



Board Report

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FINANCE, BUDGET, AND AUDIT COMMITTEE JANUARY 18, 2023

SUBJECT: FISCAL YEAR 2024 BUDGET DEVELOPMENT PROCESS

ACTION: RECEIVE AND FILE

RECOMMENDATION

RECEIVE AND FILE The Fiscal Year 2024 (FY24) Budget Development Process.

ISSUE

This is the first of a series of monthly updates to the Board to kick-off the FY24 Budget development process, culminating in a planned May 2023 Board Adoption. This report lays the framework for the annual budget development, with the primary objective for the annual budget to achieve Metro's transit and transportation goals, with an equity lens, in a fiscally sound and financially responsible manner.

This report sets up the economic context for the upcoming fiscal year, starting with an updated Near-Term Outlook outlining the revised assumptions for the revenues and expenses over the next 3 years. An outline of the planned Equitable Zero-Based Budget (EZBB) process and schedule follows to address the delivery of Metro objectives in the next fiscal year. During the budget development process, a comprehensive and transparent public outreach engagement has begun to maximize public input and ensure Metro's stakeholders have an active role in the process.

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 is authorized on a life of project basis. Beginning January 2023, staff will begin to provide a series of status updates on the FY24 Budget development process to the Metro Board's Finance, Budget, and Audit Committee.

DISCUSSION

Metro is a regional transportation planner, builder, funder, and transit operator for Los Angeles County. The budget represents an annual snapshot of the agency's needs to continue with the multi-year programs and plans underway. Applying budget resources to these programs is a comprehensive and iterative year-round process.

Near-Term Outlook Update

The three-year Near-Term Outlook (FY24-FY26) shows improvement since twelve months ago. There is both a decrease in the overall affordability gap and the gap is also pushed out from FY24 to FY25 and continuing into FY26. This is mainly driven by better-than-expected sales tax revenue receipts, cost control efforts utilizing the Equitable Zero-Based Budget (EZBB) process, and creation of task forces to mitigate specific areas of concern early on.

The Near-Term Outlook projects an increase in sales tax revenue driven by the FY22 actual receipts due to improved economic conditions, higher inflation, and continuing growth off a higher base. Fare revenue is also projected to increase with the implementation of NextGen and Customer Experience initiatives, although the impacts of fare capping are still estimates. The new rail service expansions are also expected to spur ridership growth. However, the additional revenues are partially offset by the decrease in federal stimulus funding related to the pandemic which are no longer assumed for the outyears due to the nature of this one-time funding ending in FY23. Federal, state, and local grants are expected to increase because of federal formula funds increasing in the Bipartisan Infrastructure Law and higher CPI projections.

The overall expense financial outlook has growing costs driven by escalating electrification efforts, continuation of costs with new lines opening and incremental costs for new initiatives. Additional debt is projected from FY24 to FY26 to cover shortfalls in certain programs; however, new debt issuance will be used as a last resort and is subject to the maximum bonding capacity. Issuing new debt is always weighed carefully in considering higher borrowing costs, negative impact on Metro's credit ratings, inability to spend the bond proceeds in due course due to project schedule changes and decrease in Metro's debt service coverage ratios.

Long term sustainability continues to be a concern, as resources remain scarce for the increasing needs. Therefore, 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.

COVID-19's Impact on Transit Funding

Ridership dropped significantly after the beginning of the COVID-19 pandemic, leaving huge operating shortfalls due to the decline in fare revenue and sales tax revenue. Congress provided

temporary relief, but the funding gap is set to return as the COVID funding is expended. This “fiscal cliff” or affordability gap is an issue facing transit agencies across the nation. The Board approved 2023 Legislative Plan includes advocacy at the state and federal level on this topic.

Equitable Zero-Based Budget (EZBB) Process and Schedule

Building on last year’s foundation, the CEO is reinforcing the budget process by focusing on early public outreach and engagement, and collaboratively developing the agency’s strategic imperatives and priorities with Cabinet leadership. Under our CEO’s leadership, Metro planned early and partnered with an outside consulting company to facilitate structured reflection and planning sessions to maximize the impact of four (4) strategic workshops. These workshops provide a unique opportunity to proactively shape the role of Metro in the foreseeable future, keeping riders at the core of our efforts. The objective of each workshop is as follows:

1. Align on the shared strategic vision and aspiration across the entire LA Metro Leadership team.
2. Define Practices and “ways of working: models that must change - and how those must shift.”
3. Create action plans for each department along with metrics for success; and
4. Assess progress against action plans, adjusting plans as necessary

The strategic imperative and priorities established from these workshops by the CEO and Cabinet leaders will be incorporated into the FY24 Equitable Zero-Based Budget (EZBB) process to help prioritize and benefit our community, including riders, local residents, and other stakeholders. EZBB continues to be the driving force in this year’s annual budget development process and serve as a cost control tool that integrates an equity lens to develop a fiscally responsible budget. The FY24 EZBB 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.

