STAFF REPORT
ACTION REQUIRED

Capital Budget: Capacity-to-Spend Analysis

Date:	September 6, 2016
To:	TTC Budget Committee
From:	Chief Executive Officer

Summary

Over the 10 years between 2006 and 2015, the average annual capital expenditure rate was approximately 80%. In 2015, TTC’s expenditure rate was 77%. In recognition of spending trends which are typical of large and diverse capital programs, the City budget guidelines permit carry forward from the current year to the next, providing flexibility to manage unforeseen events.

As part of TTC’s 5-Year Corporate Plan to modernize the organization, staff from TTC and the City of Toronto have been reviewing the TTC’s overall spending tends over the past four budget cycles. Capacity-to-spend reductions were incorporated into the 10 year capital budgets for this. As part of the 2017-2026 capital budget process, the TTC has conducted a more systematic review of the trend, the results of which are contained in this report.

Identification of root causes for this trend found constraints that are within our ability to influence or control and constraints that are not. Causes and planned corrective action include, for example, the short maintenance window for track and signal repairs, lengthy processes for material purchasing and recruitment of resources that are in the midst of being made more efficient, and vendor delays to material and equipment resulting in deferral of expenditures. All of these constraints have significant impact to our capacity-to-spend.

While work continues to improve our capacity-to-spend, it is recognized that the trend is persistent and that it affords an opportunity to reallocate funding to priorities that could not otherwise be advanced due to the gap in capital funding.

Recognizing that slippages in budget will always occur to projects in a program as complex as TTC’s, the CEO directed staff to target the achievement of 90% scope and budget; however, this will take time. In consideration of how long it is expected for corrective action to have an effect and in recognition of the fact that the City of Toronto reaches its debt ceiling in 2019 and 2020, staff proposes a budget reduction target across

all fully funded programs (excluding revenue buses) of 15% in 2017 through 2020 and a reduced target of 10% from 2021 to 2026.

This recommendation amounts to a reduction of approximately $850 million over the next 10 years. While currently unspecified (not apportioned to individual programs), staff will allocate the targeted reduction program-by-program and incorporate the revisions into the budget for submission to the City this fall.

This new approach to proactively adjust the capital budget based on a detailed review of our capacity-to-spend may afford the opportunity to fund new projects that might not otherwise go forward. It may also offer an opportunity for the City to provide matching funds to the Federal Government's Public Transit Infrastructure Fund. The opportunity presented is to do more with less without risking the achievement of any of our in-flight projects.

Recommendations

It is recommended that the Budget Committee:

1. Endorse the concept of a capacity-to-spend reduction target in the order of $850 million to be applied to the 2017-2026 capital budget;

2. Request staff apportion the targeted reductions program-by-program and resubmit the revised cash flows directly to City Financial Planning;

3. Request staff undertake annual reviews of the organization's capacity-to-spend and, if required, recommend adjustments to the reduction through the annual budget process; and

4. Request staff report annually to the Board through the budget process on the status of corrective actions taken to increase spending capacity and continue to report quarterly on the capital burn rate through the CEO report.

Implementation Points

- Upon approval of this report, TTC staff will update the 2017-2026 capital budget submission.

- Routine reporting of associated targets for improvement and updates to KPIs are to be reported to the CEO and executive team until all root causes have been addressed.

- A quarterly report on the progress of TTC efforts will be included in the CEO report.

The CEO's Office will be responsible for implementation tracking.

Financial Summary

If approved by the Board, the 2017-2026 capital budget as revised would include capacity-to-spend reductions of approximately $850 million without impacting the scope of affected projects. Details on the opportunities for reallocation of these funds will be presented to the Budget Committee through the 2017-2026 capital budget submission on September 6, 2017. Generally, however, these opportunities may include one or more of the following:

- Funding to continue with all approved projects;
- Funding for new projects and increases to existing projects as outlined in the 2017-2026 budget submission; and
- Funding that could be used as matching funds for the City to apply to the Federal Public Transit Infrastructure Fund.

The Chief Financial and Administration Officer has reviewed this report and agrees with the financial impact information.

Accessibility/Equity Matters

This report has no negative impact on existing accessibility or equity programs. Programs including easier access and the TTC's ability to meet the AODA objectives for 2025. The budget as submitted for approval includes the Wheel-Trans Transformation program which would be fully funded if the proposed budget and capacity-to-spend reductions are approved.

