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FINANCE, BUDGET, AND AUDIT COMMITTEE JANUARY 15, 2026

SUBJECT: FISCAL YEAR 2027 BUDGET DEVELOPMENT PROCESS

ACTION: RECEIVE AND FILE

RECOMMENDATION

RECEIVE AND FILE the Fiscal Year 2027 (FY27) Budget Development Process.

ISSUE

This report establishes the foundation for the development of the FY27 Equitable Zero-Based Budget (EZBB) by providing the updated Near-Term Financial Outlook and outlining the budget development schedule, with final adoption planned for May 2026.

On June 18, 2025, staff identified key internal and external financial pressures, outlined a strategic workplan, and adopted Guidelines for Addressing the Fiscal Cliff.

Since then, Metro staff has advanced the cross-departmental strategic workplan through:

- Deep Dive on Revenue Generating Opportunities: presented to the Board on September 18, 2025
- Deep Dive on General Fund: presented to the Board on September 18, 2025
- Near-Term Financial Outlook Update

As the FY27 Budget is developed amid fiscal uncertainty, Metro remains committed to disciplined, results-driven financial management aligned with the Board adopted guidelines, prioritizing the preservation of essential transit services and investments that improve the rider experience.

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.

In alignment with these governance standards, this report is the beginning of a series of status updates on the FY27 Budget development process to the Finance, Budget, and Audit Committee. These updates will provide ongoing transparency into financial assumptions, strategic priorities, and emerging fiscal considerations as Metro progresses toward final budget adoption.

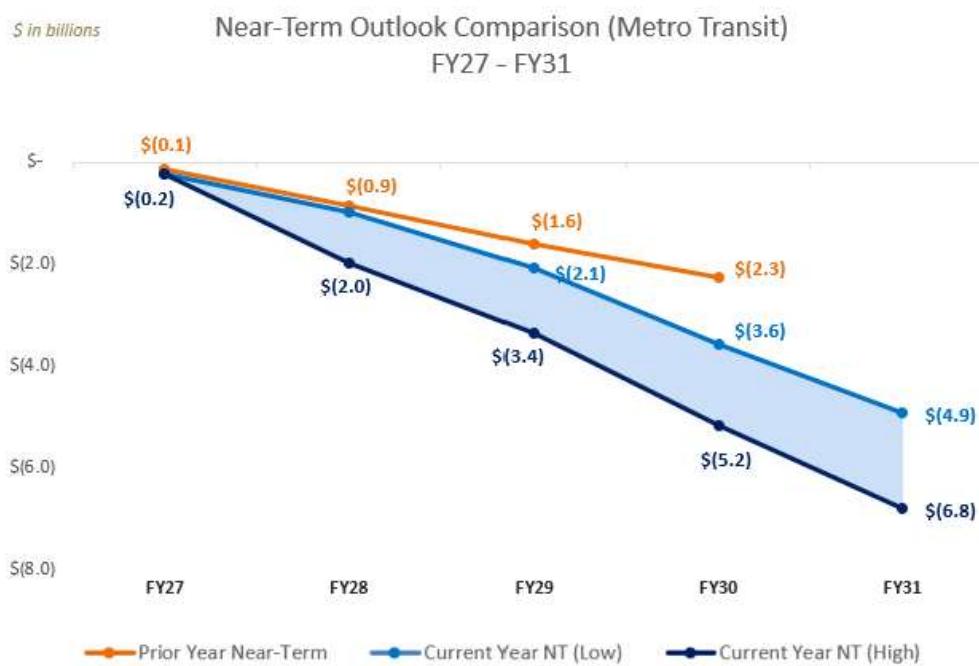
DISCUSSION

Near-Term Outlook Update and Challenges Ahead

Metro continues to emphasize disciplined financial planning in executing its transit investments and sustaining operational excellence. The EZBB cycle commences with the Near-Term Outlook, which presents a five-year financial forecast grounded in a comprehensive assessment of macroeconomic conditions, revenue trends, cost inflation, Board-approved priorities, and major capital investment planning.

The Agency's Near-Term Outlook is in line with FY27. However, starting in FY28, the deficit widens from \$0.9 billion to as much as \$2.0 billion. Looking ahead, Metro projects a cumulative financial gap in the range of \$3.6 to \$5.2 billion by FY30 (Figure 1). The gap is comprised of \$4.3 billion for Metro Transit Operations & Maintenance (O&M) and \$0.9 billion for Metro Transit Capital Improvement Program (CIP).

Figure 1:



Note: These figures do not include cost assumptions for the 2028 Games.

