Date: August 21, 2013

To: Transit Service Delivery Advisory Committee

From: Department of Rail and Public Transportation Staff

Subject: Capital Asset Tier Categories and Definitions

A. Overview

The Transit Service Delivery Advisory Committee (TSDAC), along with the Director of the Department of Rail and Public Transportation (DRPT), has been charged with evaluating a tiered approach to distributing funds for capital purposes based on asset needs and available revenues. The purpose of the tiered approach was to incentivize investment in categories of assets that the Commonwealth Transportation Board views as the most important to transit in Virginia. The specific charge of the Committee with respect to transit capital funding in Chapter 639 of the 2013 Acts of Assembly is as follows:

> *(d) Of the funds pursuant to this section, 25 percent shall be allocated and distributed utilizing a tiered approach evaluated by the Transit Service Delivery Advisory Committee along with the Director of Rail and Public Transportation and established by the Commonwealth Transportation Board for capital purposes based on asset need and anticipated state participation level and revenues. The tier distribution measures may be evaluated by the Transit Service Delivery Advisory Committee along with the Director of Rail and Public Transportation every three years and, if redefined by the Board, shall be published at least one year in advance of being applied. Funds allocated for debt service payments shall be included in the tier that applies to the capital asset that is leveraged.*

At the request of TSDAC, DRPT staff has prepared a list of proposed capital asset tiers and definitions of each tier. In defining the capital tiers, DRPT and TSDAC considered how funds should be prioritized based on funding needs identified in the state's six-year improvement plan (SYIP). DRPT and TSDAC also considered the ability of transit systems to determine whether a capital project is needed to meet state of good repair needs versus expansion needs, particularly for facilities that will serve both purposes.

As part of its evaluation process TSDAC has addressed the need to provide predictable funding streams, particularly for large capital projects that feature significant costs for several years at a time. However this must be balanced with the need to maintain some flexibility in the event that revenues substantially decline or capital needs substantially exceed funding based on percentages that are in place. The legislation provides some guidance to the Department with respect to establishing a reserve to allow for state participation percentages that can be held constant for at least a three-year period. Specifically, the Codes states:

(f) The Department of Rail and Public Transportation may reserve a balance of up to five percent of the Commonwealth Mass Transit Fund revenues under this subsection in order to assure better stability in providing operating and capital funding to transit entities from year to year.

DRPT has prepared numerous capital allocation scenarios using both actual capital projects from FY 2012 through FY 2014 as well as planned capital projects for FY 2015 through FY 2019. The different scenarios serve to compare forecasted capital funding needs, by tier, to estimated future revenues. Additionally, DRPT applied the tiered approach to FY2012 to FY 2014 to provide a sense of the impact of the proposed policy changes. Further scenarios were produced to show the impact of altering the base used to calculate state participation, i.e. gross project cost vs. the non-federal share of the project cost.

Additional details regarding the proposed funding allocation strategy are presented in this memo. It begins by defining the capital asset tiers. This is followed by a description of two funding allocation approaches, based on gross costs and non-federal share of project costs, and a summary of the estimated funding percentages under each approach. Next, two proposals are discussed for adjusting funding percentages in the event of a significant shortfall in the resources needed to meet the established state participation rates. Finally, implementation steps are summarized.

B. Capital Asset Tiers

At its meeting on Monday, July 29, 2013, TSDAC approved three tiers which comprise categories of capital needs. Capital funds would be allocated to each tier based on a matching percentage that reflects the priorities of the Commonwealth Transportation Board (CTB). The tiers are defined as follows:

1. **Replacement and Expansion Vehicles**: Activities eligible for funding under this tier include the acquisition of rolling stock for either replacement or expansion purposes. Other eligible activities include:
    - Line inspection
    - Fare collection equipment
    - On-vehicle radios and communication equipment
    - Surveillance cameras
    - Aftermarket installation of farebox, radios, and surveillance cameras
    - Vehicle tracking hardware and software
    - Scheduling hardware and software
    - Rebuilds and mid-life repower of rolling stock

2. **Infrastructure/Facilities:** Activities eligible for funding under this tier include the construction of infrastructure or facilities for transit purposes, such as maintenance facilities, bus shelters, administrative buildings, or guideway infrastructure. Other eligible activities under this tier include:
    - Real estate used for a transit purpose

- Signage
- Surveillance/security equipment for facilities
- Rehabilitation or renovation of infrastructure and facilities
- Major capital projects

3. **Other**: Activities eligible under this category include, but may not be limited to the following:
   - All support vehicles
   - Shop equipment
   - Spare parts
   - Hardware and software not related to vehicle tracking or scheduling
   - Project development expenses for capital projects
   - Office furniture and other equipment
   - Handheld radios
   - Landscaping
   - Other transit-related capital items

Funds allocated for debt service and lease payments will be included in the tier that applies to the underlying capital asset that is being financed.