Issue Background

In previous years, the capital budget was compiled using inputs from individual project managers and each year the budget was a snapshot of the funding required to perform all of the work TTC staff understood was necessary to maintain, rebuild and replace our assets.

Over the 10 years between 2006 and 2015, the average annual capital expenditure rate was approximately 80%. Between 2013 and 2015 the average annual rate was 76%. In 2015 the budget was $1,149 million; however, the actual expenditures for the year totalled $881 million or 77%.

Recognizing this trend, City Financial Planning staff began working with TTC staff in 2014 to analyze the TTC's capacity-to-spend based on historical spending. That exercise identified opportunities to reduce cash flow funding and timing for various state of good repair projects. The cash flow funding that was reduced, which in 2016 – 2025 totalled $346 million was placed "below the line" to establish a state of good repair SOGR backlog.

In early 2016, following initial analysis, the CEO directed the Deputy CEO to work with the Portfolio Management Office and Finance to undertake a program by program review of the TTC's capacity to spend its capital program without introducing any risk to the achievement of project scope. In doing so, staff were expected to recommend a revised budget that better reflected the TTC's needs but also constraints.

Comments

The exercise to systematically analyze capital budget expenditure rates was designed to:

1. Identify the root causes and propose corrective action to improve our ability to maintain assets in a state of good repair (SOGR);

2. Identify permanent capacity-to-spend reductions that could be used to:
    a. Reduce or eliminate the capacity-to-spend portion of the TTC's SOGR backlog;
    b. Fund new projects and recommended increases to existing projects submitted through the 2017-2026 budget; and
    c. Match funding for the federal Public Transit Infrastructure Fund.

If approved by the Board, it is further recommended that the Board request City Council approve the reallocation of the spending detailed in the 2017-2026 capital budget submission being presented to the TTC Budget Committee on September 6, 2016.

A program-by-program review of actual expenditures against the approved budget was undertaken. For each program the historical trend was reviewed, root cause(s) were tabled and staff discussed corrective actions. Root causes were identified by the department heads and project managers as follows:

- **Cause:** Limited maintenance window prevents sufficient access to subway right-of-way to perform the required routine and corrective maintenance.

  Corrective action planned/taken: Continuous re-evaluation of planned work to maximize effectiveness during the maintenance window. Re-opening Keele Yard would allow for faster deployment of crews to the worksite. A yard in the west end of the city would provide a similar advantage. A longer maintenance window is to be investigated to allow for more work to be performed.

- **Cause:** Limited workcar availability to maintain subway infrastructure (track, signals, communications, way-side equipment, etc.)

  Corrective action planned/taken: Initiated business case to request the purchase of new workcars

- **Cause:** Incomplete asset inventory

  Corrective action planned/taken: TTC is in the process of establishing an Enterprise Asset Manager. The mandate will be to create an enterprise wide asset inventory, asset condition assessment, asset life cycle management plan and a consolidated long-term capital asset management plan.

- **Cause:** Insufficient resources for new projects and system growth

  Corrective action planned/taken: Improved resource planning and expedited recruitment processes. Where necessary, budget requests for additional capital headcount.

- **Cause:** Increased due diligence during the procurement of orders above $100k has resulted in longer bidding processes.

  Corrective action planned/taken: The procurement process is being re-evaluated to ensure the quickest possible turnaround while maintaining due diligence.

- **Cause:** Inconsistent performance of vendors and/or business partners resulting in deferred expenditures.

  Corrective action planned/taken: Improve vendor management and claims management. Clear agreements with business partners. In addition, staff is considering how to improve its commercial management capacity as a means to ensure TTC is doing its part to best manage vendor relationships and performance.

Many of these root causes are systemic in nature and have impacts across the entire capital portfolio. The TTC's Portfolio Management Office will take the lead to develop a project plan for the implementation of corrective actions. Routine reporting of associated targets for improvement and updates to KPIs are to be reported to the CEO and executive team until all route causes have been addressed.

In addition, staff will report annually to the Board through the budget process on the status of corrective actions taken to increase spending capacity and continue to report quarterly on the capital burn rate through the CEO report.

Given that the action plans are expected to take anywhere between six months (process changes) and six years (major equipment acquisitions) for implementation the TTC's capacity-to-spend will not improve immediately. Staff will therefore undertake annual reviews of the capacity to spend and recommend adjustments through the annual budget process.

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