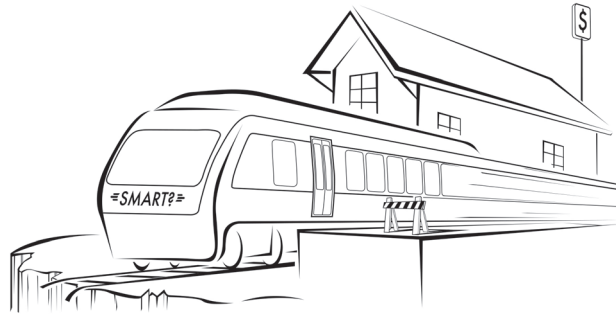


# “The Train Has Left the Station”

## Five Years Later – The Outlook for SMART



### Introduction

**The creation of a passenger rail service spanning Sonoma and Marin Counties is the largest infrastructure commitment ever undertaken in the region. With construction progressing toward a start of service in 2016, a heightened level of oversight is required to ensure that funding and operating requirements are met.**

### Summary

The California State Legislature created the Sonoma-Marina Area Rail Transit District (SMART) in 2003. It gave SMART the authority to plan, build, and operate a passenger railway from Sonoma County to a ferry terminal in Marin County with connection to San Francisco. In 2008, voters passed Measure Q, authorizing a 1/4-cent sales tax over 20 years to fund the development and operation of a passenger rail service and bicycle/pedestrian pathway. Initial plans called for SMART to use the existing Northwestern Pacific Railroad corridor. The proposal envisioned 14 stations along a 73-mile corridor between Cloverdale and Larkspur, weekday commuter service at 30-minute intervals, and shuttles linking to other public transportation systems.

The Measure Q Funding Plan also included obtaining regional, state and federal transportation grants (Grants), as well as a bond issue backed by future sales tax revenue. Operation was scheduled to begin in 2014. Financial models indicated that the proposed tax would generate over 60 percent of SMART's 20-year funding requirements. If the economy did well and consumers spent money, SMART would be on sound financial ground. But if these assumptions did not hold, SMART and the public would face delays, reduced services, or higher taxes.

The Sonoma County Civil Grand Jury (Grand Jury) investigated SMART's development, financial projections and funding outlook. It found significant financial gaps between the projections provided to voters at the time Measure Q was approved in 2008 and the current reality. SMART attributes this difference to the 2007-2009 economic downturn. To address funding shortfalls and cost increases, SMART extensively revised its plans, delaying the start of service to 2016. It limited the initial route from downtown San Rafael to the Sonoma County Airport and decided to build in stages and as funds became available.

The Grand Jury also investigated SMART's governance and management. It found that SMART has sound executive leadership. However, within public agencies such as SMART, the boards of directors are accountable to the public for oversight and information. When boards limit their involvement and rely extensively on management to set and enact policy, the public can be shortchanged. A more active role with stronger oversight by SMART's Board of Directors (Board) could create a more proactive culture, reducing the risks from unpredictable future events.

At the core of the Grand Jury's recommendations is the regular use of the Board's standing committees, especially the Executive Committee. These committees can bring a higher level of attention to the important issues affecting policy.

SMART is overseen by a 12-member Board. A General Manager directs day-to-day operations, staff, and contractors. A Citizen's Oversight Committee (COC), mandated by Measure Q and appointed by the Board, only provides input and direction to SMART's Strategic Plan and its updates.

Attracting sufficient funding to honor its obligations to voters remains the prime challenge. To date, SMART has raised \$123 million of the estimated \$353 million required to complete the project. Greater public input and transparency can benefit the cause. SMART has begun to show initiative in this area with more comprehensive reporting and plans for public advisory groups.

## Background

The 2009-2010 Marin County grand jury issued a report on SMART. Records indicate that no investigative report has been issued on SMART by the Sonoma County Grand Jury. With more than four years of development on the passenger rail line completed and the start of service in sight, the Grand Jury initiated an investigation into the current status of SMART's development, focusing on its future operation and viability.

## Approach

The Sonoma and Marin County grand juries have undertaken independent investigations into SMART's current infrastructure development and the outlook for future operations. Although the two grand juries combined their resources for interviewing, the interpretation, analysis, and reporting have been handled independently by each jury in accordance with civil grand jury law and protocol, as defined in the California Penal Code.

The Grand Jury interviewed SMART management, Board members, members of the COC, Metropolitan Transportation Commission management, and community adversaries opposing the project. It reviewed and analyzed various governing documents, project data records, and reports provided by SMART. The Grand Jury also attended SMART Board meetings. A detailed summary of reference materials is included in the bibliography.

