



Board Report

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Agenda Number: 7.

FINANCE, BUDGET, AND AUDIT COMMITTEE JANUARY 17, 2024

SUBJECT: FISCAL YEAR 2025 BUDGET DEVELOPMENT PROCESS

ACTION: RECEIVE AND FILE

RECOMMENDATION

RECEIVE AND FILE The Fiscal Year 2025 (FY25) Budget Development Process.

ISSUE

In preparation for the FY25 Budget development process, the Office of Management and Budget (OMB) provided the Finance, Budget, and Audit Committee an oral report on October 18, 2023, focusing on the major cost growth drivers over the next five years. In addition, the Board requested additional information on the fare box recovery ratio, which is included in the report.

This report builds on the oral report surrounding the challenges ahead and sets up the context for utilizing the Equitable Zero-Based Budget (EZBB) process. This report highlights the EZBB Attainments and Efforts Underway, highlighting service optimization and Operations' successes on cost containment as well as the capital cost mitigation work by the Early Intervention Team (EIT) and Program Management teams.

An outline of the planned EZBB process and schedule follow to address the delivery of Metro's objectives in the next fiscal year, culminating in a planned May 2024 Board Adoption. During the budget development process, a comprehensive and transparent public outreach engagement will be run to maximize public input and ensure Metro's stakeholders have an active role in the process. This report lays the framework for the annual budget development, with the primary objective of proposing a balanced FY25 Budget while achieving Metro's transit and transportation goals in a fiscally sound and financially responsible manner.

BACKGROUND

California Public Utilities Code Section 130105 requires Metro to adopt an annual budget to manage the revenues and expenses of the Agency's projects and programs. The budget is the legal authorization to obligate and spend funds and to implement Board policy. It includes all operating, capital, planning and programming, subsidy funds, debt service requirements, and general fund activities for the fiscal year. The legal level of control is at the fund level. Total annual expenditures

cannot exceed the final appropriation by the Board at the fund level except for capital expenditures, which are authorized on a life of project basis. Beginning in January 2024, staff will begin to provide a series of status updates on the FY25 Budget development process to the Metro Board's Finance, Budget, and Audit Committee.

The Near-Term Outlook projects slowing sales tax growth while the Agency's Transit Operations and Capital Improvement Program (CIP) costs anticipate significant growth. Metro faced significant financial challenges during the pandemic, but with careful cash management and one-time stimulus funding, the agency was able to balance the budget over the last three years. With the exhaustion of stimulus funding and slow growth in sales tax revenues, continuous efforts are needed to mitigate this financial risk. The higher-than-expected sales taxes in FY23 will help mitigate FY25; however, FY24 sales taxes are coming in lower than projected, indicating a slowing economy that will bring financial challenges ahead.