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

Month	Topic
January	Budget Development Process: • Near-Term Update • FY24 EZBB Development Process and Schedule • Preliminary Sales Tax and CPI Forecast • Public Outreach and Engagement
February	Budget Development Parameters: • Sales Tax Forecast, Resources Assumption • Cost Inflation Estimate • Other Expense Assumptions
March	Infrastructure Planning and Construction: • 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	<p>Public Hearing and Board Adoption:</p> <ul style="list-style-type: none"> • Consolidated Agency-wide Expenses and FTEs Budget Proposal • Proposed Budget Book published on May 2, 2023 • Public Hearing on May 17, 2023 • Summary of Public Comment and Stakeholder Review • Final Board Adoption on May 25, 2023

Financial and Cost Management

Metro recognizes that we have a unique opportunity to rethink our current internal processes and put an even deeper focus on our customers, placing them at the center of everything we do. The task forces were developed in FY23 and will continue to undergo a deep dive on expenses and searching for optimal cost mitigation strategies. For Metro Transit, the task forces 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. For our Capital program, the task force has evaluated policies along with internal processes and introduced the Early Intervention Team advancing actions on a number of capital cost mitigation steps coinciding with the CEO’s participation at the White House Roundtable to discuss strategies for lowering infrastructure costs around the nation in December 2022.

Metro is committed to delivering safe and reliable transportation services by monitoring its financial performance and Key Performance Indicators (KPIs) on a quarterly basis. Fiscal Year 2023 Budget was developed through an equity lens and Metro continues to exercise fiscal discipline and accountability by reviewing its available resources and budget usage each quarter. Agencywide KPIs, which aligns to Metro’s strategic imperatives and priorities, were developed around key areas of interest to monitor performance and improvements.

FY24 Preliminary Sales Tax Revenue Forecast

Metro relies on sales taxes for over 60% of its total revenues. In addition, municipal transit providers in Los Angeles County schedule their service levels and operating costs based on our sales tax revenue projections. Metro’s local sales tax ordinances have voter approved directives regarding how each subfund should be spent which limits our ability to deal with unexpected costs not factored into the sales tax ordinance spending plans. These facts necessitate cautious evaluation and forecasting of the sales tax growth rate to determine available funds in FY24.

To forecast sales tax, Metro uses multiple approaches and sources to project and validate estimated sales tax revenues. One model involves examination of the individual economic sector activity to isolate and evaluate the economic changes in specific segments of the economy. The following assumptions will be used to develop projections for FY24:

- Economic growth is anticipated to normalize in FY24 into a less rapid pace resulting in sales tax revenue growth resembling pre-pandemic patterns.

- Thanks to mitigating efforts of the Federal Reserve, FY24 cost inflation, as measured by the Consumer Price Index (CPI), is expected to slow down in FY24.
- A cautionary note from Metro’s paid outside economic forecasting sources warns of a possible recession in FY24 as the Federal Reserve continues to raise interest rates.

Metro staff also uses a technical multiple regression analysis applied to the economic sector performance forecast to validate the business sector model results. This regression model determines the relationship between relevant variables including sales tax revenue, unemployment rate, CPI, and population in Los Angeles County. Historical actuals since FY94 are employed as observations and a regression equation is derived. Internet sales tax impact from the Wayfair decision is also factored. The FY24 sales tax revenue prediction is expected to reconcile closely with the economic sector model projection and staff will update as needed throughout the budget process.

Long term and short term historical actual receipts, and leading professional forecasts of economic trends are also considered in the sales tax growth rate development.

Figure 1 compares Metro’s actual historical sales tax revenue dollars along with estimates from leading regional forecasts for FY18 thru FY22. FY24 sales tax revenue projections from UCLA, Beacon Economics and Muni Services are currently between \$1.0917 billion to \$1.2324 billion per ordinance. Currently, Metro anticipates FY24 sales tax revenues to be in the range of \$1.20 billion and \$1.28 billion per ordinance. This is based on year-to-date actual current year revenues which is higher than the FY23 budget. Staff continues to monitor the actual sales tax receipts. Updated information including Metro’s FY23 Reforecast Budget sales tax revenues and FY24 Assumption data will be presented in the February FY24 Budget Development Board Report.

