TriMet General Manager's Budget Task Force

March 11, 2014

Mr. Neil McFarlane
TriMet General Manager
1800 SW 1st Avenue, Suite 300
Portland, OR 97201

RE: FY15 Report – "Turning the Corner"

Dear Neil,

The General Manager's Budget Task Force (BTF) came together for the third year to provide a community perspective on TriMet's annual budget and long-term financial stability. Even though we still believe that TriMet's most urgent cost structure challenge is the unsustainable labor costs driven by active and retiree healthcare obligations, the BTF finds TriMet's incremental policy changes and strategic investments in the FY15 Budget have the potential to enhance the agency's long term financial stability. No fare increase, investments in the restoration of service and vehicle and infrastructure improvements, acceleration of pension funding and the response to recommendations made in the Secretary of State's Audit are encouraging. That is why we titled our report *Turning the Corner: Growing Service, Controlling Costs and Delivering High Quality Service.*

This year, you asked the BTF to answer four questions: 1) <u>*Should the focus of the FY15 Budget be to strengthen TriMet's long term fiscal foundation and to restore and grow service?*</u> The BTF believes, as in past years, that restoration of service should be TriMet's first priority. Capital maintenance assumptions that support system growth and service restoration are appropriate. 2) <u>*Are the pension and Other Post Employment Benefits (OPEB) strategies on the right track?*</u> The BTF concurs with TriMet's approach of treating OPEB as a benefit issue and the pension liability as a funding issue. The BTF agrees with the recently adopted pension funding policy, but believes that cost control for current and retiree health care is vital to reducing the OPEB liability. 3) <u>*Are revenue assumptions reasonable?*</u> The BTF believes that TriMet's FY15 budget revenue assumptions and forecasted growth are reasonable and that risks have been correctly identified. 4) <u>*What recommendations from the Secretary of State's Audit does the BTF want to reinforce?*</u> The BTF agrees with the audit's statement that the $852 million unfunded OPEB liability is the greatest risk to the agency's long term financial stability. The BTF also agrees with the audit's safety recommendations and those that improve communication with frontline employees.

We also express our continued support of an electronic fare system; establishment of a "fair" fare policy that includes a regionally equitable Youth fare, an Honored Citizen fare that is in alignment with peers and provides fare mitigations for those most in need; and development of a non-union compensation plan that attracts and retains highly skilled employees.

The BTF is comprised of individuals with varied perspectives and backgrounds committed to ensuring this region has a strong transit system. This report reflects our collective thoughts and that commitment.

Sincerely,

Luann Pelton

Luann Pelton, Chair
TriMet General Manager's Budget Task Force

TriMet General Manager's Budget Task Force

The FY 2015 Budget

Turning the Corner

Growing Service, Controlling Costs and Delivering High Quality

March 11, 2014

BACKGROUND

Containing Labor Costs Still the Priority for Long-term Financial Stability

For the past two years, the General Manager's Budget Task Force (BTF) has provided its perspective on TriMet's annual budget and long-term financial stability.

In 2012 the Task Force was faced with tough choices as TriMet was considering fare increases and service cuts to fill a potential $17 million shortfall in its FY13 Budget. In our second report later that year, we focused our comments on TriMet's long term financial stability. We believed then and believe now, that TriMet's most urgent cost structure problem is related to labor costs – especially in active and retiree health benefits.

Although progress has been made to contain benefit costs with TriMet prevailing in the 2012 labor arbitration, long-term financial stability is still in question as an appeal of that decision has been filed by the Amalgamated Transit Union (ATU). Meanwhile, TriMet and the ATU are once again in labor negotiations and may be headed for arbitration.

The BTF continues to support efforts by TriMet and ATU that will result in sustainable health care and wages for its employees that are in alignment with its peers. As we said last year in our FY14 report, *Back to Basics: TriMet's Path to Financial Stability*, "the labor contract must be fair, reasonable and cost effective."

