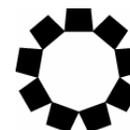


# ASSOCIATION OF BAY AREA GOVERNMENTS

Representing City and County Governments of the San Francisco Bay Area



**ABAG**

Date: November 10, 2016

To: ABAG Executive Board

From: Brad Paul, Deputy Executive Director  
Courtney Ruby, Finance and Administrative Services Director  
Kenneth Moy, Legal Counsel

Subject: **Option 7 Implementation Action Plan—MTC Due Diligence Reports**

Summary: At the October 28 joint meeting of the ABAG Administrative Committee and the MTC Planning Committee, Public Financial Management, Inc. (PFM) and Orrick, Herrington & Sutcliffe LLP (Orrick) presented reports (Reports) on financial and legal due diligence, respectively, in connection with the Option 7 Implementation Action Plan (Attachment A). This memorandum provides a summary of the salient points in each report and a brief discussion of our approach to address the issues raised.

Discussion: The PFM and Orrick Reports provide platforms for discussions about the challenges related to the implementation of Option 7 and for negotiations on how the Contract for Services (CS) will address those challenges. Both reports were commissioned and paid for by MTC. ABAG staff and management provided documentary information and participated in interviews to inform the reports.

MTC shared the initial presentation with ABAG senior management on October 25. We provided some preliminary feedback to the presentations made to the MTC Planning Committee and the ABAG Administrative Committee. We were not able to develop substantive responses for consideration by the committees or MTC senior management by the October 28 meeting date. This memorandum provides a brief overview of some possible ways to address the challenges described in the reports.

## A. PFM Report

The PFM report notes two significant findings about the finances of ABAG and MTC that frame their discussion:

- (a) MTC's personnel costs and indirect overhead rate are higher than ABAG's. This will cause budget deficits for ABAG and its local collaboration programs (which PFM describe as 'enterprise programs') unless additional revenues/subsidies are provided or costs are reduced.

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- (b) Grants comprise eighty-five percent (85%) of ABAG's revenues. This will create funding uncertainty that increases over time as multi-year grants expire.

PFM notes that if both agencies took no action in response to these two issues, there would be a cumulative \$14.83 million deficit for ABAG and its local collaboration programs by 2023. PFM also identified that while ABAG was effectively maintaining its grants there are advantages to implementing MTC's more robust management control system for grants, especially given ABAG's dependence on them. Finally, PFM presented three scenarios for addressing the deficit that included combinations of revenue increases and cost reductions. One of the more important conclusions is that ABAG membership dues are critical to any future plans for balanced budgets. From this, we conclude that member satisfaction is a critical component of any strategy for a successful implementation of Option 7.

We have preliminarily reviewed the data and calculations used by PFM in its report. We have identified some immediate cost efficiencies to implement in anticipation of the implementation of Option 7. These identified savings were not included in the PFM baseline analysis but some elements, such as vacancies, have been identified among the cost saving strategies modeled in two of the PFM alternative scenarios.<sup>1</sup> Additionally, we are working with the local collaboration programs to identify grant and revenue opportunities for the near and medium term while we are working with MTC senior management to identify resources that can be used to defray revenue shortfalls. As indicated in the PFM Report, ABAG and MTC need to address the base case deficit of \$14.83 million between now and 2023. The sooner we increase revenues and reduce costs, the easier the task, yet we must be prudent in our approach realizing that it cannot all be done in FY 2017-18.

### B. Orrick Report

The Orrick Report notes two central issues:

- (1) There are no legal impediments to the proposed staff consolidation. This clears the way for proceeding with Option 7.
- (2) Each of ABAG's local collaboration programs has a unique legal and governance structure that ties the program to ABAG. Some modifications in those structures or additional legal documentation will be necessary for MTC to provide staffing to these programs.

The report identifies a number of approaches to making the necessary modifications.

The Orrick Report also states that ABAG and MTC expect that the staff currently providing support for the local collaboration programs will continue to do so after the consolidation. We understand that the MTC's management of programs outside its core statutory responsibilities involves simpler legal structures and a more direct governance model that ties these programs to their Commission. It may be advantageous to consider parallel changes to the local collaboration programs that provide direct linkages between some of these programs and the ABAG Executive Board. However, all discussion of such modifications should take into

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<sup>1</sup> ABAG and MTC have (1) agreed to refrain from filling non-critical staff vacancies, (2) begun coordinating our respective renewals or extensions of contracts for products and services to save money and (3) achieved some cost savings through co-location at 375 Beale Street. In particular, PFM did not take into account item (1) and the likelihood that many vacancies will not need to be filled with new staff.

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account the history behind each local collaboration program, the nature of each program and should occur in consultation with the local collaboration programs.

We are in the middle of introducing the Executive Board to each of the local collaboration programs and its direct impacts on the region and the co-benefits it generates for ABAG and the other local collaboration programs. We have begun that process with the MTC senior management at the staff level. We are encouraging and providing support for a process that will expand those discussions to include the governance bodies of local collaboration programs with the Commission and Executive Board. We are cautiously optimistic that an accommodation on legal structure and governance acceptable to all affected parties can, and will be, achieved.