Figure 1:

Sales Tax Revenue per Ordinance Forecast Comparison

(\$ in Millions)

Forecast Source	FY18	FY19	FY20	FY21	FY22	FY23 Reforecast	FY24 Assumption
1 Actual	\$836.7	\$846.8	\$824.7	\$911.7	\$1,091.5	\$1,150.0 - \$1,200.0	\$1,200.0 - \$1,280.0
2 Metro- Adopted	802.0	844.0	873.0	778.1	865.0	1,031.8	TBD
3 UCLA	810.0	863.6	838.1	770.2	794.4	1,058.1	1,150.4
4 Beacon Economics	816.9	835.4	843.5	892.3	896.7	1,013.4	\$1,091.7 - \$1,232.4
5 Muni Services	803.6	827.7	868.1	737.3	881.7	1,017.1	1,137.6

⁽¹⁾ FY23 Actual and FY24 Assumption will be presented in the February FY24 Budget Development Board Report.

Cost Inflation Indicator - Consumer Price Index (CPI)

On the expense side, Metro program cost and cash flow requirements are impacted by cost inflation, labor contracts agreements and program guidelines. The most common indicator of cost inflation is the CPI as published by the Bureau of Labor Statistics. Accurate sales tax revenues and CPI

projections are important to provide a sound revenue and expenditure budget plan.

Historical trends, recent year’s high inflation, and leading regional forecasts are taken into account when estimating cost inflation. A continued tight labor market, rising demand for consumer goods, and global fuel and goods disruptions are expected to continue pushing prices higher for the remainder of FY23. To tackle the uncomfortably high inflation, the Federal Reserve has executed multiple interest rate hikes in calendar 2022 and signaled intentions to continue rate hikes into calendar 2023. CPI growth rate is therefore expected to stabilize from recent highs and settle in a range of 3.4% to 3.9% in FY24 (Figure 2). We will continue to monitor CPI trends and updates from regional economic forecasting sources and provide final FY24 Assumption for CPI as part of the February 2023 Budget Board Report.

Figure 2:

Annual Change in Consumer Price Index (CPI)

Forecast Source	FY18	FY19	FY20	FY21	FY22	FY23	FY24 Assumption
1 Actual	3.48%	3.40%	2.48%	2.30%	6.54%	4.70% ⁽¹⁾	TBD
2 Metro	1.75%	2.25%	2.28%	2.30%	2.00%	3.30%	3.40% - 3.90%
3 UCLA	2.78%	2.42%	2.60%	2.19%	1.68%	3.78%	3.71%
4 Beacon Economics	2.00%	2.15%	1.83%	2.30%	2.07%	3.86%	2.36%

⁽¹⁾ Reforecasted figure based on FY23 YTD actual. FY23 Adopted Budget is 3.30%.

Public Outreach and Engagement

Engaging Metro customers, key stakeholders and the public through an equitable, transparent, and comprehensive process is vital to fulfilling Metro’s vision and mission. With the goal of continuously improving the budget outreach process, below is a list of engagement and outreach efforts. This year, more emphasis is being placed on marketing that engages with people who reside in Equity Focused Communities (EFC), in an effort to yield more participation from underrepresented communities and riders than previous years. The following engagement efforts have already begun and a detailed plan on the public outreach and engagement efforts will be provided in the next monthly budget update.

Telephone Town Hall Meetings

Metro will continue outreach through a series of Telephone Town Hall (TTH) meetings. This year, public engagement has started early to hear from the public with the first TTH held on October 18, 2022, and two more scheduled in January and March 2023.

My Metro Budget - NEW Budget Tool

A new interactive “My Metro Budget” public learning and feedback activity was created and found at <http://mybudget.metro.net/>. This tool, available in nine languages, focuses on educating the public about Metro’s complex budget and solicit feedback from riders on various budget areas that will help Metro in developing the FY24 budget.

FINANCIAL IMPACT

The assumptions described above are the budget planning parameters and will guide the development of the FY24 Budget. They may be adjusted as more specific and updated information becomes available.

EQUITY PLATFORM

In FY24, staff are undertaking two separate but aligned budget equity exercises. In October, staff completed the FY23 Equity Focus Communities (EFC) Budget Assessment baseline, which was shared with the Board in November (File # 2022-0736). Staff have been directed to use these EFC Budget Baseline results when planning for the FY24 budget, specifically seeking opportunities to increase and/or sustain the FY23 percentage of their budget requests allocated towards EFC benefits, especially targeted benefits.