In that report, the BTF outlined what it believes is our community's expectation of TriMet to grow and deliver transit service that is safe, dependable, accessible and affordable. This remains the lens by which we reviewed the FY15 budget and have reached our recommendations.

FY 2015 BUDGET

<u>TriMet is Turning the Corner</u>

We are pleased that the FY15 budget has no fare increase, restores service, continues to make vehicle and infrastructure improvements, accelerates funding of the pension liability, and responds to recommendations made in the Secretary of State's audit. We also want to make mention of our support of TriMet's efforts to increase service reliability and quality, especially in those areas that improve safety. Efforts at the negotiation table along with the ability to restore and improve service says to the BTF that TriMet is on the right path, perhaps has even started to turn the corner.

TriMet has taken numerous steps to improve its financial foundation and to pave the way for increased service in the coming years. Recent actions demonstrate that incremental policy changes and strategic investments have the potential to greatly enhance the long-term financial outlook for the agency. However, there is still much work ahead as TriMet prepares for the opening of the Portland-Milwaukie Light Rail line on September 12, 2015, the introduction of electronic fare, and the development of southwest, southeast, north-central and eastside Service Enhancement Plans.

THE CHARGE

Our charge this year was to answer these four important questions:

1. Should the focus of the FY15 Budget be to strengthen TriMet's long-term fiscal foundation and to restore and grow service?
2. Are the Pension and Other Post Employment Benefits (OPEB) strategies on the right track?
3. Are FY15 revenue assumptions reasonable?
4. What recommendations from the Secretary of State's Audit does the BTF want to reinforce?

TRIMET'S FY15 BUDGET

1. *Should the focus of the FY15 Budget be to strengthen TriMet's long-term fiscal foundation and to restore and grow service?*

Yes, TriMet's FY15 Budget should continue to strengthen TriMet's fiscal foundation in order to restore and grow service. Even when faced with service cuts in the FY13 Budget, the BTF noted that when fiscally able, the agency's first priority should be restoring service levels. We are pleased that this begins in the current fiscal year with the restoration of 15 minute service during the day on ten bus lines.

The greatest benefit of increased financial stability is the ability of TriMet to focus on service improvements, particularly addressing capacity/crowding on buses and needs identified during the regional service enhancement planning process now underway. In this time of improved revenues due to greater growth in the regional economy, TriMet should proceed with restoring frequent bus service levels, addressing reliability/overcrowding, and expanding service to underserved areas by making strategic enhancements and investments in service.

2015 looks to be a good year for TriMet's riders with respect to restoration of 15-minute service on the more popular frequent service bus lines and continued work on Service Enhancement Plans. The BTF still cautions against restoring or expanding service beyond levels that can be reasonably sustained in light of the uncertainty pertaining to current financial and revenue forecast assumptions. Our advice is to proceed with service restoration but in a cautious and fiscally transparent manner.

The BTF also recognizes that restoring service requires containing costs. Thus, we reiterate the importance of controlling health benefit costs and ensuring cost-effective delivery of service. This is best accomplished through a negotiated labor agreement between TriMet and the ATU that has both parties recognizing the need for reform if TriMet is going to be able to deliver the transit service this region needs.

Capital maintenance assumptions which support system growth and service reliability are appropriate. Specifically, the forecast includes replacement of 254 fixed route buses between FY13 and FY16 and MAX system capital asset improvements. The bus replacement program has already increased reliability of bus service and is seen as a key investment for containing maintenance costs, achieving a state of good repair, and increasing service reliability.

After service improvement and key capital investments assumed in the budget, other funding priorities recommended by the BTF are:

(1) Heightened prioritization and commitment to efforts to instill a "safety culture" throughout the agency.

(2) Improved communication with frontline employees and increased involvement by them in decision-making.

Although there is no question the biggest cost issue is health care benefits, the BTF also wants to emphasize that cost-effective service also means finding ways to be more productive and efficient – from ensuring operators have the training they need to streamlining work processes. Focus on productivity and efficiency creates the continuous improvement work environment TriMet should foster.