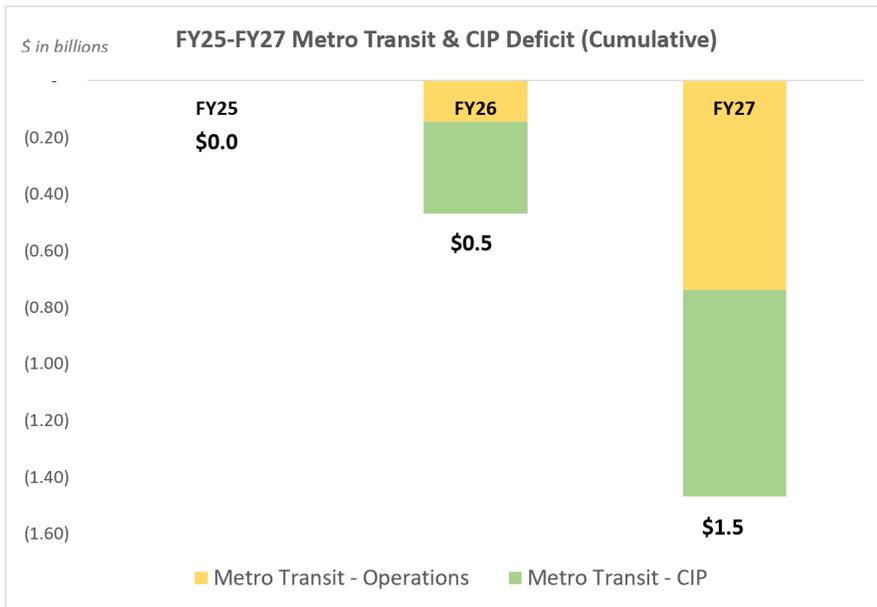
DISCUSSION

Near-Term Outlook Update and Challenges Ahead

Metro continues to recognize the importance of sound financial planning to successfully implement transit investments and operating plans. The EZBB cycle begins with the Near-Term Outlook, which establishes three-year assumptions based on assessing the economic environment on revenues, continuing programs in place today, evaluating the market cost escalations, meeting Board approved priorities, as well as planning for significant investments.

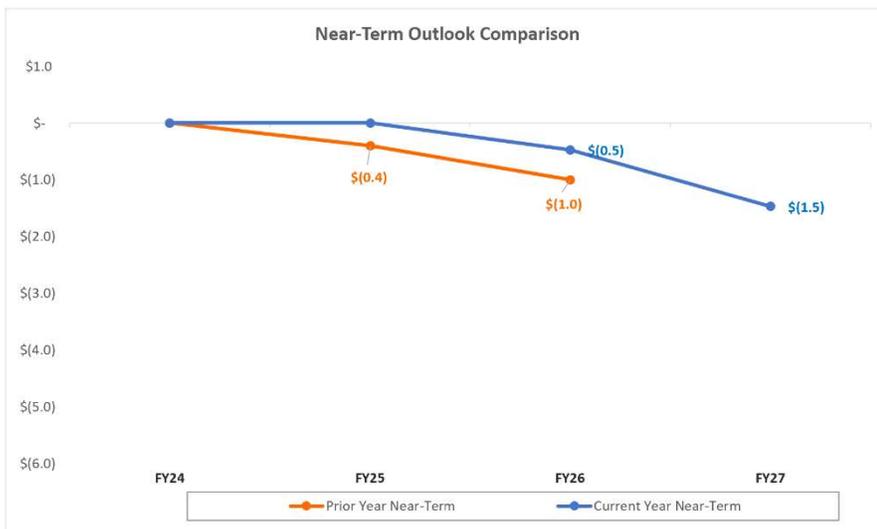
The Agency's updated Near-Term Metro Transit Operations and Capital Improvement Program (CIP) results in a financial deficit of \$1.5 billion by FY27. (Figure 1) The gap is made up of \$555 million for Metro Transit Operations due to growing transit costs driven by labor and market inflation, property, liability and insurance premiums, rail expansion and incremental costs for post-pandemic induced changes, including enhanced safety and cleanliness. The \$915 million gap in Metro Transit CIP is predominately due to the accelerated electrification efforts. In addition, Metro continues to recognize the financial risks stemming from the Transportation Infrastructure Development (TID) program faced with project cost increases due to scope and schedule changes, market bid prices and labor and supply chain constraints.

Figure 1



The near-term outlook has improved from twelve months ago from \$1 billion deficit by FY26 due to: 1) higher revenues realized in FY23 than anticipated, 2) spending at a slower pace than projected primarily for deferred capital expenses, and 3) successful efforts through EZBB, instilling a culture focused on fiscal discipline and cost mitigation and revaluation of pilot programs. (Figure 2) This results in the operating deficit becoming more manageable through FY27. However, additional mitigation efforts are still needed early to avoid drastic actions later as the financial gap is anticipated to increase beyond FY27.

Figure 2



EZBB Attainments and Efforts Underway

Throughout the preparation for the FY25 Budget development process, Metro's long-term sustainability continues to be a concern as resources remain scarce for the increasing needs. Although the financial challenges are manageable for the upcoming year, immediate cost control mitigations are still necessary and relevant to safeguard Metro's financial position in fulfilling its commitment to fiscal responsibility and advancement as a mobility transforming organization.