It is expected that each agency will designate the appropriate tier for each project in its annual grant applications. DRPT will review and confirm these designations as part of the grant approval process. Any capital needs that are not addressed above will be allocated by DRPT to the most appropriate category.

DRPT previously proposed to fund Major Capital Projects, which are defined as projects that have a gross project cost over $100 million (in year of expenditure dollars), at the Tier 2 percentage. Eligible activities that will be funded at the Tier 2 percentage include the following:

- Engineering and design
- Construction
- Right of way costs
- Systems
- Maintenance facilities
- Debt service costs associated with financing the project

The Committee needs to discuss the idea of allowing such large projects to be broken into smaller projects whereby the costs for vehicles associated with a Major Capital Project would be funded at the Tier 1 percentage. Similarly, costs for activities (landscaping) that would fall under the "Other" category would be funded at the Tier 3 percentage. This would require project sponsors to define separate sub-projects for each element. As such the overall matching percentage for the project, on a blended basis, may differ from 25% based on the components of the capital cost.

C. Basis for Funding Allocations: Gross Costs vs. Non-Federal Shares

Prior to the changes made in the 2013 session of the General Assembly, the Virginia Code dictated that the non-federal share of capital project cost be utilized as the basis to allocate state funds. Following changes made by in the 2013 session, the Code no longer dictates that the non-Federal share of the project cost be used as the basis for the state funding allocation process.

DRPT has proposed to allocate funds to each capital project or activity based on the gross cost of the project. This approach would differ from the current funding structure, which utilizes the gross cost of the project, less any Federal funds that have been allocated to the project by the applicant, as the basis for the funding allocation. As identified during the SJR 297 process, the use of "non-Federal share is a complicating factor and can be a barrier to the fair treatment of grantees regardless of their choice to seek Federal funding." Under the current approach, two different transit providers could be buying the exact same bus, and one transit entity would receive 16% state funding and the other received 55% state funding. This significant difference in state participation was based on how each entity allocated their federal dollars.

It is anticipated that under the non-federal share approach, the large urban systems may increasingly apply Federal funds, such as Section 5307 dollars, to Preventive Maintenance in order to increase the non-Federal share of capital projects and thereby maximize the amount of state capital funding that they would receive from the state.

DRPT recommends that under the gross cost approach that the entity providing federal funds to a capital project be allowed to voluntarily supplant state funding with federal funding. This would allow DRPT to cap the total funding provided through the state sources and state-controlled federal programs to a 99% maximum share.
Under the gross cost approach, it is recommended that grantees be allowed to apply for a program of capital projects that would apply state tier rates to determine the state allocations. The grantee and DRPT would subsequently determine a funding plan for the capital program of projects that would allow the state funding to be moved within the approved program but would require that all projects in the program be completed.

At the request of TSDAC, DRPT has analyzed the impacts of the gross cost and non-Federal share scenarios. The results of this analysis, which illustrate the potential impacts on each transit agency for the total funds between FY 2015-FY 2019, are presented in Table 1.

Table 1: Summary of Capital Grants by Scenario by District, FY15-FY19 ($000)

Applicant	**Estimated State Funding: Gross Project Costs**	**Estimated State Funding: Non-Federal Costs (Except 5307)**	**Variance**
Bristol	$105	$89	$(17)
Culpeper	675	523	(152)
Fredericksburg	1,133	943	(190)
Hampton Roads	25,741	35,744	10,003
Lynchburg	9,440	5,850	(3,590)
Northern Virginia	428,152	420,221	(7,932)
Richmond	11,931	17,335	5,404
Salem	14,503	12,642	(1,861)
Staunton	2,853	1,881	(972)
Total	**$494,533**	**$495,226**	**$693**

Note: The results of this analysis are illustrative only, and do not constitute final funding allocations.

