

**SOUND TRANSIT  
STAFF REPORT**

**RESOLUTION NO. R2007-26**

**Establishment of Capital Replacement Reserve**

<b>Meeting:</b>	<b>Date:</b>	<b>Type of Action:</b>	<b>Staff Contact:</b>	<b>Phone:</b>
Finance Committee	11/15/07	Discussion/Possible Recommendation to Board for Approval	<b>Brian McCartan, Executive Director – Finance and IT</b>	(206) 398-5100
Board	11/29/07	Action		

<b>Contract/Agreement Type:</b>	✓	<b>Requested Action:</b>	✓
Competitive Procurement		Execute New Contract/Agreement	
Sole Source		Amend Existing Contract/Agreement	
Interagency Agreement		Contingency Funds (Budget) Required	
Purchase/Sale Agreement		Budget Amendment Required	

✓ *Applicable to proposed transaction.*

**ACTION**

Establishes a capital replacement reserve

**KEY FEATURES**

- Establishes a capital replacement reserve (CRR) to fund the capital replacement of agency assets and major mid-life maintenance.
- Establishes the CRR as a reserve within the agency’s financial system and states that the funds will be maintained in separate accounts.
- Requires that the CRR be budgeted at levels sufficient to fully fund asset replacement and major maintenance.
- Establishes that the CRR can only be used for capital replacement or outlays that would extend the useful life of existing assets.
- Delegates to the chief executive officer the development of an asset management policy that:
  - inventories all major agency capital assets;
  - identifies expected useful lives for all major assets;
  - identifies mid-life major maintenance requirements and schedules;
  - establishes a methodology and procedures for identifying lifecycle costs of capital assets and for evaluating environmental sustainability;
  - incorporates environmental sustainability measures into evaluation of capital replacement.
- The establishment of the reserve is not an authorization to expend funds for replacement of assets. Any such authorization shall be obtained through the processes contained in the agency’s budget and procurement policies.

## **BUDGET IMPACT SUMMARY**

There is no action outside of the current Board-adopted budget; there are no contingency funds required, no sub area impacts, or funding required from other parties other than what is already assumed in the financial plan.

## **BUDGET DISCUSSION**

The Adopted 2007 Budget contains \$22 million for capital replacement in 2007. These funds have not yet been spent and would be allocated to the CRR under this action.

In addition, the Proposed 2008 Budget contains \$353 million in future lifetime budgets for capital replacement that would also be allocated to the CRR under this action in each of those fiscal years.

## **REVENUE, SUBAREA, AND FINANCIAL PLAN IMPACTS**

The proposed action is consistent with the current Board-adopted budget and is affordable within Sound Transit's current long-term financial plan and the sub area financial capacity.

## **BUDGET TABLE**

Not applicable.

## **SMALL BUSINESS PARTICIPATION**

Not applicable.

## **PROJECT DESCRIPTION and BACKGROUND for PROPOSED ACTION**

Since 1997, the agency's long-term finance plan has contained estimated funds for capital replacement through the use of a sinking fund. "Contributions" to this fund began in 2007 for Sounder and ST Express and will begin 2009 for Central Link. These periods correspond to the dates in which most Phase I projects would be fully operational.

An annual contribution to the fund is calculated for each class of asset and its replacement cycle. There may be several replacement cycles per class. The annual contribution is a fixed annual payment for each unique combination of asset class and replacement cycle. These payments, plus accumulated interest earnings, are calculated to exactly equal the (inflation-adjusted) replacement cost of the asset at a specified future date.

The annual payment calculation assumes that 77% of replacement costs will be funded from Sound Transit funds, with the remainder (23%) being funded from grants. The interest earnings rate is currently set to 5.5% annually. This is higher than the interest earnings rate (3.0%) assumed for other funds (e.g., the general fund) because the long lead time on capital replacement would allow Sound Transit to invest in longer-term securities that usually offer higher earnings. The compounding of interest earnings allows the annual payments to the sinking fund to be less than the annual straight-line depreciation cost of an asset.

The replacement date for assets follows generally-accepted principles for the useful life of transit plants and equipment. The twelve-year replacement cycle for buses is the industry

standard. The replacement cycles for commuter rail (Sounder) and light rail (Link) equipment were adopted from "Methodology for Projecting Rail Transit Rehabilitation and Replacement Capital Financing Needs," by Robert L. Peskin, published in Transportation Research Record 1165, Transportation Research Board, 1988. Portions of the assets in a group are replaced on fixed cycles. It is notable that less than 100% of rail capital asset cost is subject to replacement. This reflects the permanent nature of some heavy civil structures such as tunnels. The replacement cost estimates are refined as more detailed component costs become available.