Metro looks forward to building on its current momentum by continuing to undergo a deep dive into expenses and search for optimal cost mitigation strategies through an equity lens. While trying to tighten costs, Metro has also successfully implemented many new investments toward refining our care-based programs, such as:

- Westlake/Macarthur Park interventions to improve community health and safety;
- Increased outreach for those experiencing homelessness;
- Putting in place the Transit Ambassador pilot and
- Implemented fare subsidy programs such as the Low-Income Fare is Easy (LIFE) program, Fare Capping, and Go Pass

Farebox Recovery Ratio

The farebox recovery ratio measures how much in fare revenues pay for operating transit. Prior to the pandemic, this ratio was at 15.6% and had fallen to 1-3% during the pandemic with the pause in fare collection. The federal stimulus funding replaced the loss in fares. The actual FY23 ratio of 5.8% came in 1% higher than budgeted, with FY24 budgeted at 6.2%.

While Metro does not solely rely on fares to operate service, fare revenues are reinvested into the system to maintain service and improve customer experience. This ratio is continuously impacted by the rising operating costs and the inability of fares to grow at the same pace. With fare revenues not expected to reach pre-pandemic levels and the loss in federal stimulus funding, this will further strain the availability of operating eligible funding and may limit the investments to improve service. Continued EZBB efforts are necessary to address the rising operating costs that impact this ratio.

Service Optimization and Operations Cost Mitigation Efforts

Operations have centered their focus on delivering a more optimal service design as well as conducting bus and rail cost analyses to identify cost saving opportunities. The task force focused not only on investigating the quantity of service but also explored solutions to provide optimal service level and quality customer experience with implementing the NextGen Bus Plan and an update to the C & K Line Operating Plan to enhance rider travel experience resulting in an estimated savings of \$10 million.

NextGen efficiencies transferred bus revenue service hours (RSH) from peak to off-peak service frequency, reducing bus operator and peak bus requirements by several hundred hours. Metro also adjusted light rail peak frequencies to better allocate service from peak to base and weekend with 8 min peak/10 min off peak headways versus the pre-COVID 6 min peak/12-15 min off peak light rail

service plan, reducing wait times for riders especially off peak. The opening of seven stations on the K line in October 2022 provides new rail service for the communities of West Adams, Jefferson Park, Baldwin Hills, Leimert Park, Hyde Park, Inglewood, Westchester, and more. Metro looks forward to connecting the K Line to Metro's C Line and the LAX Automated People Mover (APM) by the end of 2024.

The North San Fernando Valley Transit Corridor Project was reimagined with a new plan adopted by Metro's Board in December 2022. The new plan consists of an enhanced bus network to increase connectivity and provide high-quality bus service and transit infrastructure in North San Fernando Valley communities from Northridge on the west to North Hollywood on the east. This new innovative approach called the BRT Network Improvements, builds off extensive outreach and Metro Board direction, applying BRT attributes to improve the rider experience on seven existing transit lines in the San Fernando Valley. As part of this project, Metro will implement peak period dedicated bus lanes on Roscoe Boulevard and higher frequency service on Roscoe Boulevard and Nordhoff Street bus lines for shorter wait and travel times.

The project will add new bus shelters at almost 400 locations through a partner agreement with the City of Los Angeles (LA), as well as additional passenger amenities at five key transfer locations. The project will also fund 75 new quiet zero emission battery electric buses for four bus lines, including charging infrastructure. The project will also fund transit signal priority and bus bulbs for seven corridors and all door boarding on all buses in the San Fernando Valley to improve travel times and service reliability for our San Fernando Valley riders.

Metro Transit task forces have also produced a framework tool to assess the most cost-effective way of making insourcing versus outsourcing decisions for long-term financial stability. Additionally, Metro staff is working towards achieving the performance and cost efficiency goals through a new business model for Micro Transit Pilot (MTP) Project (2023-0464). Using the information from the MTP evaluation and peer agencies' comparison, Metro will pursue reducing the current per-trip cost to \$20-\$25.