## Discussion

In November 2006, voters of Sonoma and Marin Counties narrowly defeated a measure to create a passenger rail system. In November 2008, the following ordinance and its accompanying Expenditure Plan were approved with the required two-thirds majority:

***Measure Q – To relieve traffic, fight global warming and increase transportation options, shall Sonoma-Marin Area Rail Transit District be authorized to provide two-way passenger train service every 30 minutes during weekday rush hours, weekend service, a bicycle/pedestrian pathway linking the stations, and connections to ferry/bus service, by levying a 1/4-cent sales tax for 20 years, with an annual spending cap, independent audits/oversight, and all funds supporting these environmentally responsible transportation alternatives in Marin and Sonoma Counties?***

At the time of its acceptance, the cost of constructing the rail and pedestrian/bicycle system between Cloverdale in the north and Larkspur in the south was estimated to be \$541 million. Eight months later, the 2007-2009 economic downturn was taken into account, and the estimate increased to \$664 million. Today, construction plans have been scaled back and are being managed in segments. The first phase, between Sonoma County Airport and San Rafael, represents approximately 60 percent of the system's intended distance at a projected cost of \$428 million. SMART estimates another \$230 million will be required to complete the entire 73-mile project.

SMART's inability to generate accurate cost and revenue projections puts into question the reliability of its forecasting methodology.

## Funding

When Measure Q was passed, the 20-year revenue stream generated by sales tax was forecasted to total \$890 million. Eight months later, that projection was reduced to \$845 million. Based on a combination of SMART's actual income to date plus forecasts, it now appears that amount will be \$769 million.

Faced with the fallout from the 2007-2009 economic downturn, SMART took steps in 2011 to deal with declining revenue projections and growing costs by scaling back the project and only building what was currently affordable. The first 43-mile segment with 10 stations servicing downtown San Rafael to the Sonoma County Airport is expected to be operational sometime in 2016—two years later than specified in Measure Q.

### SMART Funding Projections (Sonoma County Grand Jury Analysis)

	Measure Q	2009 Strategic Plan	Current
<b>Sales Tax</b>	\$890 million	\$845 million	\$769 million
<b>Bond Issue</b> , (Issued Dec. 2011)	TBD (20 year term)	\$215 million	\$180 million
<b>Grants</b> , (regional, state & federal)	\$210 million (est.)	\$327 million	\$353 million **
<b>Other</b> , (fares, fees, advertising, SCTA)	\$300 million (est.)	\$230 million	\$118 million ***
<b>TOTAL*</b>	<b>\$1.4 billion</b>	<b>\$1.402 billion</b>	<b>\$1.240 billion</b>

\*Excludes bond proceeds to be repaid from sales tax.

\*\*As of 5/1/2014 - \$123 million of required \$353 million secured.

\*\*\*Grand Jury estimate.

The most significant component of SMART's funding plans has always been the revenue generated from sales tax, which is dependent on local economic trends. If the economy is healthy, and taxable retail sales in Sonoma and Marin Counties grow, SMART revenues will grow. Economic trends such as those experienced in 2007-2009 can result in declining revenue. SMART's financial forecasts are highly sensitive to fluctuations in the economy.

Bonds backed by Measure Q sales tax revenue were issued to finance the project and accelerate the construction phase. They must be repaid within the 20-year term specified by Measure Q.

At the time of this report, SMART forecasts a 3-percent annual growth in sales tax revenue each year after 2014. This may seem reasonable under current conditions where the recovering economy contributed a 7-percent increase in tax revenue during 2013. However, SMART's forecasts should also account for potential economic fluctuation over the next 15 years, including possible economic downturns. A shortfall in projected revenue means Sonoma and Marin residents may be subject to more compromises, reduced service, or new taxes. The local economy went through several periods of expansion and contraction from 1990-2010, resulting in an average annual growth rate of 2.5 percent. Over the next 15 years, a 1/2-percent change in the annual growth rate will result in an equivalent +/- \$16 million fluctuation in sales tax revenues.

In 2009-2010, SMART had not adequately foreseen and was forced to react to funding shortfalls, cost increases and changes in the bond market. SMART should keep this in mind and be especially vigilant as it develops new forecasts for the 2014 Strategic Plan Update. Although the current strategy of 'only build what we can afford' has provided a tighter control on budgets, SMART has yet to quantify future train operating costs.