This decline reflects mounting financial pressures primarily driven by the following factors:

- Downward revisions of sales tax revenues based on less favorable trends and indicators. Sales tax revenue is projected to decline by 7% relative to the prior forecast of 2.3%, establishing a lower base for the current planning horizon
- Projected grant reductions of up to 12%, reflecting adjustments in federal and state funding assumptions
- Continued cost growth, including labor, fuel and energy costs, and capital investments

While this projection highlights ongoing fiscal pressures, it also reinforces the importance of proactive financial stewardship and strategic planning. Metro views this outlook as an opportunity to strengthen its long-term fiscal framework through targeted mitigation and continuous improvement initiatives. Metro is actively advancing a comprehensive response that emphasizes:

- Enhanced cost management through data-driven budgeting and operational efficiencies;
- Strategic prioritization of capital investments to ensure alignment with the Board's policy goals and the region's mobility needs;
- Continuous efforts in evaluating revenue generating opportunities

Through these concerted efforts, Metro remains confident in its ability to reduce the financial gap, sustain service delivery, and continue investing in a more connected, sustainable, and equitable transit system for the region.

Revenue Update

One of the first steps in updating the near-term outlook is revising the revenue estimates and projections based on the most recent information available.

Sales Tax Projections

Sales taxes make up over two-thirds of Metro's resources. To provide a realistic near-term forecast, actual FY25 sales tax receipts are used as the base for projections, the FY26 Budget is reassessed based on the available economic data and reforecast as necessary.

The FY25 actual receipts were 6.6% or \$304 million below budget, resulting in a lower base for the current near-term outlook. As a result, this year's five year forecast projects a 7.0% or \$2.4 billion reduction in overall sales tax revenues compared to the prior forecast, primarily due to the lower starting level and lower projected growth rates of 2.3% vs. 2.9% average.

Economic developments such as slower job growth, increasing consumer debt and loan delinquencies, and continued spending shifts to non-taxable categories such as services, health care and housing costs are major drivers eroding consumer confidence and taxable goods sales. Forecasting agencies including UCLA Anderson Forecast, Beacon Economics and Muni Services expect the region's sluggish economic growth to continue into FY27 but gradually improve in the

following years.

Grant Resources

Overall grant resources are decreasing up to 12.2% (\$1.5B) over a five-year period relative to the prior forecast based on the latest grants projections. Federal grant funds savings for Operations is being accelerated in usage due to depletion of one-time stimulus funding by FY27. In addition, reauthorization negotiations at the Federal level have just begun and are difficult to predict.

At the state level, growing budget deficit projections have led to a freeze on the ZETCP program that could impact cash flow or total funding for the program depending on future state budgets. Formula funding from the state fluctuates based on diesel fuel prices and sales but is relatively steady year-over-year.

Grants included in the near-term comprise only those known and highly likely to be received. Given the economic and political uncertainties involved and associated changes in national policies and priorities, additional state and federal funding is difficult to predict at this time.

Metro staff will continue to pursue federal, state and local grant opportunities and present to the Board as additional information becomes available. While a forecast decline of grant funding will place added pressure on local funding resources, staff will also work closely with the region's elected political delegations at both the state and federal levels -along with APTA and the broader transit community-to educate about the needs for and benefits of public transit and advocate for continued and enhanced transportation funding from our external funding partners.

Major Cost Growth Drivers

As Metro moves forward with developing the FY27 Budget, recent trends and changes have been evaluated and projected in the current expense outlook. This report outlines the key developments since the Board Report on Addressing the Fiscal Cliff in June 2025, where staff provided the Board with Metro's workplan, guiding principles, and timeline of managing the projected deficit in the upcoming years.

The following cost drivers constitute the majority of metro transit costs, and their anticipated growth rate continue to outpace projected sales tax revenue growth of 2.3%:

- **Zero-Emissions Bus (ZEB) & infrastructure** costs due to achieving a zero-emission fleet by 2035
- **Cleaning Costs** are driven by Station Innovation Experience initiatives and cleaning frequency, with continued investments in expanding rail system
- **System Expansion** due to at least one major rail opening per year through FY28
- **Labor Cost growth** is expected to continue with the latest collective bargaining agreements starting in the current fiscal year and for the next five years
- **Insurance/WC/PLPD** premiums due to higher loss payment projections and set up of

Department of Public Safety (DPS)

- **Public Safety** Resources: scaling internal Department of Public Safety (DPS) capabilities while maintaining overlapping contractor obligations through the transition period
- **Parts, Fuel & Outside Services** growth driven by inflation, utilities, other parts & supplies and professional services

Additional Risks and Challenges

As Metro continues to implement strategies to mitigate cost growth drivers, it is important to acknowledge that several unquantified risks remain in the current financial forecast. These risks-both external and internal-pose potential implications for Metro's near-term fiscal stability and long-term strategic objectives.