Correspondingly, to ensure the continued success and sustainability of the Metro Bike Share (MBS) program, Metro updated the operational model to a Privately-Owned and Publicly Managed program to improve overall performance and support a more sustainable regional bike share program. This update will help meet Metro's equity, scalability, expansion, affordability/cost, and efficiency goals for the program.

Metro will also continue to extensively review its internal major cost growth areas. This includes examining overtime usage, Workers' compensation, and Personal Liability and Property Damage (PLPD) insurance areas. Other significant cost growth areas to be evaluated include cost inflation for parts, fuel, power, contract services, public safety, cleaning, rail expansion, and a wide range of other activities that support Metro's partners throughout the Los Angeles County region.

Metro's Early Intervention Team (EIT) and Program Management Cost Mitigation Efforts

The Metro's Early Intervention Team (EIT) efforts are underway to ensure issues are identified early and projects remain within initially established (life of project) LOP's. EIT has conducted 12 project

reviews to date focused on understanding each project's objectives, risks, and scheduling and financial ramifications. These reviews included:

- East San Fernando Valley (ESFV) Transit Corridor;
- East Side Transit Corridor Phase 2 (ESP2);
- I-105 Express Lanes;
- North Hollywood to Pasadena BRT;
- C-Line Extension to Torrance;
- Sepulveda Transit Corridor;
- Active Transportation Group projects;
- North San Fernando Valley BRT;
- West Santa Ana Branch;
- Green (C-Line) capital projects;
- New Rail Operations Center (ROC)/Bus Operations Center (BOC); and
- Vermont Corridor BRT

The EIT additionally completed process-oriented reviews focusing on alternative project delivery strategies and real estate acquisitions. The EIT completed its reassessment of financial forecasts for all Measure M capital projects in the delivery pipeline and distributed the baseline updates for incorporation in various management reports.

FY25 Equitable Zero-Based Budget (EZBB) Process and Schedule

Metro continues to use Equitable Zero-Based Budgeting (EZBB) for its FY25 Budget development process, which is a year-round process. The EZBB cycle begins with the Near-Term Outlook to prepare a financial prospect for the next several years. This is followed by Capital Budgeting as Metro anticipates upcoming capital project needs through a detailed and interactive process, focusing on cost management and sustainable cash flows.

The annual budget is then developed at the beginning of the calendar year with a holistic program and cabinet reviews with the CEO, focusing on strategic priorities for the upcoming fiscal year. Metro will continue to utilize management controls and tools, starting with evaluating project milestones and performance-based activities. These strategies will maximize available resources and optimize funds for operations. In parallel, Metro creates and launches the Agency's outreach plan and conducts quarterly financial reviews throughout the year via CEO and Cabinet workshops, focusing on financial accountability.

The FY25 Budget will continue Metro's core mission to improve transit services, keep transit assets in a state of good repair, fund and plan for regional transportation programs, and construct

transit/transportation infrastructure according to voter approved sales tax ordinances, State and Federal regulations, Board approved policies and guidelines.

Metro staff will work collaboratively and partner with the Board of Directors to identify mitigation strategies and strengthen cost controls to produce a balanced budget by staying within our cost and equity parameters. Monthly program reviews will provide not only an opportunity to acquire a holistic program review and understanding of the budget but also a chance to reassess the Agency’s needs.

Here is a summary of the schedule of topics to be presented over the next few months, culminating in the final Board Adoption in May.

| Month | Topic |
|----------|---|
| January | Budget Development Process: • Near-Term Update • EZBB Attainments and Efforts Underway • FY25 EZBB Development Process and Schedule • Public Outreach and Engagement |
| February | Budget Development Parameters: • Sales Tax Forecast, Resources Assumption • Cost Inflation Estimate |
| March | Infrastructure Planning and Construction: • Transit Infrastructure Expansion • Multimodal Highway Investments • Regional Rail • Regional Allocations and Pass-Throughs |
| April | • Metro Transit - Operations & Maintenance (O&M) and Capital Improvement Program (CIP) • Congestion Management • Planning and Administration |
| May | Public Hearing and Board Adoption: • Consolidated Agency-wide Expenses and FTEs Budget Proposal • Proposed Budget Book published on April 30, 2024 • Public Hearing on May 15, 2024 • Summary of Public Comment and Stakeholder Review • Final Board Adoption on May 23, 2024 |

