onto the agency or if it was internal measurements that were being tracked for financial wellbeing. CFO Henry replied the coverage ratio was a Sound Transit policy which stated that Sound Transit must have 1.5x revenue amount to pay for debt service in any year after factoring in operating costs. The goal was what internal staff tried to reach for best practice. Mr. Fisher added that Sound Transit had a statutory policy and was why the line was drawn at 0 percent.

For major changes and impacts in this financial plan update since Spring 2023, for 2017 to 2046, the agency was projecting $1.7 billion more revenue compared to the spring plan. The revenue consisted of an increase in taxes, grants, and other revenues with a slight decrease in fares. There was $2.3 billion more in expenditures compared to the spring plan. The increased expenditures decreased the agency’s debt position. There was $768 million in bond issuance required to cover $505 million in funding gap. Changes in expenditures were greater than change in revenues by $505 million, bond proceeds were required to cover increased costs and interest on debt and new debt service and reserve contributions totaled $263 million.

Tax revenues increased by 2.5 percent, or $2,341 million, compared to Spring 2023. Of that increase, $2,083 million sales tax due to increased regional growth, $250 million was MVET mostly due to increased CPI assumptions, $26 million was an increase in rental car tax due to travel recovering post pandemic, and a decrease of $18 million for property tax due to decline in assessed value forecast.

Fare revenue was projected to decrease of $931 million, of that, $210 million was due to decreased ridership from known in-service date delays, and $721 million due to decreased boardings with fare media. The Link had an updated short-term rate of 55 percent and long-term rate of 75 percent – the pre-pandemic assumption was 80 percent. CFO Henry noted CEO Timm had a plan referencing security and fare ambassadors being deployed throughout the system to increase the percentage of those with fares. CEO Timm added there was current ongoing conversation regarding the implementation of the Board’s of fare compliance policy and ensuring it was handled in an equitable and sustainable manner. There was further discussion needed around how fares were collected sustainably. That conversation would be continued into early 2024.

Grants and other revenues increased by $350 million compared to Spring 2023, of that, $117 million was from grants, the majority of which was from an additional federal appropriation for Federal Way and Lynnwood Link extensions. Interest earnings increased by $333 million due to higher cash balances and short-term interest rates. These increases were offset by a decrease of $100 million with the ORCA regional programing billing reimbursements.

Capital expenditures increase by $2 billion with $1.6 billion due to inflation index updates and latest project schedules, $288 million due to Stride baseline project costs, and $133 million for enterprise resource planning and enterprise asset management systems assumptions update. No project cost estimates were updated.

Operating expenses were projected to increase by $210 million compared to Spring 2023. $240 million was due to enhanced janitorial/cleaning, ST Express and Sounder service restoration, and insurance increases. $159 million was due to inflation, labor and benefit market increases. Those increases were offset by $189 million due to updating BRT in-service dates to baseline dates.

CFO Henry briefed the assumptions updated this fall and how those updates affected the program’s affordability. Headwinds included labor market, cost increases for projects in planning, scope changes for projects in planning, additional light rail vehicle needs, operations and maintenance facility capacity and associated operating costs, fare revenues, and claims on construction projects. Tailwinds included new carbon credit market sales revenues and increased CIG grants assumptions.

Committee Vice Chair Dammeier commented that there were updates to project cost estimates in the current report and asked if there would be updated cost estimates for the spring 2024 LRFP update. CFO Henry confirmed the team had planned for those updates for the Spring 2024 update.

Executive session – None

Other business – None

Next meeting

Thursday, December 15, 2023
8:30 to 10:00 a.m.
Ruth Fisher Boardroom and Virtually via WebEx

Adjourn

The meeting adjourned at 4:15 p.m.

ATTEST:

______________________________	______________________________
Nancy Backus Finance and Audit Committee Chair	Kathryn Flores Board Administrator

APPROVED on _____________ JG.