In the event that revenues exceed budget, priorities for any surplus funds during the budget year should be dictated by the nature of the extra funding: one-time revenues should be dedicated to one-time expenses, and on-going funds can be used for on-going or one-time expenditures. Funding decisions should be consistent with strengthening TriMet's fiscal foundation and growing future service.

PENSION AND OTHER POST EMPLOYMENT BENEFITS (OPEB)

2. Are the Pension and OPEB strategies on the right track?

The BTF finds TriMet's strategies with respect to pension and OPEB as stated in TriMet's response to the Secretary of State's audit report are on the right track. TriMet's approach of treating OPEB as a *benefit* issue and pension liabilities as a *funding* issue is appropriate and consistent with past BTF recommendations given the distinct nature of the two obligations.

OPEB continues to be the single greatest long-term financial challenge facing TriMet. The BTF endorses TriMet's current proposal to the ATU to bring union retiree health benefits in line with those of peer transit agencies and other public sector comparators. TriMet's current proposal would reduce the OPEB liability by an estimated 50 percent over the next 15 years. At that point, TriMet could begin to address the OPEB liability as both a continued benefit and funding issue. The BTF believes cost control for current and retiree health care is an on-going issue to be addressed in each contract negotiation and budget cycle.

With the 2012 arbitration decision, the Defined Benefit pension plan was closed to new union employees. Now, both non-union and union new employees have Defined Contribution pension plans. Therefore, the BTF finds TriMet's proposed Pension Funding policies are the appropriate strategy to address the unfunded pension liabilities. The proposed Pension Funding policies would fully fund the pension over the average working life of the remaining active participants on the plan. This is roughly six years for the Management plan and 11 years for the Union plan. The BTF is pleased that the recently adopted Pension Funding policies include language regarding the downward pressure on the discount rate used in the actuarial calculation of the unfunded liabilities. The BTF finds the pension funding policies responsive to the Secretary of State audit recommendation.

REVENUE ASSUMPTIONS

3. Are revenue assumptions reasonable?

The BTF finds TriMet's FY15 budget revenue assumptions and forecast reasonable. Risks to the revenue forecast include lower than anticipated employment growth in the region, higher inflation and lower federal funding formula levels—risks that have been correctly identified by TriMet.

TriMet's operating revenues are derived from three main sources: a regional payroll tax, passenger fares and Federal government grant funds.

- **Payroll tax revenues** are roughly 50 percent of TriMet's operating revenues. TriMet's FY 15 budget anticipates a 6.2 percent growth in payroll tax revenues. This revenue growth reflects the final total 1 percent increase in the payroll tax rate to fund the construction and operation of new services and a forecasted increase of 5.2 percent in underlying payroll tax revenues. The forecast assumes no further payroll tax rate increases in future years. The 5.2 percent growth in underlying payroll tax revenues is due to an approximate 2 percent wage increase and a projection of 3.2 percent increase in employment. The BTF finds the payroll revenue assumptions reasonable and consistent with national and regional economic forecasts, which are showing acceleration in employment growth in the next two years.

  A key element of TriMet's proposed Strategic Financial Plan is for growth in the payroll tax revenues resulting from employment growth to fund new service. As in past years, the budget outlook for FY15 and future years and the ability to grow service to meet the needs of the region will also depend upon TriMet's ability to contain cost growth and manage expenditures. The BTF finds this approach reasonable.

- **Passenger revenue** constitutes approximately 25 percent of TriMet's operating revenues. The forecast reflects 4.6 percent average growth in passenger revenues, though slightly lower in the near-term reflecting current ridership and service levels. The forecast assumes no fare increase in FY 2015 and inflation adjusted fare increases in years thereafter.

- **Federal funding** typically provides about 15 percent of TriMet's operating revenues. TriMet assumes Federal formula funds are flat through FY16, and then increase with inflation in years thereafter. In addition, the budget assumes State of Good Repair funds for future year rail asset repairs and maintenance. The BTF finds these assumptions reasonable, though not without the noted risk given that the Federal Mass Transit Fund is expected to be depleted in the coming years and congressional action will be required to find replacement revenues.