Public Outreach and Engagement

To advance Metro's commitment to its vision and mission, it is essential to foster inclusive and open engagement with customers, stakeholders, and the public. This involves refining the budget outreach process to ensure it remains dynamic and effective. This year, Metro is emphasizing marketing strategies to reach Equity Focused Communities (EFC) by including the distribution of physical information cards throughout Los Angeles County, striving for increased participation from historically underrepresented groups and riders. Additionally, OMB is working with the Women & Girls Governing Council (WGCC), Metro Youth Council (MYC), LIFE Program, On the Move Riders Program, Metro Station staff, and other Metro groups to increase participation this year. We have already initiated several engagement activities, and a comprehensive update on our public outreach and engagement strategies will be presented in our monthly budget updates.

Telephone Town Hall Initiatives

Metro is continuing outreach through the Telephone Town Hall (TTH) meetings. These meetings began early this year with the first session in October 2023 and are designed to facilitate direct

communication with the public. The next TTH is scheduled for March 2024.

"My Metro Budget" Interactive Tool

The "My Metro Budget" tool is a novel interactive platform designed for public education and feedback. Available at <http://mybudget.metro.net/>, this tool aims to educate the public about the complexities of Metro's budget and to gather valuable input from our riders. The insights gained will be instrumental in shaping the FY25 Budget.

EQUITY PLATFORM

In FY25, staff continue to conduct exercises to assess equity in Metro's budget for each fiscal year.

For the fifth fiscal year, staff will apply the Metro Budget Equity Assessment Tool (MBEAT) to capital projects and operating expenses in Metro's budget, assessing equity impacts from Metro's large-scale projects as well as department-level budgets. Staff will also analyze FY25 Budgets against budget equity principles aligned with Metro's Equity Platform framework. Once completed, staff will compile a summary of MBEAT results to support ongoing FY25 Budget decisions.

Staff will also conduct the Equity Focus Communities (EFC) Budget Assessment for the FY25 Proposed Budget. In response to the Board's direction, staff will also conduct the EFC Budget Assessment for FY23 Actuals to the EFC Budget Assessment with real expenditures. This exercise will be completed in Spring before the FY25 Proposed Budget Hearing. This practice will also continue for all FY Actuals, once available, and staff will conduct the FY24 Actuals EFC Budget Assessment in Summer 2024, updating the FY24 Proposed EFC Budget Assessment completed last fiscal year.

IMPLEMENTATION OF STRATEGIC PLAN GOALS

The recommendation supports the following Metro Strategic Plan Goal:

Goal # 5: Provide responsive, accountable, and trustworthy governance within the Metro Organization.

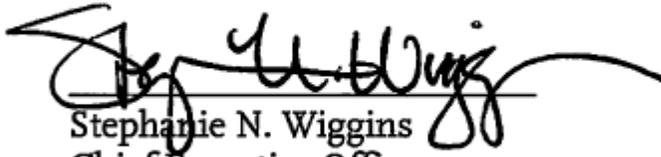
NEXT STEPS

Metro staff will provide regular Budget briefings to Board members and their staff starting this month. We will also provide receive-and-file reports monthly, as previously detailed.