## Development and Construction

To complete the 73-mile Cloverdale to Larkspur system promised voters, SMART will need to attract additional Grants. To date, approximately \$123 million in commitments have been secured for the Phase 1 construction. SMART estimates an additional \$230 million will be required to complete the remaining 30 miles of the project and portions of the bicycle/pedestrian pathway. Sales tax revenues, fares and local revenues have been leveraged as far as possible at this stage. The remaining funds required to complete the project will need to come from higher levels of government. SMART contends that attracting such funds can be more successful once train service is operational. However, SMART’s ability to compete for available funds may be compromised by the low population density of the unfunded northern segment.

The anticipated connection with San Francisco via the Larkspur ferry still needs to be funded. SMART is optimistic that federal grants and matching regional funds will be committed later in 2014. However, even with sufficient funds in place, SMART and the public face serious logistic challenges, including an extremely awkward diagonal crossing at Andersen Drive and a foot path of up to a half mile between the Larkspur train station and the ferry dock.

Beyond funding the Larkspur extension, SMART has not assigned priority or timing to the other uncommitted segments. Funding for these is dependent on the availability of Grants.

SMART’s plans do not include the construction of new commuter parking, limiting riders to existing services and facilities.

### **SMART Development Cost Projections**

(SMART February 19, 2014– Project & Status Update Report)

<b>Project Segments</b>	<b>Phase 1</b>	<b>Unfunded</b>
Downtown San Rafael-Sonoma County Airport	\$428 million	
Bicycle/Pedestrian Pathway		\$40 million
Cloverdale Extension		\$61 million
Healdsburg Extension		\$46 million
Larkspur Extension		\$45 million
Petaluma Additional Station		\$11 million
Windsor Extension		\$27 million
<b>Total</b>	<b>\$428 million</b>	<b>\$230 million</b>

Experience from Phase 1 development has revealed that the environmental and permitting process has been the most significant variable impacting construction, time, and cost. Although the true impact of this has been unclear, it has most certainly contributed to the two-year delay in operations. For each segment of construction between two stations, up to 15 approvals can be required from federal, state and regional authorities. SMART was not prepared for the delays and resulting cost increases brought about by environmental permitting.

## Operations

Once service begins, revenue generated by sales tax will be required to offset operating and maintenance costs. Fares and other subsidies (leases, advertising, parking, etc.) are only expected to cover 20 to 30 percent of ongoing expenses. To date, SMART has only identified operating and maintenance reserves in its long-term forecasts. Actual costs will not be understood until labor contracts and operating logistics are better known—probably in 2015. The unpredictability of operations and maintenance costs represents an enormous economic risk. SMART has limited options for dealing with unexpected costs.

Although the Grand Jury's investigation focused primarily on financial matters, the train system faces significant safety challenges. Among other issues, the San Rafael to Santa Rosa line, a distance of 45 miles, includes approximately 70 grade-level street crossings, a concentration much higher than faced by similar systems serving densely populated areas.

### **Ridership**

SMART has not conducted ridership studies since early 2011. These surveys indicated that weekday use between San Rafael and Santa Rosa will rise progressively over 20 years, from 2800 to 4800 riders per day. Growing tourism may augment these forecasts. Obtaining more recent projections should be an important component of SMART's 2014 Strategic Plan Update. The project has been justified to voters and funding sources on its ability to remove traffic from Highway 101. A better understanding of ridership is therefore important to attracting new funding.

### **Management**

SMART has faced several significant management changes since Measure Q was approved in 2008. Such transitions can often be disruptive and even catastrophic for a public works project. In this case, these adjustments appear to have generated positive change. For example, greater transparency is evident in financial reports and project reviews. The Board is to be commended for successfully handling the management changes.

### **Direction and Governance**

As specified by the SMART Administrative Code, the Board is comprised of elected officials in Sonoma and Marin Counties and two representatives from the Golden Gate Bridge Highway and Transportation District. The 12-member Board is responsible for the creation of policy, direction and oversight of all financial matters and the administration of all staffing and contractual relations.

Like most boards, the SMART Board concerns itself with the important role of directing policy and providing oversight. To be effective, however, Board members, individually and collectively, must be willing to involve themselves and provide direction to the important strategic considerations facing SMART, especially financial planning. Standing committees of the Board can provide concentrated effort in the critical areas affecting policy. The SMART Administrative Code provides for three standing committees: Executive Committee, Real Estate Committee, and Operations Committee. Standing committees report to the Board and provide a closer level of oversight not afforded by the full Board. Currently no standing committees are in use.

To date, the two most significant challenges faced by the Board have been the impact from the economic downturn that began in 2007 and the construction delays caused by the complicated bureaucratic challenge of securing environmental permits. The Board seems to have been blindsided by these factors, which might not have occurred had the Board been attending more carefully to its governance responsibilities.