Staff will also be completing the FY24 Metro Budget Equity Assessment Tool (MBEAT), which has been modified into two questionnaires to best assess equity impacts from Metro's large-scale projects as well as department-level budgets. The Capital Projects MBEAT includes project-based questions that assesses potential impacts to marginalized groups and identifies equity considerations and methods for tracking ongoing impacts to marginalized groups. The Cost Centers MBEAT assess equity in operating budget expenses, including resources allocated to demographic data analysis, inclusive and accessible engagement, and supporting a diverse and inclusive workforce.

Once completed, staff will compile a summary of MBEAT results to support ongoing FY24 budget decisions.

IMPLEMENTATION OF STRATEGIC PLAN GOALS

Recommendation supports the following Metro Strategic Plan Goal:

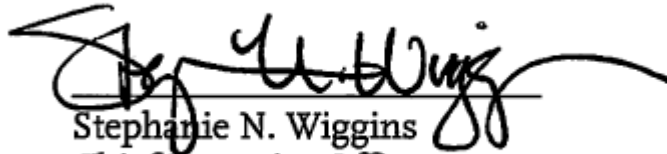
Goal # 5: Provide responsive, accountable, and trustworthy governance within the Metro Organization.

NEXT STEPS

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

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FY24 Budget Development Update

Finance, Budget and Audit Committee

January 18, 2023

Near Term Forecast Update



- COVID-19 constrained operating resources creating Affordability Gap partially mitigated by federal stimulus (*similar to other transit agencies across the nation*)

Affordability Gap shows slight improvement from twelve months ago, but financial challenges still exist in the near-future starting in FY25:

- Sales Tax revenues growing due to economic recovery and higher inflation, however cannot replace the permanent revenue lost at the start of pandemic
- Loss of federal stimulus funding in FY24
- Expenses rising due to:
 - Electrification efforts
 - New rail lines opening
 - New initiatives
- Long term sustainability remains a concern
- Cost control mitigations are still necessary and relevant

EZBB and Financial and Cost Management



- Continue Equitable Zero-Based Budgeting (EZBB) that began in FY23 into FY24 as a cost control tool
- Task forces were established in FY23 and continue to undergo a deep dive on expenses and searching for optimal cost mitigation strategies
- Metro Transit Task forces focused on delivering a more optimal service design as well as conducting bus and rail cost analyses to identify cost saving opportunities
- Capital Program Task Force evaluated policies along with internal processes and introduced the Early Intervention Team advancing actions on several capital cost mitigation steps

FY24 Revenue & Cost Price Index (CPI) Preview

Revenue

- FY24 Assumption in \$1.20B to \$1.28B range
- Economic growth is anticipated to normalize in FY24 resembling pre-pandemic patterns
- Outside economic forecasting sources signal of a possible recession in FY24 as interest rates rise

CPI

- Expected to stabilize from recent highs and settle in a range of 3.40% to 3.90%
- Historical trends, recent year's high inflation, and leading regional forecasts are considered when estimating cost inflation

Metro will continue to monitor and update in next month's budget board report

Public Outreach & Stakeholder Engagement



- October 2022**
 - **Telephone Town Hall**
 - Launch My Budget Tool
Available in 9 Languages
- November 2022**
 - Social Media launch My Metro Budget Marketing
- December 2022**
 - **EFC engagement** for My Metro Budget – physical marketing cards



WE ARE HERE



- January 2023**
 - **Telephone Town Hall**
 - Regional Service Council Budget Briefing
- February 2023**
 - Community Advisory Council - Tentative
- March 2023**
 - Community Advisory Council
 - **Telephone Town Hall**
 - Policy Advisory Council
- April 2023**
 - San Gabriel Valley COG
 - Bus Operators Subcommittee
 - Regional Service Council, Budget Briefing
 - Streets & Freeways
 - Community Advisory Council – General
- May 2022**
 - Technical Advisory Committee
 - Valley Industry and Commerce Association
 - Local Transit Systems Subcommittee
 - San Gabriel Valley COG
 - Bus Operators Subcommittee
 - Accessibility Advisory Committee
 - **Budget Public Hearing**



Note: Updated as additional meetings are scheduled.



ONGOING PUBLIC PARTICIPATION

Schedule & Next Steps



- Near-Term Update
- FY24 EZBB
- Prelim. Sales Tax & CPI Forecast
- Public Outreach & Engagement



- Sales Tax Forecast, Resources Assumptions
- Cost Inflation Estimates
- Other Expense Assumptions



- 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
- Public Hearing
- Board Adoption