External Risks

Metro operates within a complex and evolving global environment. Several external factors may adversely affect cost structures, funding availability, and financial planning:

- **Geopolitical Instability:** Global tensions and supply chain disruptions may lead to increased procurement costs and material shortages.
- **Potential Tariff Escalations:** Tariff adjustments and import cost fluctuations could elevate Metro's purchase prices for key materials and equipment.
- **Changes in Tax-Exempt Status:** Any revision to Metro's current tax exemption privileges could directly increase operating and capital costs.
- **Federal Funding Uncertainty:** The availability and timing of Federal transit grants and infrastructure program allocations remain uncertain.
- **Persistent Inflationary Pressures:** Sustained inflation continues to weaken purchasing power, elevate contract costs, and strain budget forecasts.

Internal Risks

In addition to external dynamics, Metro faces internal financial pressures stemming from operational, capital, and strategic program commitments:

- **Operational Cost Growth:** The expansion of system operations is projected to outpace available operation-eligible funding, with an estimated 40% funding gap emerging by FY27 and increasing through FY31.
- **Rail Operations Funding Constraints:** Limited eligible funding for rail operations is anticipated to intensify after FY27, following depletion of existing rail balances.
- **Games Readiness:** Preparation and operations for the 2028 Olympic and Paralympic Games without secured supplemental funding presents substantial fiscal and operational risks.
- **Restricted Funding for Underground Construction:** Funding eligibility limitations for underground projects constrain Metro's flexibility in capital deployment.
- **Capital Cost Risks:** Continued cost increases from project scope changes and delays may divert funds from bus and rail operations. Unfunded projects for system expansion integration

also compete for operating funding.

FY27 Equitable Zero-Based Budget (EZBB) Process and Schedule

Metro continues to employ its EZBB process as a year-round strategic framework guiding the development of the FY27 Budget. The process begins with a comprehensive five-year financial outlook, followed by Capital Budgeting to anticipate project and funding needs, ensuring a disciplined approach to cost management and long-term fiscal sustainability.

As Metro navigates an economic slowdown projected to persist into FY27, Metro remains focused on mitigating and deferring near-term deficits through proactive financial management. Efforts will center on preserving core service delivery, advancing key capital priorities, and aligning resource allocation with Metro's strategic and operational objectives.

The FY27 Budget will reflect Metro's enduring commitment to its mission-enhancing transit services, maintaining critical infrastructure, and advancing regional mobility initiatives-while adhering to Board-approved policies, fiscal regulations, and sound financial governance principles.

Metro will continue to collaborate closely with the Board of Directors to ensure alignment on funding priorities and financial strategies. This partnership will be reinforced through monthly program reviews, enabling Metro staff to continuously reassess needs, optimize spending, and uphold budgetary balance.

The table below outlines the monthly schedule of budget development milestones and discussion topics, culminating in the Board's final adoption of the FY27 Budget in May.

Month	Topic
January	Budget Development Process: <ul style="list-style-type: none"> • Updated Near-Term Financial Outlook • FY27 EZBB Development Process and Schedule • Public Outreach and Engagement
February	Budget Development Parameters: <ul style="list-style-type: none"> • Sales Tax Forecast, Resources Assumption • Cost Inflation Estimate
March	Infrastructure Planning and Construction: <ul style="list-style-type: none"> • Transit Infrastructure Expansion • Multimodal Highway Investments • Regional Rail • Regional Allocations and Pass- Throughs
April	<ul style="list-style-type: none"> • Metro Transit - Operations & Maintenance (O&M) and Capital Improvement Program (CIP) • Congestion Management • Planning and Administration
May	Public Hearing and Board Adoption: <ul style="list-style-type: none"> • Consolidated Agency-wide Expenses and FTEs Budget Proposal • Proposed Budget Book published on May 6, 2026 • Public Hearing on May 21, 2026 • Summary of Public Comment and Stakeholder Review • Final Board Adoption on May 28, 2026

FY27 Budget Outreach and Engagement

Metro maintains a commitment to fiscal transparency, utilizing a multi-platform approach including web tools, social media, stakeholder meetings, and on-system rider interactions. The initial phase of Budget outreach and engagement activities has recently commenced. The outreach is strategically focused on engaging riders through diversity, such as targeting perspectives from youth under 18, female riders, the Spanish-speaking community, and riders living in Equity Focus Communities.