SECRETARY OF STATE'S AUDIT

4. *What recommendations from the Secretary of State's Audit does the BTF want to reinforce?*
   Below are comments on specific audit topics.

As they relate to the FY15 Budget, we would encourage TriMet to make sure that implementation of the audit's recommendations that require additional resources are reflected in the budget. Special attention should be made to look for technological solutions that can help advance initiatives.

The BTF reiterates and reinforces the importance of the following recommendations from the Secretary of State's audit in the following areas:

Long-term Financial Stability - The Secretary of State's audit said, TriMet's "most serious and looming concerns are the health benefits costs of employees and the $852M unfunded liability to pay these benefits." We agree and continue to support TriMet's efforts to reduce these liabilities by bringing benefits in line with peers.

Safety – TriMet has said it will focus first on recommendations from the audit that have safety implications such as "fitness for duty" tests. The BTF supports this approach and TriMet's continued investment in creating a culture of safety. We would encourage TriMet to use outside consultants and pilot programs to test ideas and allocate resources in the FY15 Budget accordingly. The BTF acknowledges the safety strides TriMet has made in the last few years, but agrees with the audit that more remains to be done to ensure that this ethos permeates the organization in both visible and subtle ways.

Frontline Employee Engagement – The audit made a number of recommendations to improve communication with frontline employees. This issue is one the BTF mentioned in its last report and it is worth repeating. The BTF recognizes the difficulty in communicating with a diffused workforce and views improved two-way communications as necessary to improve morale and also an important element to increase the safety culture at TriMet. The BTF specifically endorses the Secretary of State's audit recommendation of providing one-on-one, in-person performance evaluations to frontline employees.

We would further emphasize the importance of face-to-face communications recognizing that additional resources are needed to do this effectively with so many of frontline employees working in the field. Other ways of doing outreach might be useful to explore, such as using employee opinion leaders as communicators.

OTHER ISSUES

The BTF acknowledged that its primary charge was to make recommendations on the FY15 Budget, but we also wanted to provide some guidance on TriMet issues the BTF has followed over the past few years, but have not studied in-depth. Those items are listed below.

Investment in New Technology Projects

The BTF endorses the need for TriMet to invest in new technology projects but recognizes that investment in these areas is costly and that often a public transit agency delays the implementation of these projects until secure funding and general public approval can be established. But this delay may have implications for transit safety, operations and customer service. So there is a delicate balancing act in providing funds for ongoing operational needs while advancing future technological needs. Both are critical for an agency to provide high quality, daily service, as well as meeting the future new technology needs such as signal control systems for train operations and alternative clean fuel technologies for the bus fleet.

TriMet's experience with its electronic fare (e-fare) system is a good case study of the agency's involvement in new technology funding, development and implementation. For financial reasons, the agency delayed its capital investment in e-fare technology. On the negative side, this delay resulted in additional maintenance costs for fare boxes, outdated ticket vending machines, additional labor costs for maintainers, loss of fare revenue and poor customer service. On the positive side, the delay allowed for TriMet to participate in the next generation of electronic fare technology of open-payment system, while benefitting from the prior and often poor experiences of other public transit agencies. It also permitted TriMet to establish a sound capital funding mechanism in spite of a difficult economic situation within the region.

Based on a recent presentation, the BTF believes TriMet is now on a path to achieve a world class, state-of-the-art, e-fare technology system. With management and Board oversight, capital costs covered, and a project plan outlined, the e-fare project is on the critical path to enhance operations, revenue control and customer service. As with all new technology, the project must be closely monitored in full transparency. Critical to its success will be the development of new fare scenarios and a customer-driven operations plan. The successful implementation of e-fare technology offers the opportunity for TriMet to enhance its reputation within the district and to help restore positive customer attitudes. This is an important, high stakes, new technology project for TriMet with many lessons to be learned for its future technology initiatives. The BTF will watch its progress closely.

