



Virginia Department of Rail and Public Transportation

Options to Develop a Program for the Financing of Statewide Transit Capital Needs Using the Master Equipment Leasing Program (MELP)

Final Report

November 1, 2018

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Executive Summary

The 2018 Virginia General Assembly directed the Virginia Department of Rail and Public Transportation (DRPT) to investigate options to finance statewide transit capital needs through the Commonwealth's Master Equipment Leasing Program (MELP).

In order to comprehensively address the request made by the General Assembly, DRPT conducted research on MELP's structure, undertook conversations with the Departments of General Services (DGS) and Treasury, which manages MELP, and discussed the transit community's potential interest in a financing program through the Transit Service Delivery Advisory Committee (TSDAC) serving as the official work group.

DRPT found that while MELP is an effective program to provide consolidated and cost-effective financing for Commonwealth owned capital equipment, the specific financing needs for local transit agencies provide several challenges that either prohibit the use of the existing program, or would require a significant restructuring of the program. Nonetheless, the Commonwealth Transportation Board (CTB) could consider adoption of a short-term financing program administered by DRPT and structured to the business model and needs of public transportation agencies across Virginia.

This report follows the completion of the work of the Transit Capital Project Revenue Advisory Board (Chapter 609 of the 2016 Virginia Acts of Assembly), which was charged with identifying the impact of the loss of \$110 million in annual revenues currently dedicated to the statewide transit capital program. Nearly 44% of the program relies on these revenues, financed by 30-year Commonwealth Project Revenue (CPR) bonds with terms that fully sunset in 2020.

The 2018 General Assembly enacted numerous reforms to statewide transit funding programs that changed many of the RAB's previous assumptions. Chapter 856 of the 2018 Acts of Assembly restructured the Commonwealth Mass Transit Trust Fund to dedicate 53.5% of all revenues to the Washington Metropolitan Area Transit Authority (WMATA) for capital and operating expenses for that agency. This significantly reduced the RAB's previous needs assumptions which at the time included WMATA. The first two rounds of the SMART SCALE program also provided nearly \$200 million for major expansion transit capital projects, thereby reducing previously anticipated demands on the statewide transit capital program.

Chapter 856 of the 2018 Acts of Assembly also enacted a series of significant reforms to all statewide transit programs, including a project-based prioritization framework for the statewide transit capital program effective in FY 2020. The TSDAC noted that once those reforms have been fully implemented and their impacts evaluated, a short-term financing program in Virginia could be used to serve as a form of bridge financing while a funding solution that does not rely on the use of long-term debt is identified.

Statement of Need and Approach

This report was prepared pursuant to Chapter 2, Item 445 F.1-3 of the 2018 Virginia Acts of which directed that DRPT conduct the following study:

The Department of Rail and Public Transportation, in conjunction with the Department of Treasury and the Department of General Services shall investigate options to develop a program for the financing of statewide transit capital needs using the Master Equipment Leasing Program currently operated through the Department of the Treasury as a model to facilitate group purchases of mass transit equipment. The goal of the program would be twofold: (i) to achieve cost savings through bulk purchases and (ii) to establish a revolving fund to meet transit capital replacement needs that does not rely on the use of longer-term debt for items with a limited life cycle.

As part of this effort, the department shall convene a work group that includes representatives from the Northern Virginia, Rappahannock and Potomac, and Hampton Roads Transportation District Commissions, at least one transit property that is not a member of a Transportation District Commission, the Virginia Municipal League and the Virginia Association of Counties. The work group shall utilize the Report of the Transit Capital Revenue Advisory Board findings relating to state of good repair needs to develop an estimate of the amount of transit capital funding needed annually and shall also identify potential sources within the Transportation Trust Fund that could be used to provide lease payments for the program.

The Director of the Department of Rail and Public Transportation shall submit a report on the proposed program, including legal requirements, terms, rates and operational structure to the Governor, the Chairman of the House Appropriations Committee and the Senate Finance Committee by November 1, 2018.