The multi-award-winning *My Metro Budget Activity* (<https://mybudget.metro.net/online>) was relaunched in November to deepen public understanding of Metro's budget. The new *My Metro Priorities* tool for riders under 18 (<https://mybudget.metro.net/prioritize>) debuted at the Youth Council Summit in September 2025. Feedback from both tools will inform the FY27 budget beginning in January. Progress and updates on all engagement activities will be reported in forthcoming monthly Budget Board Reports.

EQUITY PLATFORM

As Metro advances the development of the FY27 Budget, the Agency's steadfast commitment to equity continues to guide its financial strategies, investment decisions, and policy implementation. Guided by Metro's Equity Platform Framework, the FY27 Budget process prioritizes equitable

outcomes for everyone while addressing key organizational priorities such as public safety, system cleanliness, system expansion, labor equity, and environmental sustainability. The overarching goal is to deliver a transit system that is efficient, safe, inclusive, and equitable for all Los Angeles County residents and riders.

Metro's EZBB process has been further refined to integrate budget equity tools that strengthen data-driven decision-making. Through the Agencywide Budget Equity Assessment (ABEA) Project, Metro has improved both the procedural and distributional equity aspects of its budgeting framework, expanding analysis beyond geographic proximity or direct impacts to Equity Focus Communities (EFCs).

Historically, Metro utilized two distinct quantitative tools: the Metro Budget Equity Assessment Tool (MBEAT) and the EFC Assessment. While MBEAT provided a more detailed analysis, it was administratively burdensome and did not result in regular data reporting. In contrast, the EFC Assessment offered a more streamlined approach with annual reporting to the Board. Starting with the FY28 Budget, Metro will integrate the strengths of both tools into a single Equity Budget Assessment (EBA). Staff are currently working with departments to refine the data collection and analysis mechanisms, ensuring this unified approach enables continued quantitative tracking, year-over-year analysis, performance monitoring, and transparent reporting. Metro will continue to conduct EFC Budget Assessments for FY25 and FY26 Actuals and report on the outcomes as we transition to the new EBA.

VEHICLE MILES TRAVELED OUTCOME

VMT and VMT per capita in Los Angeles County are lower than national averages, the lowest in the SCAG region, and on the lower end of VMT per capita statewide, with these declining VMT trends due in part to Metro's significant investment in rail and bus transit.* Metro's Board-adopted VMT reduction targets align with California's statewide climate goals, including achieving carbon neutrality by 2045. To ensure continued progress, all Board items are assessed for their potential impact on VMT.

As part of these ongoing efforts, this item is expected to contribute to further reductions in VMT. This item supports Metro's systemwide strategy to reduce VMT through investment activities that will improve/benefit and further encourage transit ridership, ridesharing, and active transportation. Although projects and programs in this budget have mixed outcomes, taken as a whole, most of the investments described in this report will likely decrease VMT in LA County. Within the suite of projects funded in this budget, Metro seeks to reduce single-occupancy vehicle trips, provide a safe transportation system, and increase accessibility to destinations via transit, cycling, walking, and carpooling. Some of the projects funded include items that will ease congestion for cars and trucks, or expand vehicle capacity, resulting in the possibility of increased VMT. However, the investments Metro is making into programs such as rail, bus, active transportation and shared mobility will result in an overall decrease in VMT. Metro's Board-adopted VMT reduction targets were designed to build on the success of existing investments, and this item aligns with those objectives.

*Based on population estimates from the United States Census and VMT estimates from the highway performance monitoring system data between 2001-2019.

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 begin providing regular Budget briefings to Board Members and their staff starting this month. In addition, Metro will submit monthly receive-and-file reports, consistent with the established reporting schedule, and will hold a Budget Workshop for Board members.

Prepared by:

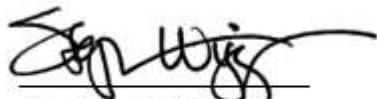
Jeffrey Lopez, Senior Manager, Budget (213) 418-3183

