



Summary Minutes

Finance and Audit Committee Meeting May 9, 2024

Call to order

The meeting was called to order at 10:32 a.m. by Committee Chair Nancy Backus and was available for viewing in person and online.

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	(A) Bruce Dammeier, Pierce County Executive

Board Members	
(P) Dow Constantine, King County Executive	(A) Kristina Walker, Tacoma Councilmember
(P) Christine Frizzell, Lynnwood Mayor	(A) Girmay Zahilay, King County Council Vice Chair
(P) Ed Prince, Renton Council President	

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

Report of the Chair

None.

CEO Report

John Henry, Chief Financial Officer, spoke to the CEO report in Interim CEO Sparrman’s absence. Mr. Henry briefly announced that the agency was executing initiatives outlined from the Board and Technical Advisory Group and the Board would begin to see this as the budget process for 2025 began.

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 comments received.

Business Items

Item for Final Committee Action

March 14, 2024 Finance and Audit Committee meeting minutes

It was moved by Board member Frizzell, seconded by Board member Prince, and carried by unanimous voice vote of the committee members present that the minutes of the March 14, 2024

Finance and Audit Committee meeting be approved as presented.

State Auditor's Office – 2022 Accountability Audit Exit

Chair Backus noted the 2022 Accountability Exit report from the State Auditor's Office was in the meeting packet. This was an annual independent audit focused on compliance with laws, regulations, and the agency's own policies in areas selected for testing and determined if public assets were safeguarded against loss or misuse.

Economic and Sound Transit Financial Management Overview

Dr. Dimitri Delis, Managing Director with Piper Sandler Financial Strategies, provided the presentation on Economic Realities in 2024. He shared a graph that displayed what was occurring with monthly Consumer Price Index (CPI) inflation broken down into five categories: services (such as rent), rent of shelter, core goods, food, and energy. Energy was a large factor, contributing to inflation during COVID-19. Over the last 15 months, energy was below the negative axis which meant it was deflationary. For food and core goods, they had been contracting so there was no inflation present. The area that remained strong in the month ahead was rent of shelter. Shelter costs were comprised of owners' equivalent rent and primary rent. These costs were already predetermined and reflectively and mechanically move lower between now and the end of the year.

Dr. Delis explained the owners' equivalent rent and primary residence rent was how the Federal government determined the CPI. The Federal government was using information based on 12 months ago. The BLS New Tenant Rent Index Rent only had information based on the last month. Inflation would not be an issue and supply chains were reported back to normal. He displayed a graph showcasing delivery times currently versus the future 6 months. Currently it was tracked at -10 which meant supply chains were improving and delivery times were shorter and closer to normal. Demand was no longer an issue and money was not expanding as it did. What sustained inflation was an abundance of money, such as the Federal government providing three rounds of stimulus money.

Dr. Delis shared a graph showing M2 supply against headline CPI and what occurred when money was introduced to the system. Inflation was moving lower, and money was contracting on a Year over Year basis. If the money supply was contracting, there was no mathematical way that inflation could remain at sustained levels. He noted the importance of realizing that inflation was a lagging indicator. Money supply took 16 months before inflation manifested itself because it was tracking a lagging affect. The fiscal policy was responsible for the inflation surge. He shared a slide comparing the core Personal Consumption Expenditures (PCE) against the Cumulative Excess Personal Savings and the PCE tracked the latter closely, keeping in mind the lag effect of what the government was tracking. Inflation was tracking events that already occurred. The government made decisions based on delayed information and inflation was projected to continue to drift lower.

The market had two rate cuts in early 2024, whereas 6-7 rate cuts were previously projected. The government's latest projection from March 2024 was at around 3 cuts. Since the early 1980s, yields had always declined when the Federal government started cutting rates. Whether the government started cutting rates in July or September 2024, Dr. Delis explained the rates would come down and the curve would steepen. Since the early 1980s, the yield curve had always steepened when the government started cutting rates. He explained what would occur over the next 3-4 months: rates would come down and the curve would steepen, which is what occurred over the last 7-8 years. He showed a chart showing the decline in expected rate cuts had put upward pressure on long-term rates and 10-year treasury had moved sharply higher. He noted the importance that this only took 2-3 months to occur. If it stays at the current levels, it would put pressure on the 10-year treasury to be trading more closely at a much higher level, such as 10-12 percent, which would put the U.S. on a fiscally unsustainable path. He

shared a chart showing interest and what the U.S. was paying. He explained the reasoning on how the U.S. can avoid this path and keep rates low, which was to lower rates to zero.