To meet this mandate, DRPT consulted the Departments of General Services (DGS) and Treasury. DGS noted that it views MELP as a bridge loan program used to meet annual funding needs to procure and maintain its fleet of statewide vehicles in years where needs exceed appropriated funds.

The Department of Treasury establishes credit and borrowing terms, including loan repayment terms, pledge of revenues and collateral, solicitation to banks to provide financing, and reviews of MELP's structure and function. DRPT also analyzed, with the Department of Treasury's guidance, MELP's potential for meeting the Commonwealth's transit needs. In the process of this analysis, DRPT identified potential statutory, administrative, and debt financing issues that would need to be changed in order to use MELP for transit asset financing.

Finally, DRPT engaged with the Commonwealth's transit providers through TSDAC, which includes representatives from the Virginia Association of Counties, Virginia Municipal League, the Virginia Transit Association, and DRPT, in addition to outreach to the Potomac and Rappahannock Transportation Commission (PRTC) and other regional entities.

MELP Overview

MELP was established in 1987 under Virginia Code Section 2.2-2417 to provide all Commonwealth agencies with consistent and competitive credit terms for financing equipment and energy efficiency projects. Each year the Treasury Board procures a line of credit through one or more banks to provide financing for equipment pursuant to the Virginia Public Procurement Act, the Agency Procurement and Surplus Property Manual and the Commonwealth Accounting Policies and Procedures Manual. Credit lines procured each year are typically in the amount of \$25-\$30 million. The line of credit is subject to a master lease agreement where individual lease financings between a state agency and the bank(s) are incorporated into the master lease as an appendix to the agreement.

All state agencies, institutions, boards, and authorities can participate in MELP. The Department of General Services utilizes MELP to finance items including vehicles, office copiers, and medical/research equipment. Local governments and entities including public transit agencies or transportation district commissions are not eligible borrowers. The equipment to be financed must be used for a governmental purpose. This allows the Treasury Board to borrow at tax-exempt rates. Lease terms cannot exceed the useful life of the asset being financed and typically range from 3 to 10 years.

Agencies seeking access to MELP can apply to the Department of Treasury by submitting a request form that includes a project description, estimated financing costs and estimated financing date. The Department of Treasury then reviews each request for appropriateness and ensures: the asset to be financed is eligible as personal property, i.e. equipment, vehicles, etc. and not for land acquisition or real estate purposes; the financing is for at least \$10,000; the loan term is consistent with the asset's useful life; the essentiality of the asset to be financed; and the exclusion of "soft" costs involved in the installation, shipping and handling and maintenance of the asset. Treasury provides its approval or disapproval typically within a week. While agencies are not required to use MELP, alternative financing arrangements must be first approved by the Treasury Board.

Leases are secured by state revenues, typically from the general fund, and are subject to appropriation by the General Assembly each year. As such, MELP is considered state tax-supported debt and is incorporated as part of the Commonwealth's annual debt affordability calculations.

The Master Lease Agreement provides significant protections to the banks to discourage non-payment on a lease. If one agency does not make a lease payment, then all leases under the Master Agreement are in default. Borrowing agencies also pledge a security interest in the asset being financed. In the event of a non-appropriation or non-payment the lessor can repossess all of the equipment/projects financed under the Master Lease Agreement. Given that MELP's credit quality rests with the Commonwealth, including the pledge of state revenues, the security interest in the assets financed and strong incentives to discourage non-payment, the Treasury Board receives highly competitive interest rates bids from banks.

MELP's Applicability toward Financing Transit Capital Needs

Transit capital assets, like bus or rail vehicles, are typically procured by local agencies on a pay-as-you-go basis using federal grants, state funds, and local transportation funds. Any short-term financing tool, like MELP, would require an initial appropriation to capitalize the loan program. TSDAC members expressed some interest in a short-term financing program like MELP as a form of bridge financing until a more permanent funding solution is defined to close the gap between transit needs and resources.

