From: Ben Porter [bporter@porter-inc.com]
Sent: Friday, September 04, 2009 1:15 PM
To: Ryan, James (FTA)
Cc: Jackson, Brian (FTA); Holland, Tonya (FTA); Donna McCoy, CPA
Subject: potential financial issues for Honolulu FD
Jim:

You asked that I summarize the financial issues that Honolulu may face in entering Final Design, based on what I learned from preparing the recent financial assessment.

Generally, I observe the current plan to make a number of favorable assumptions that act in concert to minimize the City's potential financial obligations for construction of the Project, and for on-going costs to operate the transit system and to maintain a state of good repair.

If I were tasked to perform a financial capacity assessment in support of a Final Design decision, here are the issues I would focus on, listed in priority order:

1) Additional financial support for the Project: The cash flow projection for the Project is too weak to withstand stress tests on GET surcharge revenues or increases in Project cost, and would very likely be unable to withstand a stress test on a less-favorable New Starts funding schedule. In the financial plan, the City identified several sources that could provide additional funds; these are mentioned in the financial assessment. The City needs to further define these funding alternatives and develop realistic implementation plans.

2) GET surcharge revenue forecast: I have recommended before that the City obtain an independent revenue forecast. By independent, I mean someone or a firm that is knowledgeable about the Hawaii economy that is also not a beneficiary in any way of the Project (or a critic, for that matter). This time around, the City included in its financial plan a forecast by PB, a firm that also serves as the planning and design contractor and stands to profit from the Project moving forward. The forecast differed materially from a state-level forecast prepared by the Council on Revenues (which reports to the governor), and was, in my opinion, optimistic. We can save a lot of energy in debates over the forecast if it is prepared by an independent and credible firm.

3) Debt structure: The City has indicated that the Project debt can be accommodated within its policy-based debt ceiling (which is not a "soft" threshold but rather is a consideration in the rating of City general obligation debt), and has also indicated the debt can be issued as general obligation debt. These assumptions should be confirmed with the City's CFO, along with the assumptions that led to this conclusion (e.g., forecast of City operating budget, forecast of debt service on non-Project G.O. bonds).

4) Reality of additional O&M funding: The financial plan indicates that the 33% or so increase in operating subsidies associated with Project implementation can be accommodated from existing sources of general fund and highway fund revenue. In today's dollars, this translates to about $44 million. Effectively, this assumption means that the funds would very likely need to be re-programmed from existing uses. I have not seen enough information, nor had the time to devote to this question in the scope of a financial assessment, to determine if this is a reasonable assumption. This question needs to be fully explored.

5) O&M cost forecast for the Project: Based on a review of Brian's memo (I have not talked with him), I don't believe the City has a credible basis at this point for projecting O&M cost for the rail project with any degree of certainty. Using WMATA Metrorail as a point of departure just doesn't make sense to me. The review I did of cost per vehicle mile for several heavy rail systems mentioned in the memo, as well as a couple of light rail systems that have relatively high-speed operations, suggests the O&M cost estimate is low. Maybe they are right, but the material I've seen is unconvincing and the results risky, given that additional O&M funding rests on a pretty breezy assurance that the City could just allocate more money to transit.

6) Funding of on-going bus capital: The City is facing significant bus fleet replacement needs, as indicated by its relatively old fleet age (9.2 years average age at June 2008). The financial plan assumes a doubling of historical Section 5309 bus funds to support fleet replacement. That does not seem reasonable to me, especially given the unusually high New Starts funding for the Project, coupled with the use of Section 5307 funds to make the Project financial plan appear workable. The City needs to show that the fleet can be replaced using historical (or lower) rates of discretionary bus funding.

7) O&M cost forecast for bus and Handi-Van services: The rates of growth in unit cost for these services are lower than actual experience, by about 1.3% for bus and over 8% for Handi-Van. The financial plan needs to be more realistic about unit cost growth or, alternatively, substantiate why lower rates of growth may be reasonably expected.

8) Rail O&M unit cost growth: After the Project is fully implemented in 2019, the rail unit operating cost is escalated at only 1.5% annually. It is not unusual for rail unit costs to grow more slowly than for bus, but this seems unrealistically low to me, based on experience with other rail systems.

I'd be pleased to answer any questions you may have on the above.

best regards,
Ben Porter

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