Tina Panek, Deputy Executive Officer, Finance (213) 922-4530

Tim Mengle, Executive Officer, Finance (213) 922-7665

Irene Fine, Deputy Chief Financial Officer (Interim), (213) 922-4420

Reviewed by: Michelle Navarro, Chief Financial Officer (Interim), (213) 922-3056



Stephanie Wiggins
Chief Executive Officer

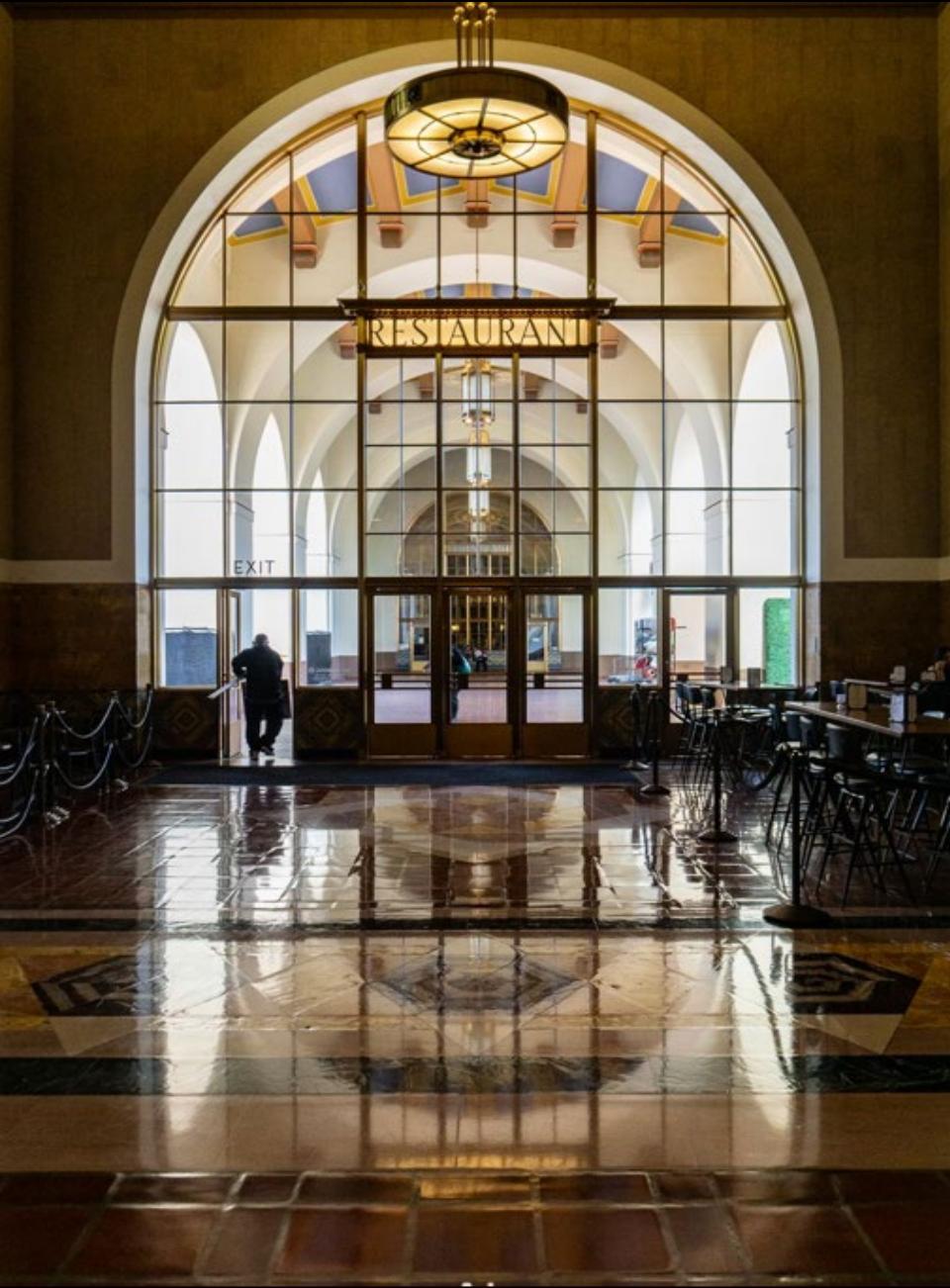


FISCAL YEAR 2027 BUDGET DEVELOPMENT PROCESS

January 2026 | Finance, Budget and Audit Committee



Metro



- FY27 Near-Term Financial Outlook
 - Near Term Outlook
 - Sales Tax Revenues
 - Grant Resources
 - Cost Growth Drivers
 - Additional Risks and Challenges
- FY27 Mitigation Strategy
- Budget Outreach & Engagement
- Next Steps