Lastly, Dr. Delis shared a graph displaying the leading indicators index such as building permits, new orders, slope of yield curve, equity, etc. Whenever the index had dropped to lower levels, recessions would occur 100 percent of the time. Soft landings would show leading indicators barely in the negative. The same was in play for the yield curve: whenever slope of the yield curve would turn negative, that would 100 percent equate to a recession. The yield curve inversions had been reliable predictors of recessions. Looking towards indicators with small business statistics, whenever this index dropped to negative levels, there was a recession. Recessions would begin after the government starts cutting rates.

Board member Frizzell thanked Dr. Delis for providing the robust information and graphics and was anticipating another presentation to address what steps can be taken as an agency. Dr. Delis shared his opinion and in summary, it would be to lower rates.

John Henry, Chief Financial Officer, Ryan Fisher, Deputy Executive Director of Financial Planning, Analysis and Budget, Jeff Clark, Deputy Executive Director of Financial Operations, and Lisa Wolterink, Deputy Executive Director of Fares, Grants and Revenue, provided the presentation for the Sound Transit Financial Management Overview. Mr. Fisher explained that the long-range financial plan was a 30-year financial forecasting model that projected all revenues and expenditures through the life of the planned system expansion program, which was currently anticipated to be complete and in revenue service by 2046. The Financial Plan fully funded the completion, operation, and maintenance of the almost \$75 billion capital program approved by the voters. Peak capital spending was currently expected to occur in the early to mid-2030's. This model projected when and how much debt the agency must assume to complete the program and enabled the agency to track debt against affordability constraints.

The financial plan was used to monitor program affordability, comply with federal and state reporting requirements, participate in the credit rating process, and provide analysis of legislative proposals and initiatives to see how they would affect the agency's financial outlook. The financial plan considered the agency's financial policies, including subarea equity, debt limits, and farebox recovery ratios, project cost estimates and schedules, planning assumptions, such as ridership, service levels, and fare compliance, independent economic forecasts, including inflation indices and tax revenue forecasts twice a year, and most recent actuals and budgets. With all of the data, provided a high-level look at the financial outlook for the program. Critical financial constraints that were highlighted with this committee and the Board included projected remaining available debt capacity, which tracks outstanding projected debt balances, and projected net debt coverage ratio which tracked projected ability to pay back debt balances.

Mr. Fisher reviewed a bubble chart which showcased both the relative size of each major revenue and uses in the long-range financial plan projections through 2046, as well as the relative ability to control each of the sources or uses. Tax revenues, which included sales, MVET, property, and rental car taxes, were the agency's biggest source of revenues with over half of the revenues expected to be contributed by taxes. Mr. Fisher noted the agency did not have much control over tax revenues as the overwhelming majority of these were established in the voter approved plans. The agency did have greater control over grants that were secured and the agency's financing structures. Pre-baselined projects were the biggest forecasted uses in the long-range plan with over a third of the projections earmarked for pre-baselined projects. There was some level of control over baselined projects and items such as insurance and these costs would typically get locked in with contractual terms and show less ability to control than other expenses. Items such as State-of-Good-Repair, Purchased Transportation, staffing and other operating costs showed some degrees of control and were mainly driven by both service levels and inflation trends.

Mr. Fisher reviewed a chart with two lines with both the year over year (YOY) growth trends over the last two years and the cumulative collections. The growth trend had been decelerating, particularly in the last half of 2023, but this trend stabilized in the last 4 months carrying into 2024. Staff observed a recent jump towards positive YOY growth in February 2024. Staff anticipated having an updated forecast for the Spring Annual Program Review and again in the Fall with the agency's long-range financial projections during the budget cycle.

As for operating cost trends, the trend of inflation and platform hours were both trending up and impacting budgets seen in the Fall approval cycles. While inflation held strong, platform hours was a bigger contributor to cost increases with the openings of the expansion projects including Hilltop in September 2023 and the recent 2 Line in 2024. This trend would continue in 2025 and 2026 as more extensions would open, including Downtown Redmond Link, East Link, and Federal Way Link extensions.