MELP's current structure presents several barriers to utilize the program as a vehicle for financing transit capital needs. These include:

- MELP does not allow non-state entities to access the program. As such, local governments, transit agencies and transportation district commissions cannot borrow funds from MELP to finance transit capital investments. As an alternative, DRPT may borrow funds from MELP. However, DRPT's ability to pledge the assets being financed as collateral poses additional complications described in the next bullet.
- Transit capital assets are funded from a combination of Federal Transit Administration (FTA), DRPT and local sources. FTA Circular 5010.1E dated February 3, 2017 governing Grant Management Requirements¹ states that the "FTA retains a federal interest in any federally assisted property financed with FTA assistance, until and to the extent, FTA relinquishes its federal interest in that federal assisted property. This applies to real property, equipment and supplies." The circular further states that title to a federally assisted property is vested in the recipient (i.e., the local government, transit agency or transportation district commission). Further, the recipient must not encumber the property without prior approval from FTA. Given MELP's requirement that capital assets financed under the program are pledged as collateral, DRPT would need to seek agreement from the local transit entity and

¹https://www.transit.dot.gov/sites/fta.dot.gov/files/docs/Grant%20Management%20Requirements%20Circular_5010-1E.pdf

the FTA to allow the equipment to be pledged as collateral. Since FTA requires that it retain an interest in assets financed with FTA funds, it is unclear whether FTA would grant such a request to assign a security interest to a third party.

- MELP, or a unique program created to facilitate transit asset financing, would need to expand its capacity to accommodate transit capital needs. Over the FY 2019-2028 period, DRPT estimates a \$43.4 million shortfall between available state transit resources and transit vehicle capital needs. In addition, the length of the loan repayment period would need to be extended, on average to 11 years to match the useful life of the vehicles financed (buses, non-revenue vehicles and paratransit vehicles).
- An expanded MELP program, or unique program created to facilitate transit asset financing, will need to be weighed against the increased use of Commonwealth tax-supported debt. Since loans to finance transit needs would be repaid from DRPT sources derived from state taxes, these loans would be counted as tax-supported debt. According to the 2017 debt capacity study, the Commonwealth has capacity to issue a total of \$1.6 billion in new tax-supported debt through FY 2019.
- Given the needs and debt capacity assumptions noted above, DRPT modeled a revolving loan program with a 3% fixed rate, 11-year repayment period, and \$28 million available annually to fund vehicles in cash and pay debt service. While this rate is low enough to solicit interest from local public transit agencies and also meet annual capital needs, it would be insufficient to fund associated debt service payments. Additionally, the policy question to be resolved is how the demands for financing transit capital assets weigh relative to other competing demands for Commonwealth tax-supported debt capacity.

Conclusions

MELP is an effective program to provide consolidated and cost-effective financing for Commonwealth equipment, including vehicles. Well-established credit terms and oversight by the Department of Treasury provide strong incentives for banks to provide competitive lines of credit and for state entities to finance their needs and repay their obligations on a full and timely basis.

The financing needs for the Commonwealth's transit agencies provide several challenges that either prohibit the use of the existing MELP program as a financing vehicle, or would require a significant restructuring of the program. Issues identified include MELP's limitation on lending only to state agencies, thus excluding borrowing for local transit agencies.

Nonetheless, the CTB could consider adoption of a short-term financing program administered by DRPT and structured to the business model and needs of the public transportation industry in

Virginia, within the current statutory authorities of the agency. However, a low-interest loan program would not provide new funding that would meet future needs for transit capital equipment across the state. Rather, it may be used to serve as a form of bridge financing, while a longer-term funding solution is identified.

While there may be a scenario in which DRPT could serve as a borrower on behalf of transit agencies, a requirement for a collateral pledge on the assets being financed adds further complications. Transit assets are funded in large part by FTA grants, where the FTA retains a continuing interest in the assets they fund. As such, it is unclear whether or how FTA would allow for a collateral pledge to a third party.

Finally, given transit vehicle needs, MELP lending capacity would need to be expanded and weighed against the Commonwealth's competing priorities for available tax-supported debt capacity.