Prepared by:

Irene Fine, Sr. Executive Officer Finance, (213) 922-4420
Michelle Navarro, Sr. Executive Officer Finance, (213) 922-3056
Melissa Wang, Deputy Chief Financial Officer, (213) 922-6024

Reviewed by: Nalini Ahuja, Chief Financial Officer, (213) 922-3088



Stephanie N. Wiggins
Chief Executive Officer

FY25 Budget Development Update

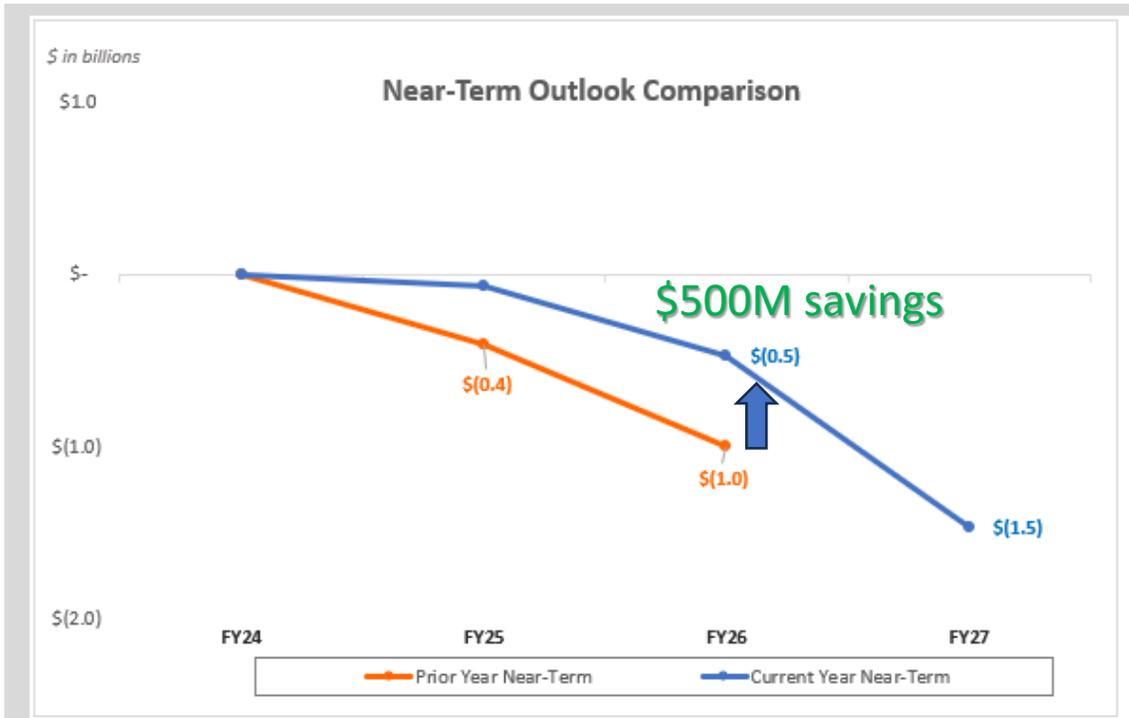
- Near-Term Outlook Update
- EZBB Efforts Underway
- Public Outreach & Next Steps

Finance, Budget & Audit Committee

January 17, 2024

Update to Near-Term Outlook and Financial Challenges Ahead

Metro's Objective: Develop a balanced, Board priority-driven FY25 Budget proposal for adoption in May 2024



Reduced FY26 cumulative deficit by \$500M through:

- ✓ Higher revenues realized in FY23 than anticipated
- ✓ Optimizing cash flow
- ✓ Cost control through tangible EZBB savings

- Although the FY26 outlook has improved from twelve months ago, a financial deficit (operating and capital) remains at \$1.5 billion by FY27
 - Metro Transit Operations (\$555M) due to growing transit costs
 - Metro Transit Capital Improvement Program (CIP) (\$915M) due to electrification efforts
- Financial Challenges persist due to:
 - Exhaustion of one-time federal stimulus funding that was used to balance budgets the last three years
 - Operating costs projected to grow faster than operating revenues
- Long term sustainability remains a concern as the financial gap is anticipated to exacerbate beyond FY27
- Through the Equitable Zero-Based Budgeting (EZBB) process, continuous cost control actions are still necessary and relevant to mitigate early