Focus areas for the 2024 budget cycle were reviewed. First, introducing a more formal zero-based budgeting for the agency, which was a grounds-up approach and emphasized an agency-wide effort to prioritize resource allocation. Second, specific to staffing levels, the agency had seen a higher than projected vacancy rate actualized in the last couple of years and into early 2024. The agency was focusing efforts on filling those vacancies with high priority roles over adding more vacancies to the budget. Third, the agency was evaluating its Service Delivery Projects in the Transit Improvement Plan (TIP) which included State-of-Good-Repair, Enhancement, and administrative projects. This was presented at the March 2024 Finance and Audit Committee meeting regarding the agency's use of Board approved resources. As an outcome of this deep dive, staff was expecting was a reallocation of some existing resources that had not yet been executed on to higher priority projects, including State-of-Good-Repair projects. This did not mean other projects wouldn't eventually get executed on, but rather the agency was actively managing the TIP to ensure the near-term projects were the highest priority.

Mr. Clark reviewed the Asset and Liability Management highlights. The agency had approximately \$5.2 billion in investments as of the end of Q1 2024, of which \$4.5 billion was unrestricted. Outstanding Debt as of the end of Q1 2024 was approximately \$3.5 billion. Available TIFIA draws were an additional \$2.47 billion. In preparation for active debt issuance, staff was engaging an external financing advisor, exploring utilizing third party funding or financing, exploring financing alternatives, optimizing federal funding sources, and staying informed on market conditions and market opportunities. Staff would continue to adjust the timing and nature of investments and debt issuances depending on market conditions.

The Financial Plan assumed over \$15 billion in grant revenue from three main categories: Capital Investment Grants (CIG) for major link expansions, FTA formula funding, and other national regional grant competitions. The agency also sought federal loans, including TIFIA loans, for Link projects and Railroad Rehabilitation and Improvement Financing (RRIF) loans for Sounder projects.

Potential strategies to increase grant and loan funding included exploring the FTA's Expedited Project Delivery (EPD) Pilot Program for West Seattle Link. The EPD pilot program doesn't require a New Starts rating and the grant could be secured faster. Traditional CIG grants could take 3-5 years to secure and the EPD program allowed for a much faster approval of grant funding once the requirements were met. The agency was also partnering with WSDOT to pursue Federal Railroad Administration grants for the track improvements in the Sounder South Capacity Expansion. FRA sources were not assumed in the Financial Plan so that would be an additive funding source. Lastly, the agency was also pursuing additional/new TIFIA and RRIF loans and potentially increasing the federal share of those loans.

Ms. Wolterink reviewed several grant risks and opportunities. For risks, the overall federal share of grant assumptions was low, only 20 percent of capital program was assumed to be funded by grants, but the agency had multiple large CIG projects happening around the same time, requesting high annual

appropriations. Delays in projects could also impact the timing of grant revenue. Lastly, national funding levels for transit projects could impact the agency's grant amounts. As for opportunities, the FTA formula funding and other competitive grant assumptions were modest, mitigating some of the risk of other assumptions. There was also potential for additional/new TIFIA and RRIF loans. Ms. Wolterink introduced Peter Peyser, the agency's Federal Funding Advisor. Mr. Peyser acknowledged the upcoming presidential election and how that shifted focus to political risks. He shared his history working with Sound Transit since 1999 and has observed several transitions in administration and noted there was little downside risk over time resulting in election outcomes. He explained that over a 25 year, there was a moderate upwards sloping line with an average of 5-6 percent annual growth. There were few deviations on the up and down scales. In the last three years, there was significant uptick in spending due to the Bipartisan Infrastructure law and noted there was some risk when the law comes up for reauthorization in 2026. Some risk would be that a third of the program relied on the Infrastructure Law funding as opposed to the long-term ongoing funding that came from the underlying program that had been in place for 40 years. With his experience, he shared there were some political risks but not to the extent that it would sidetrack plans that the agency had in place between now and 2046.

Board member Frizzell asked whether there should be concerns related to global wars. Over the time of observations, Mr. Peyser shared on behalf of Sound Transit and his personal experience, when defense spending goes up then domestic goes up as well but they usually rise together so there may be a little pressure as a result but there was no historic indication, including the Cold War era, that that would create significant pressure on the program.

Executive session – None

Other business – None

Next meeting

Thursday, July 11, 2024
10:30 a.m. to 12:00 p.m.
Ruth Fisher Boardroom and Virtually via WebEx

Adjourn

The meeting adjourned at 11:27 a.m.

ATTEST:

Nancy Backus
Finance and Audit Committee Chair

Kathryn Flores
Board Administrator

APPROVED on _____ JG.