



July 25, 2007

Ms. Karen Miller, Chair  
Citizen Oversight Panel  
22208 53<sup>rd</sup> Avenue West  
Mountlake Terrace, WA 98043

Dear Ms. Miller:

Thank you for your Sound Transit 2 Report and for recognizing the lessons learned approach to the Sound Transit 2 (ST2) Plan. The Board appreciates the careful review and objective analysis undertaken by the COP of the Plan that will go to the voters this fall on the joint Roads & Transit package. This Plan will tackle the region's most pressing road and transit needs for the next 20 years. However, a 20 year plan is not without risks. The following is my response to the concerns pointed out in your report:

### **Ample Financial Cushion to Cover Likely Economic Shocks**

The ST2 financial plan contains ample contingency to deal with likely economic or financial shocks and provides the Board with a number of policy options to deal with changes to subarea financial programs. The ST2 financial assumptions are based on long-term historic performance for costs and revenues. Over a twenty year period, these economic variables will undoubtedly differ from the forecasts – higher in some years and lower in others. However, overall the long-term growth rates for inflation and revenue growth are reasonable and are consistent with experience in the region over the last twenty years.

In the event that costs or revenue trends turn out to be worse than anticipated under the Plan, the agency will still have financial contingency to draw upon. "Stress tests" on the ST2 Plan indicate that the agency could withstand a 10% increase in costs, a 0.5% (percentage point) increase in annual rate of cost inflation, or a 0.4% (percentage point) decrease in annual sales tax growth before the Board would need to utilize the tools available in the financial policies. These tools include utilizing remaining contingencies, re-evaluating program costs and scope, re-evaluating program schedules and reviewing agency financial policies. These tools, combined with the underlying contingencies in the financial plan provide a solid foundation to deliver the ST2 Plan.

### **Concerns and Challenges in ST2**

We appreciate the COP's concern that a program the size and length of ST2 carries risks in the areas of project costs, debt servicing and revenue generation. We believe the best way to guard against these risks are:

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**Joni Earl**

1. Prudent assumptions used in developing conceptual project costs and financial forecasts for the Plan;
2. Real-world experience with project cost estimation and actual delivery; and
3. Continuous oversight of agency fiscal health and project delivery.

All three of the above elements have been and will be utilized in preparing for and implementing ST2. We have previously described how agency experience along with national experience has been utilized to develop and review ST2 cost estimates, scope risk and inflation factors. The financial assumptions used are reasonable compared to recent and historical trends, and sensitivity tests have demonstrated that these assumptions are sufficiently robust to substantiate the feasibility of the Plan as proposed. A "financial cushion" is present in the financial plan as demonstrated by forecasts of the agency's minimum debt service coverage ratio not going below 1.5 during the program, even though a relatively high bond interest rate of 6% was assumed. Maintaining the agency's excellent bond rating will control the overall costs of debt, whether it be long-term debt (which will be the majority of issuances) or short-term (which can be used strategically to "bridge" any funding gaps that might occur during unfavorable economic conditions.)

### **Caution Against Over-Promising**

As noted in your cover letter, Sound Transit has experience and success with project cost estimation and delivery and we continue to refine and apply our "lessons learned" through all stages of project development. The methods utilized by the agency assure that the projects placed out for bid are scoped to allow ample opportunity for multiple competitive bids. As you are aware, there also exist project management, monitoring and reporting practices within the agency. Additionally, for any "New Start" projects receiving FTA funds, there will be independent federal project management oversight and financial management oversight groups coordinating with Sound Transit. Supplemented by the COP itself, these oversight groups will continue to provide additional layers of risk management through required development of extensive project management plans and close monitoring of all project aspects including design, schedule, procurement, right-of-way acquisition, bid invitations, and contractor selection.

### **Financial Plan Assumptions**

We acknowledge that it is certainly possible for detrimental financial events to occur simultaneously over a 20-year period. The contingencies that are included in the ST2 project cost estimates, coupled with the prudent financial assumptions and the agency's ability to phase large projects and break them into smaller projects and sub-phases, will likely enable the agency to "weather the storm" during such a period. And economic principles would prevail during any longer-term event, i.e., dramatic inflation would likely mean growth in agency revenue, while a recession usually has the effect of contractors and material providers becoming more competitive when setting their prices.

### **Operation and Maintenance Costs**

The ST2 financial plan assumes a 5% per year inflation rate on bus operation and maintenance (O&M) costs plus 1% per year for the Service Enhancement Fund (SEF) (0.5% per year after 2021). The SEF is intended to expand future ST Express service levels modestly above today's. While it is true that total ST Express O&M costs have grown faster than 5% per year, those costs include substantial non-inflation components, such as higher service levels and increases in the number of facilities that Sound Transit maintains. The major O&M component affected by inflation, the cost Sound Transit pays our partner agencies for each hour of service operated, has grown less than 5% per year from 1999 to 2007. During that period, the average annual increase in cost per platform hour was 3.95%, 4.38% and 4.33% for Community Transit, King County Metro and Pierce Transit, respectively. For this reason, we believe that the ST2 assumption of 5% per year for inflation over the twenty-year program is reasonable and appropriate.

The ST2 Plan assumes that, as Sound Transit implements the 50-mile Link light rail system expansion, ST Express bus routes in the north, east and south corridors will change substantially. Certainly, as Link begins operating in the ST2 corridors, some ST Express routes will be modified to serve evolving transit system needs. However, it is logical for the ST2 Plan to assume that as Link light rail extensions enter operation, Sound Transit will reduce its investment in long-distance express bus service in the same corridors.

### **Construction Market**

The ST2 Plan does not include a detailed contract packaging strategy that would predetermine the size of the contracts. Once the ST2 Plan is approved by the voters each project will undergo preliminary engineering for preparation of an EIS and a detailed project implementation plan. As a part of this process we will perform constructability reviews, value engineering studies and prepare the proposed contract packaging strategy for each project. This proposed contract packaging strategy will consider schedule, insurance and bonding requirements, market conditions, commodity prices, contractors' capabilities and availability, as well as other factors including lessons learned that, when complete, will reduce the risk of limiting competition.


### **Project Coordination and Sequencing with WSDOT & RTID**

We will be working with the Regional Transportation Investment District (RTID) to identify, to the extent practicable, opportunities for sequencing both the roads and high capacity transit programs. Considerations during sequencing will include project readiness, ridership, borrowing, agency cash flow and financial reserves. As previously stated, large projects can be separated into distinct phases, and within a phase the project can be staged and separated into individual contracts to increase competition and balance expenditures with revenue flow.

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In summary, thank you for your hard work and valuable perspective, ensuring Sound Transit succeeds in meeting its commitments to the public.

Sincerely,

A handwritten signature in black ink, appearing to read "John W. Ladenburg". The signature is written in a cursive, flowing style with a prominent initial "J".

John W. Ladenburg  
Board Chair

cc: Citizen Oversight Panel Members  
Sound Transit Board members  
Joni Earl, Chief Executive Officer  
Marcia Walker, Board Administrator