SMART and its Board cannot ignore the public's demand for a higher level of accountability from public and private boards. Lack of attention resulting from time constraints and other commitments renders a board passive and reactive. In the case of the SMART Board, this can shortchange the expectations of Sonoma and Marin residents.

Subsidized public transit systems appear to benefit from a broad cross-section of public input on a multitude of issues. The COC has the mandated role of providing input and direction to the Strategic Plan and its updates. This role could be expanded to provide opportunities for greater public oversight. So far, however, the Board has not welcomed such an expansion. The 2014 Strategic Plan Update will test the value of the COC while offering the Board an opportunity to demonstrate its commitment to public input.

The SMART train has left the station. Residents of the County are committed. Shelving this billion-dollar project is not an option. Only the persistent application of proactive oversight by the Board can mitigate future risks and render a valuable service to Sonoma and Marin Counties.

## Findings

- F1. The completion of Phase 1 in late 2016 will not satisfy what was promised to voters in 2008.
- F2. The current two-year delay in service caused by construction shortfalls represents a 10-percent loss in value generated by 20 years of sales tax revenue.
- F3. The Sonoma County Civil Grand Jury's financial analysis indicates that SMART faces potential funding challenges to complete the 73-mile project.
- F4. The Sonoma County Civil Grand Jury's financial analysis raises concerns with the forecasting assumptions and contingencies used to project future revenues generated by the 1/4-cent sales tax.
- F5. Operating plans and finances are dependent on sales tax revenues, and any shortfall could have serious consequences.
- F6. While its name suggests that it performs a public oversight function, the Citizen's Oversight Committee has not provided broad oversight; its actual contributions to the SMART project have been confined to the mandated role of overseeing the Strategic Plan.
- F7. SMART management has demonstrated resourcefulness throughout the construction phase and a prudent control of finances, but competent management is no substitute for effective Board governance.
- F8. The members of the Board of Directors have heavy time commitments, resulting in a lack of sufficient attention for SMART and an absence of the effective oversight voters expected when Measure Q was adopted.
- F9. Although an economic crisis began in 2007, SMART failed to inform voters in the November 2008 election of the resulting risks to the revenue projections contained in the Measure Q Expenditure Plan.
- F10. The Board of Directors failed to mitigate the serious impact of the economic downturn and of the land-use environmental approvals process.
- F11. The Board of Directors would operate more efficiently and effectively if it were using the standing committees defined in the SMART Administrative Code.
- F12. The lack of station parking, road-crossing disruptions, and failure to connect directly with the Larkspur ferry terminal will create serious logistical difficulties.
- F13. Once construction has been completed, public safety needs to become the highest priority.

## Recommendations

The Grand Jury recommends that:

- R1. The 2014 Strategic Plan Update include a comparison between the original financial plans in the Measure Q Expenditure Plan and the current outlook in the Updated Strategic Plan.
- R2. SMART engage the services of an independent economist to provide a forecast of the revenue to be generated by the 1/4-cent sales tax.

- R3. The 2014 Strategic Plan Update provide a forecast of operating and maintenance costs associated with the future operation of the system.
- R4. SMART provide an annual update to long-term financial forecasts which includes notification to the public of any risks associated with uncontrollable factors such as economic fluctuations and the potential consequences of such risks in its “Comprehensive Annual Report.”
- R5. SMART appoint a Citizen’s Advisory Committee to investigate and report on concerns regarding scheduling, fares, pedestrian/bicycle pathways, connecting services and safety.
- R6. The Board of Directors utilize standing and advisory committees to more effectively fulfill its obligation to provide comprehensive oversight on major policy issues.
- R7. Management issue a quarterly status report addressing the development, operations, and financial matters currently facing SMART, which could be provided in conjunction with the regular General Manager’s reports to the Board of Directors.
- R8. The Board of Directors create an ad hoc Safety Committee to provide conscientious oversight of the system’s safety policies and elevate the overall importance of safety.

## Required Responses

Pursuant to Penal Code Section 933.05, the Grand Jury requires responses as follows:

- R1, R2, R3, R4, R5, R7 – SMART General Manager
- R2, R4, R5, R6, R8 – SMART Board of Directors

The governing body indicated above should be aware that the comment or response of the governing body must be conducted subject to the notice, agenda, and open meeting requirements of the Brown Act.

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*Reports issued by the Grand Jury do not identify individuals interviewed. Penal Code Section 929 requires that reports of the Grand Jury not contain the names of any person or facts leading to the identity of any person who provides information to the Grand Jury.*