Youth Pass Fare Policy and Portland Public Schools

When the issue of a subsidy for the Portland Public Schools Youth Pass was raised in our FY13 budget discussions, the BTF recommended no subsidy. Even though the economic situation has improved since this original recommendation, the BTF continues to believe the fundamental concern is one of equity with other school districts in the region. This program should consider not only public schools, but private and charter schools that also have children from low-income households.

TriMet has developed a concept to reduce the youth fare regionally. Consistent with past BTF recommendations, reducing the youth fare brings TriMet's youth fare closer to youth fares in peer transit agencies. This, combined with TriMet's notion of offering to any school district a fare which also creates a "10 months for the price of 9" at a reduced price seems a good direction. This proposal creates for equitable treatment of youth fares and youth passes for the entire region and phases out TriMet's specific subsidy to the Portland Public School district.

Low-income Fare Mitigation and Honored Citizen Fare

The BTF supports the efforts of the low-income fare mitigation program which was launched in conjunction with the September 2012 fare increase and TriMet's willingness to dedicate dollars to offset fare increases for those who are most in need. Given the dollars allocated to date have been underutilized, we would recommend that the program continue to look for ways to improve its outreach to ensure easier access for people who are eligible. It may be that a small administrative fee for financially stretched non-profits should be considered. We believe that TriMet's interest in raising Honored Citizen fares to be in line with peers and the federal Americans with Disabilities Act (ADA) threshold is reasonable, but must be done in alignment with a robust low-income mitigation program to ensure protection for the most vulnerable Honored Citizen riders. We agree that this shouldn't be done until the mitigation program is in place, presumably over the next year.

Non-union Compensation Program

TriMet is in the process of reviewing its non-union compensation plan. Of concern to the BTF is that TriMet can continue to attract and retain highly skilled staff. Based on turnover data provided to the BTF there is some concern of flight risk especially among new and younger employees who are under a different pension plan than most long-term employees and are not eligible for retiree medical benefits. Given this discrepancy, TriMet is considering a "tiered" system of compensation based on total compensation. TriMet's non-union staff has only had one wage increase in the past five years. Although not at a critical stage yet, continuing on this path can hinder TriMet's ability to stay competitive in the job market. We recommend TriMet develop a compensation plan that considers its role as a responsible public employer and is in line with other regional employers. Any proposed changes to the non-union compensation plan should be reviewed by the Board and incorporated into future budget submittals.

NEXT STEPS

The general manger has asked BTF members who have an interest in digging deeper on these or other financial topics, to continue to provide him advice over the next year. Last year, the BTF shared its support of creating a Strategic Financial Plan (SFP) and remains interested in hearing at the conclusion of the budget process how the proposed SFP Guidelines[1] aligned with the development of the FY15 Budget.

CLOSING

The BTF titled this year's report ***Turning the Corner*** because we believe that the proposed FY15 Budget continues the course for meeting long-term financial stability. The overall economic environment is improving with financial forecasts showing employment growth and TriMet continuing to contain benefit costs. We do not want to underestimate the challenges that lie ahead.

Turning the corner means upholding the 2012 labor arbitration decision and finalizing a new labor contract that provides sustainable health care and wages that align with its peers and is fair to its employees. The BTF hopes the ATU and TriMet can work together to accomplish these very large and important tasks that hold the future for both employees and the transit system.

Turning the corner means having the resources to invest in more service and infrastructure improvements that give riders the reliable transit system they want.

Turning the corner means ensuring delivery of safe, high quality and cost-effective service by engaging employees, leveraging technology and involving community stakeholders.

Turning the corner means building and operating a transit system the region needs. The BTF believes TriMet's FY15 Budget is on the right path.

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1 In December, 2013, the TriMet Board asked staff to develop the FY 2015 Budget based on a set of Strategic Financial Plan Guidelines as a way to test their validity before adopting a formal plan and to offer more time for public input.

Submitted by the General Manager's Budget Task Force Members
March 11, 2014

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