Near-Term Financial Outlook

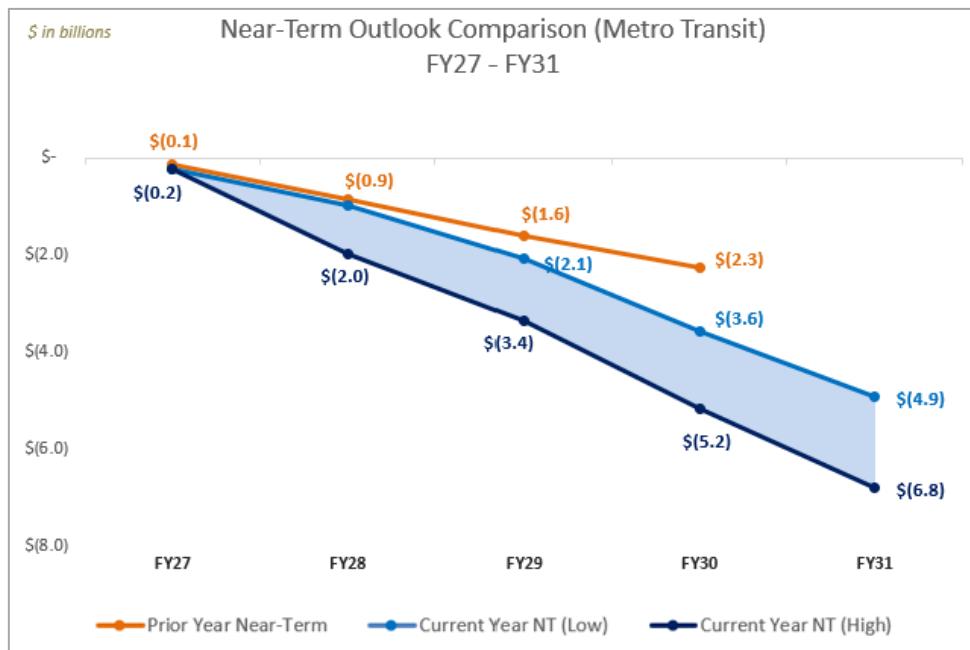
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FOR INTERNAL USE ONLY

- The projected deficit shows a less favorable trajectory compared to prior year's forecast resulting in:
 - FY28 the deficit widens from \$0.9 billion to as much as \$2.0 billion
 - Looking ahead, Metro projects a cumulative financial gap in the range of \$3.6 to \$5.2 billion by FY30
- However, targeted budgeting efforts are continuously pursued per the Equitable Zero-Based Budgeting (EZBB) process to mitigate its effects



Note: These figures do not include cost assumptions for the 2028 Games.

Financial challenges driven by:

01

Sales tax revenue projection **drops 7%** compared to prior year's forecast

02

Overall grant resources are projected to **decrease by up to 12%** relative to the prior year's forecast

03

Continued cost growth, including labor, fuel and energy costs, and capital investments

04

Fund balances continue to be depleted amid a growing transit system and rising operational demands