EZBB Attainments and Efforts Underway

- Metro continues to utilize the EZBB process to strengthen cost controls and balance the budget by:
 1. Reviewing the Near-Term Economic factors (controllable and non-controllable)
 2. Breaking down the cost drivers by urgency and root cause, and create tailored-made cost mitigation plans
 3. Instilling a priority-driven zero-based review based on milestone achievements and program/project performance (i.e., evaluation of Bike program and Metro Micro in the annual budget development)
 4. Sharing the financial risk and responsibility with CEO/Cabinet and Board of Directors through innovative cost control solutions such as:



- ✓ Rail line service restructure at C and K line to enhance rider travel experience, generating an estimated \$10 million savings, reinvested to improve cleaning and safety
- ✓ Next Gen service improvement with no additional bus fleet or capital costs, creating significant savings
- ✓ North San Fernando Valley BRT improvement to the rider experience on seven existing transit lines
- ✓ Early Intervention Team (EIT) objective to stay close to initial life of project (LOP)

WE ARE HERE



October 2023

- > **CEO's Telephone Town Hall**
Over 3,600 participants

November 2023

- > Launch My Metro Budget Activity
Available in 9 language

December 2023

- > Community group engagement – My Metro Budget physical marketing cards to:
- > GoPass, LIFE, On The Move Riders Program, Metro Youth Council, Metro Station Staff

January 2024

- > Social Media launch of My Metro Budget Activity
- > Outreach to Equity Focus Communities

February 2024

- > Regional Service Councils – Budget Briefings in all Regions

March 2024

- > **CEO's Telephone Town Hall**
- > Community Advisory Committee (TBD)

April 2024

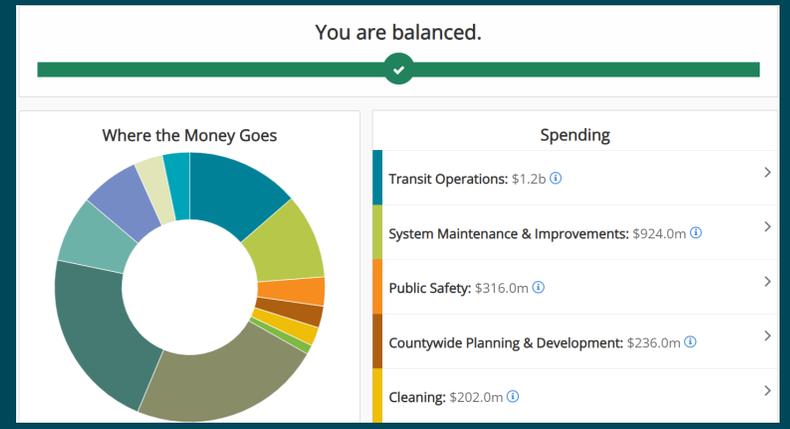
- > San Gabriel Valley COG
- > Bus Operators Subcommittee
- > Regional Service Councils, Budget Briefing
- > Streets & Freeways
- > Community Advisory Council (TBD)
- > Gateway Cities COG
- > Westside Cities COG

May 2024

- > Technical Advisory Committee
- > Valley Industry & Commerce Association
- > Local Transit Systems Subcommittee
- > Accessibility Advisory Committee
- > San Gabriel Valley COG
- > **Budget Public Hearing**

Enter to win a \$50 gift card or a TAP card with one year of free rides by helping Metro shape its budget!

Visit mybudget.metro.net/card or scan the QR code below to participate by the end of May 2024.



> Note: Updated as additional meetings are scheduled.

> Ongoing Public Participation

Schedule & Next Steps



- Near-Term Update
- EZBB Attainments and Efforts Underway
- FY25 EZBB Development Process and Schedule
- Public Outreach and Engagement



- Sales Tax Forecast, Resources Assumptions
- Cost Inflation Estimates



- Transit Infrastructure
- Multimodal Hwy Investments
- Regional Rail
- Regional Allocations & Pass-Throughs



- Metro Transit - Operations & Maintenance (O&M) and Capital Improvement Program (CIP)
- Congestions Management
- Planning & Administration



- Consolidated Agency-wide Expenses & FTEs
- Proposed Budget Book published on April 30th, 2024
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