D. Estimated Funding Percentages for Capital Tiers

Funds should be allocated to each Tier based on different matching percentages that reflect the CTB's priorities. DRPT establishes a baseline funding percentage for each tier. The proposed baseline percentages based on the analysis of FY 2015 through FY 2019 capital needs are as follows:

Table 2: Estimated Funding Percentage by Tier by Scenario, FY 2015 – FY 2019

Capital Tier	**Estimated Percentage: Gross Project Costs**	**Estimated Percentage: Non-Federal Costs (Except 5307)**
Tier 1: Vehicles	50%	80%
Tier 2: Infrastructure/Facilities	25%	39%
Tier 3: Other	15%	20%

One issue for further TSDAC consideration is the amount of differential between the matching percentages for each tier. The scenario worksheets are designed to allow for relatively easy testing of varying percentages within the tiers.

E. Approaches to Adjusting Tier 2 and 3 Capital Funding Percentages

Part of the original reason for defining 'Major Capital Projects' was to provide a mechanism for the CTB to adjust participation in projects in the event that capital funding requests far exceeded available funding. Despite an overarching goal to provide consistent state matching rates for capital projects, the CTB must have the ability to adjust the established rates downward if necessary. Several possibilities exist to accomplish this.

- Establish a reserve balance to cover shortfalls up to 15% of the annual estimated revenues. The reserve would have to be established over 2 to 3 years using the Code language allowing a 5% hold back of the revenues that exceed $160 million in a given year. For the FY 2014, this 5% would be approximately $3.6 million. Additionally, in years where the capital projects applications do not completely consume the available revenues, the excess funds would be allocated to the capital reserve account and allocated back to systems in years in which funding requests exceed available funding amounts.

- For shortfalls that exceed 15% of the available revenues in a given year, several options are available:

  Proposal 1: Under this approach, DRPT would adjust funding for all capital projects on the basis of available funding.

  - Decrease each tier by one percentage point until there are sufficient funds (including the reserve funds) to cover the approved capital requests.

  Proposal 2: Under this approach DRPT would adjust funding for all Tier 2 and Tier 3 capital projects only on the basis of available funding.

  - Decrease each tier by one percentage point until there are sufficient funds (including the reserve funds) to cover the approved capital requests. It is assumed that all projects eligible for Tier 1 would be funded at the full, established percentage.

  Proposal 3: Under this approach, DRPT would allocate available funding to most capital projects on the basis of approved project funding shares, and would adjust funding shares for Major Capital Projects or other specifically identified assets.

  - Isolate the major capital requests (projects costing $100 million or more) or specifically identified assets and deduct the gross costs for these projects from the total statewide funding requests.
  - Allocate funding to all remaining approved capital requests using the approved project funding share methodology, tiers, and percentages.

- Use any remaining funds, including the capital reserve, to determine the percentage that could be used to allocate the remaining funds to major capital projects or specifically identified assets.

In evaluating these approaches, several considerations include:

- Need for transit agencies to have a predictable funding streams, particularly for major capital projects;
- Ability for agencies of diverse sizes to meet state of good repair needs;
- Regional equity; and
- Funding needs forecasted for system expansion projects in future years, as compared to other capital projects.

F. Implementation of Proposed Approach

Based on the final recommendation of TSDAC, the Director of DRPT will recommend a tiered approach to the CTB for approval. It is expected that this approach will be applied to funding requests beginning in FY15. DRPT anticipates the following milestones for approval of the capital funding allocation plan.

September 9, 2013 – TSDAC meeting to finalize Capital Allocation Plan
September 9, 2013 – TSDAC reports key findings to Director of DRPT
September 10, 2013 – 45-Day Public Comment Period Begins
September 18, 2013 – Commonwealth Transportation Board (CTB) Presentation of Draft SB1140 Recommendations
September 18, 2013 – Public Hearing
September/October, 2013- Senate Committee on Finance, House Appropriations Committee, and Senate and House Committees on Transportation briefings
October 25, 2013 – Public Comment Period Ends
December 4, 2013 – CTB – SB1140 Action

NOTE: Meeting dates and times with the Senate and House Finance Committees are forthcoming