Sales Tax Revenues



Accounts for about two-thirds of the overall resources



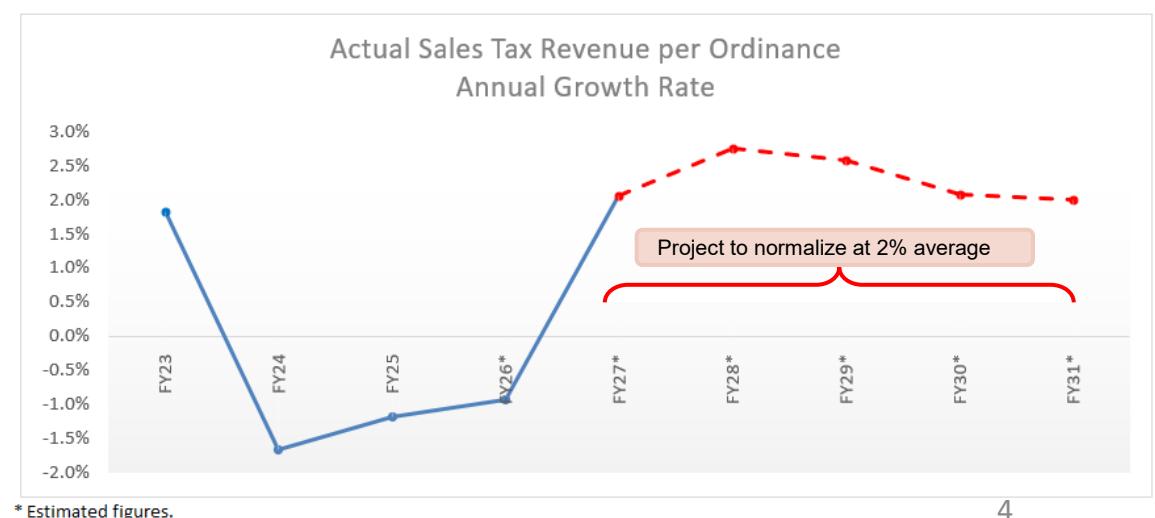
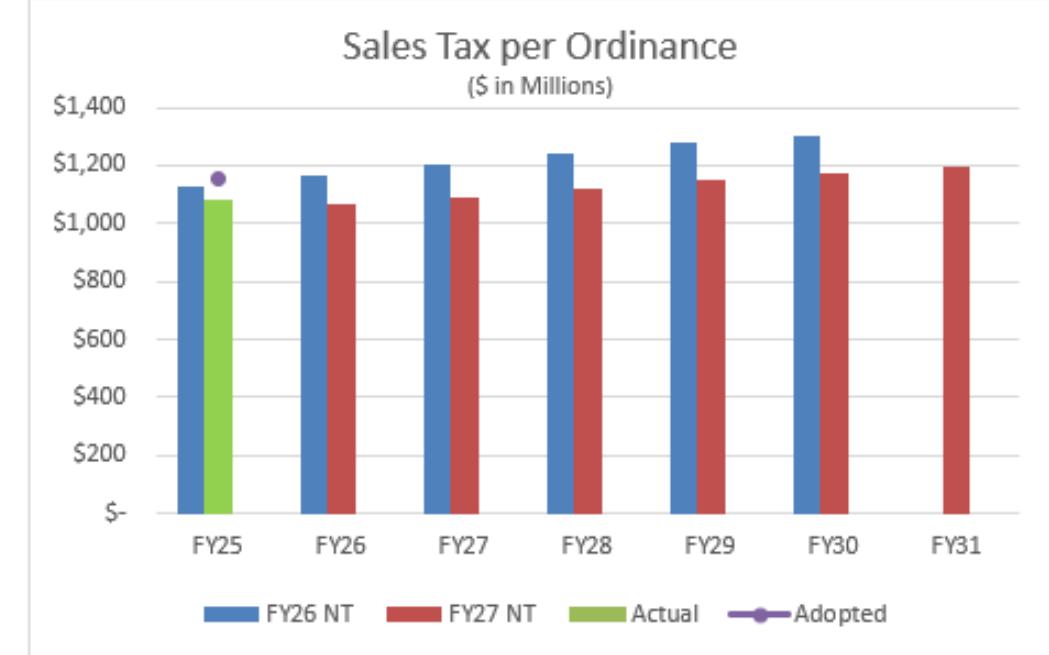
Total projection drops 7% (\$2.4B) compared to prior year's forecast

- FY25 Actuals came in 6.6% below budget, resulting in a lower base for the current near-term
- Economic uncertainties
- Stagnant elevated interest rates
- Shift from taxable goods to non-taxable services
- Volatile energy prices with growing ZEV sales



Assume gradual economic recovery to begin in FY27

- Sales tax growth to normalize at 2% average from FY27 to FY31
- Consistent with leading regional forecasts



Grant Resources

FY
27

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Overall grant resources decreased in a range of 8% to 12% compared to prior year's forecast

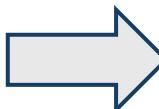
Federal grant funds savings for Operations is being accelerated in usage due to depletion of one-time stimulus funding by FY27

Administrative changes in allocation of federal transportation programs

Federal funding uncertainties

- Reauthorization
- Guidance and eligibility changes

State SB125 -ZETCP funding freeze or delay

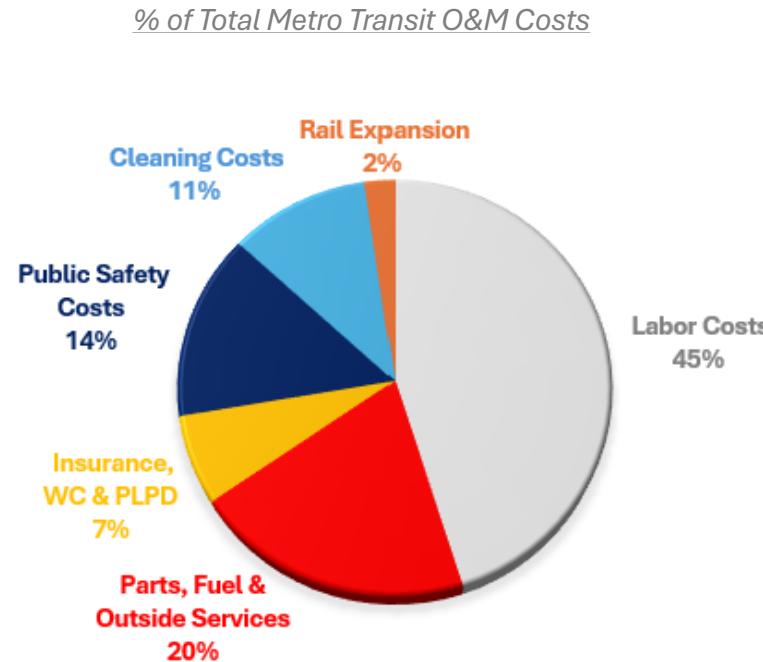


Carryover (savings) accumulated due to draw down of one-time COVID relief fund in FY21 and FY22.



