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December 8, 1997

President M. K. Pryor & Members
Board of Directors
Bay Area Rapid Transit
800 Madison Street
Oakland, CA 94608

Dear President Pryor & Members of the Board:

Thank you for your letter of November 21, 1997 about financing issues relating to the proposed extension from Colma to Millbrae. However, some of the information in your letter may be either dated or erroneous, and, because so much money—and the agency—is at risk, we wish to bring them to your attention.

For ease of reading, we present excerpts of your letter below on the left and our comments on the right.

Both the Federal Transit Administration (FTA) and the General Accounting Office (GAO) thoroughly reviewed the Project Finance Plan and concluded that BART has sufficient financial capacity to undertake the extension without threat to the existing services or programs.

The reviews cited are over one year old. Since they were completed, the financing for the proposed project has changed radically. BART went on record (Capital and Operating Finance Plan) last April as seeking to issue commercial paper to meet the project's cash flow needs.

The April financing plan shows total commercial paper financing costs of $24 million. But this is dependent upon the federal government awarding BART unlikely amounts of funds each year through fiscal year 2003. According to BART's predictions in Table 5 in the April plan, the federal government will pay an average of $111 million to BART each year, beginning with the current year and running through 2003. Other recipients of federal new starts funds have not received anything like $111 million per year.

Less money awarded each year by the federal government means that BART will have to borrow more each year to meet cash flow requirements. The more BART borrows, the greater will be the financing costs.

Given the extra financing costs associated with the commercial paper program and the low levels of federal funding being awarded to BART, would the FTA and GAO conclude today that BART still has "sufficient financial capacity" to build and operate the project?

FTA has never defaulted on any of the financial commitments made in these agreements. In California, FFGAs were awarded for…Metro Rail in Los Angeles.

The word "default" is inappropriate here, because neither the FTA nor the federal government has a legal obligation to pay BART any money. As we noted in our October letter to you, the issue is one of timing—will BART receive enough money from the federal government each year to be able to build the extension, or will debt service costs exceed BART's ability to pay them?

RAFT encourages BART to contact MTA to determine if the FFGA in southern California is actually being funded at expected levels. Our understanding is that MTA over the past three years has received less than half of what it expected from its FFGA.

Since execution of the FFGA, Congress has appropriated another $29.9 million for the BART-SFO project. This funding is included in the FY98 Appropriations Bill signed into law by President Clinton on October 27, 1997.

BART's April financing plan predicted BART would receive $54.7 million from the federal government for fiscal year 1998, not $29.9 million. Will BART have to borrow $25 million to cover the short fall? If the appropriation for the next fiscal year is another $29.9 million, BART will be behind an *additional* $44.1 million, for a total of $69 million.

If future appropriations amount to the same $29.9 million per year, then by 2003 BART will have borrowed about $486 million. At the 5.5% borrowing rate given in the April financing plan, the *annual* interest payment will be $26.7 million.

The April financing plan says, "If…the revenue and expenditure assumptions hold true, then the *total* financing costs associated with the SFO extension would equal $24 million."

This is the tremendous problem facing BART—the revenue assumptions have *not* held true, so the financing costs *will be* greater than anticipated.

Until all of the construction contracts are awarded, the exact amount of debt (principal and interest) incurred by the project in any one year cannot be finally determined.

Not only is the $24 million budgeted for financing costs unreasonable because of less than expected federal revenues, now it also appears the other key assumption of Table 5 is no longer valid. According to the December 3rd *San Francisco Independent*, the bids for the "line section" project did not come in at the expected $410-$460 million. The low bid is apparently $522 million, which means BART must take on at least *another* $62 million in debt.

The project already is seriously over budget.

In our question about the amount of indebtedness that may be taken on by BART, we were not seeking an exact number. Instead, we were hoping that BART itself would want to grapple with the issue of how much debt it is able to take on without impairing service. Given the cost overrun on the line section, the extra debt would appear to be at least $62 million more than budgeted. Added to this figure should be $25 million more, due to the current shortfall in federal funding for this fiscal year. Project debt is thus already $87 million over budget.

The use of short-term, tax-exempt financing instruments to address shortfalls in appropriations reflects prudent planning and is standard practice for governmental agencies that are relying on multi-year federal funding for large capital projects.

Here we differ. There is nothing prudent, at all, about borrowing short term to make payments over a long term. If interest rates rise significantly after beginning to borrow short-term, the interest costs can be ruinous.

FTA has determined that interest and other financing costs associated with BART borrowing for the project are eligible for federal reimbursement.

Left out of your statement is the simple fact that the federal contribution to the proposed project is capped at $750 million. The federal government will not pay for any additional charges. The unbudgeted $87 million noted above will not be covered by additional federal funds.

Financing caps are also in place with both the State of California and the County of San Mateo. It appears that the overruns will be borne by the so-called BART counties, *viz*, Alameda, Contra Costa and San Francisco. Have they been notified that they will be responsible for cost overruns?

BART has included $24 million within the project budget to cover the projected finance costs. Should this amount be insufficient, however, BART has several additional funding sources in excess of the project's FFGA budget which will be set aside in a Capital Reserve Account (CAPRA). The CAPRA will consist of surcharge revenues at the Daly City Station and a Premium Fare at the SFIA Station.

What level of surcharge is envisioned? Given the debt service BART may have to pay to cover cost overruns, is any reasonable surcharge at two stations going to help at all?

We asked in our October letter if management had any plans for paying off the debt that will be incurred to cover cost overruns. The absence of an answer in your letter indicates there is no plan. This means interest charges will be a burden for decades.

RAFT's concern remains unchanged from our first letter—is the extension to Millbrae worth the cost, and just as importantly, the risk to the solvency of the district?

For RAFT,

M. Kiesling