For the first time, in the Adopted 2007 Budget these estimates within the agency's long-term financial plan were brought into the agency's 6-year capital plan and were adopted by the board. The Proposed 2008 Budget contains an additional \$353 million in budget outlays to meet the estimates for required capital replacement contained in the financial plan.

The proposed action would establish guidance regarding the use and designation of these budgeted funds and would delegate to the CEO the authority to develop detailed policies and procedures regarding use of these funds.

### **CONSEQUENCES OF DELAY**

The Adopted 2007 Budget contained \$22 million for capital replacement. These funds need to be allocated or roll into 2008 as a budget amendment in order to make contributions to the capital replacement reserve consistent with the agency's long-term financial plan.

### **PUBLIC INVOLVEMENT**

Not Applicable

### **LEGAL REVIEW**

JW 11/9/07

## SOUND TRANSIT

### RESOLUTION NO. R2007-26

A RESOLUTION of the Board of the Central Puget Sound Regional Transit Authority establishing a capital replacement reserve.

WHEREAS, a Regional Transit Authority, hereinafter referred to as Sound Transit, has been created for the Pierce, King, and Snohomish County region by action of their respective county councils pursuant to RCW 81.112.030; and

WHEREAS, on November 5, 1996, at a general election held within the Central Puget Sound Regional Transit Authority district, the voters approved local funding for high capacity transit in the Central Puget Sound Region; and

WHEREAS, by Resolution No. 78-1 the Sound Transit Board adopted financial policies to govern the financing and implementation of the Ten-Year Regional Transit Plan and to specify budgetary guidelines for providing subarea equity in accomplishing the same; and

WHEREAS, capital replacement was recognized within *Sound Move* as an on-going cost after completion of the initial plan; and

WHEREAS, regular upkeep and maintenance of agency capital assets lengthens the useful lives of agency capital assets; and

WHEREAS, a planned, funded capital replacement program will insure the regional transit system is retained in good working condition to the benefit of current and future users of the system.

NOW, THEREFORE, BE IT RESOLVED by the Board of the Central Puget Sound Regional Transit Authority that:

Section 1. A capital replacement reserve (CRR) will be established within the agency's financial system and records.

Section 2. The CRR shall be budgeted at a level sufficient to fund, together with associated interest earnings, replacement of assets at the end of their useful life and major maintenance requirements. Any deferment of capital replacement contributions from the schedule necessary to fully fund asset replacement and major maintenance requirements will require approval by two-thirds of the entire membership of the Sound Transit Board.

Section 3. The CRR will be used only for replacement of existing capital assets that have reached the end of their useful lives, taking age, capacity and performance characteristics into consideration, or for major maintenance of capital assets to extend their useful life.

Section 4. The CRR will be designated as internally restricted within the agency's financial statements, consistent with generally accepted accounting principles. The CRR will be maintained in accounts separate from other agency funds. Budgeted funds will be credited to the account at end of each fiscal year. Funds within the CRR will be invested in securities consistent with the agency's investment policies and of a duration to match their expected usage.


Section 5. All interest earnings within the CRR will be credited to the CRR.

Section 6. All transfers from the Capital Replacement Reserve not for the purposes identified in Section 3 shall be approved by two-thirds of the entire membership of the Sound Transit Board.

Section 7. The Chief Executive Officer will establish policies and procedures to allocate funds within the CRR and maintain a long-term capital asset management plan that (1) inventories all major agency capital assets; (2) identifies expected useful lives for all major assets; (3) identifies mid-life major maintenance requirements and schedules; (4) establish methodology and procedures for identifying lifecycle costs of capital assets; and (5) incorporates environmental sustainability measures into evaluation of capital replacement.

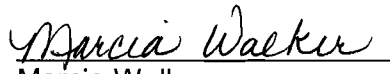
Section 8. The establishment of the reserve is not an authorization to expend funds for replacement of assets. Any such authorization shall be obtained through the processes contained in the agency's budget and procurement policies.

ADOPTED by the Board of the Central Puget Sound Regional Transit Authority at a regular meeting thereof held on November 29, 2007.



John W. Ladenburg  
Board Chair

ATTEST:



Marcia Walker  
Board Administrator