The Agency's Near-Term Outlook through FY31 includes continued cost growth in:

- Metro Transit Operations & Maintenance (O&M) AND
- Capital Improvement Program (CIP)



Major cost growth drivers as a percentage of total Metro Transit O&M costs

Average Annual Growth Over the Next 5 Years

ZEB & Infrastructure –

17.5%

Metro's accelerated Board goal of achieving a zero-emission fleet by 2035 puts further strain on funding needs, for maintaining existing assets in a state of good repair.



Insurance, WC, PL/PD –

7.6%

Incremental growth in insurance premiums, workers' compensation (WC) and property liability and property damage (PLPD) costs due to higher loss payment projections and set up of Department of Public Safety (DPS).



System Expansion – 9.0%

At least one major rail opening per year for next few years leading up to the 2028 Games.



Cleaning – 9.9%

Station Innovation Experience & cleaning frequency with continued investments in expanding rail system.



Labor Costs – 8.3%

Union labor costs have had a historical growth of 5% per year, that is expected to continue over the next 5 years given the recent union contract negotiations.



Parts, Fuel and Outside Services – 2.5%

Metro preliminary cost inflation projection and contract services.



Sales Tax – 2.3 %

Economy is volatile and sales tax revenues are trending down





**Internal
and
Structural
Risk Factors**

- **Operational Cost Growth from System Expansion**
 - ❖ *Depletion of Ops Eligible Funding: ~40% gap in FY27 and growing through FY31*
- **Limited Rail Operations Funding with Expansion**
 - ❖ *Depletion of rail balances after FY27*
- **Olympic Readiness without Assured Supplemental Funding**
 - ❖ *Substantial fiscal and operational risks*

- **Limited Eligible Funding for Underground Construction**
 - ❖ *Closing out and operationalize PLE1, 2, and 3*
- **Capital Cost Risks**
 - ❖ *Continued cost increases from project scope changes and delays may divert funds from bus and rail operations*
 - ❖ *Unfunded projects for system expansion integration also compete for operating funding*

**Geopolitical
Instability**

Volatile geopolitical conflicts can strain financial planning and long-term capital budgets

**Tariff
Escalations
and
Import Costs**

May materially escalate costs and project budgets

**Volatility in
Federal
Funding
Streams**

Uncertainty around Federal transit grants and infrastructure programs

**Persistent
Inflationary
Pressures**

Cost escalation across labor, construction, and operations

Public Outreach & Stakeholder Engagement

Calendar

FY
27



Metro



September



- Launched My Metro Priorities @ September 13th Youth Council Summit
 - **NEW** youth-focused outreach tool

October



- Distribution of Info Cards
 - GoPass
 - Other Metro outreach events
- My Metro Priorities eblast to Transportation Career Academy Program (TCAP), ELT/MIP (Metro entry level and intern staff program)

November



- Launched My Metro Budget Activity
 - Multiple eblasts
- Present to Youth Council & SEED School

December



- Begin Social Media Campaign for My Metro Budget Activity
 - Facebook, Instagram, LinkedIn, Nextdoor
- Distribution of Info Cards
- Regional Service Councils - Meet & Confer
 - All five regions

January



- Distribution of Info Cards
 - LIFE
 - Blue Shirts (Station Staff)
 - Other Metro groups (ongoing)
- Content Creator video
- Multiple eblasts

- Continued My Metro Budget activity promotion via eblast
- Promotion to new Youth Council cohort
- Departments receive internal dashboard

- Community Advisory Committee
- Distribution of Info Cards to Girls Empowerment Summit (WGGC)

- Regional Service Council Meetings
 - In all five regions
- Council of Government (COG) Meetings

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

- Launch public facing dashboard results



February

March

April

May

June

Note: This is a draft. Updated as additional meetings are scheduled.



Budget Development Parameters:

- Sales Tax Forecast, Resources Assumption
- Cost Inflation Estimate

Feb



Infrastructure Planning and Construction:

- Transit Infrastructure Expansion
- Multimodal Highway Investments, Regional Rail
- Regional Allocations and Pass-Throughs

Mar



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

Apr



FY27 Budget: Public Hearing and Board Adoption

May