

NORTHERN VIRGINIA TRANSPORTATION AUTHORITY

MEMORANDUM

FOR: Chairman Martin E. Nohe and Members
Northern Virginia Transportation Authority

FROM: Mayor Parrish, Chairman, Finance Committee

DATE: October 5, 2016

SUBJECT: Recommendation to Eliminate Contingency Reserve

- 1. Purpose:** Present Advisory Panel Contingency Reserve Recommendations.
- 2. Suggested Motion:** *I move the Authority approval of the elimination of the Contingency Reserve in the Regional Revenue Fund as recommended by the NVTA Advisory Panel and reviewed by the NVTA Finance Committee.*
- 3. Background:** The Finance Committee requested staff research and report on the establishment of two reserve funds. One reserve for project contingency (Contingency Reserve) and the other to set aside funds for future large scale projects (Transportation Project Reserve). The Executive Director established an Advisory Panel to examine and make recommendations on both reserves. Participation on the Advisory Panel was open to representatives of all member jurisdictions. Participation of jurisdiction transportation and finance representatives was especially welcomed.

After several meetings the Advisory Panel prepared this recommendation for the Contingency Reserve. The Advisory Panel also formulated a recommendation on the Transportation Project Reserve which is presented in a separate report.

- 4. Comments:** The Finance Committee expressed an interest in establishing a Contingency Reserve within the Regional Revenue Fund to provide funding to achieve completion of approved Authority projects encountering cost overruns.

Initial funding of the reserve occurred with the FY2016 budget adoption with the provision that the reserve could not be utilized until a policy covering its use was adopted by the Authority. In FY2017, the reserve level was funded at \$8,573,894 in keeping with an objective of maintaining the reserve at 3.8% of Regional Revenue Fund annual revenues. The Advisory Panel, through policy development meetings made the following observations related to the reserve:

- a.** A contingency reserve has the potential to shift project risk in some measure from the project sponsor to the NVTA. The Advisory Panel believes the NVTA should not absorb this risk.

- b.** Past project performance would need to be made a formal part of the contingency request and possibly future project evaluation processes.
- c.** The Contingency Reserve had been referred to as a 'last resort' option. The Advisory Panel questioned how the NVTA, at current staffing levels would be able to ensure other options are exhausted.
- d.** If a Contingency Reserve were to be offered, the Advisory Panel recommended localities be required to commit their 30% funds as part of the 'other options' noted above prior to making a contingency request. However this raised additional questions:
 - 1. What if the locality 30% funds are already committed by contract or other governing body action?
 - 2. Are there equity issues with Agencies since they do not receive 30% funds?
 - 3. Should and how will project sponsors be required to affirm they have no other financial options other than to request contingency use? (Given the complexity and scope of the various fund structures and budgeting as well as accounting methods, this could be extraordinarily complex, intrusive and staff time consuming.)
- e.** Having a contingency reserve and thus a portion of project risk being transferred to the NVTA would necessitate the requirement for project contingency assumptions to be disclosed as part of the project descriptions. This disclosure would then become part of the project assessment process.
- f.** The Advisory Panel questioned if contingency costs could be meaningfully disclosed without the additional disclosure of all cost components. Such disclosure would be expensive, time consuming, while potentially adding little value to the actual project.
- g.** The Advisory Panel cautioned that in an environment of broad economic changes such as inflationary labor, raw and finished material cost increases, a significant number of projects could face escalating costs at the same time for the same reasons. This potential raised questions as to:
 - 1. The sufficiency of the funding level of the Contingency Reserve.
 - 2. How will NVTA staff recommendations be formulated?
 - 3. Is there an equity issue when some project sponsors may have committed additional local funds to the project contingency while others are depending on the NVTA contingency reserve?
- h.** The Advisory Panel recognized NVTA project evaluation and selection processes could be impacted through the application of Contingency Reserve funds:
 - 1. Cost is a consideration in the NVTA project selection decision, additional costs would impact the score and may have changed the initial funding decisions.
 - 2. The existence of a NVTA contingency reserve may induce project submitters to reduce their project contingency or other cost factors in their project estimates. Therefore, the existence of a contingency reserve with a stated purpose of reducing the risk of not achieving completion of a project, may unintentionally cause a broader risk shift.

3. Multi-phase projects have an opportunity to absorb cost increases through future requests for sequential phase funding. Those costs would then be part of the next project description, evaluation and rating.
 - i. The Advisory Panel recognized that few if any project grants from other sources came with the expectation that a contingency fund would be available to a project sponsor.
 - j. The Advisory panel noted that under the terms of the NVTA Standard Project Agreement (SPA) the project sponsor agrees to provide a complete project as described in the SPA and therefore has already agreed to and conceivably planned for contingencies.
 - k. While no formal requests for use of the Contingency Reserve has been received by the NVTA, project status discussions have indicated there is approximately \$24 million in potential project cost overruns, which is almost 3 times the current targeted contingency level.
 - l. Increasing the contingency level to \$24 million would have reduced FY2017 PayGo by almost 10% and increased the need for debt financing.
 - m. Replenishing a contingency reserve on an annual basis will make a significant reduction in PayGo resources, thereby delaying future NVTA project awards or forcing a greater reliance on debt financing.
5. **Advisory Panel Recommendation:** After careful consideration of the benefits and drawbacks related to a NVTA Contingency Reserve and in light of the above considerations, the Advisory Panel recommended to the NVTA Finance Committee that a Contingency Reserve not be established.
6. **Next Steps:** If the Authority eliminates the Contingency Reserve, the reserve funding designation of \$8,573,893.78 will become fund balance in the Regional Revenue Fund. These funds will then be available for future FY2018 Project Program decisions by the Authority.