



Board Report

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FINANCE, BUDGET, AND AUDIT COMMITTEE FEBRUARY 20, 2025

SUBJECT: FISCAL YEAR 2026 BUDGET DEVELOPMENT PROCESS: NEAR-TERM OUTLOOK AND ANTICIPATED CHALLENGES

ACTION: RECEIVE AND FILE

RECOMMENDATION

RECEIVE AND FILE The Fiscal Year 2026 (FY26) Budget Development Process: Near-Term Outlook and Anticipated Challenges.

ISSUE

This report provides the updated Near-Term Outlook and lays the groundwork for the annual development of the Equitable Zero-Based Budget (EZBB) process. 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 2025 Board Adoption.

In preparation for the FY26 Budget development process, the Office of Management and Budget (OMB) initiated early engagement by providing an oral report to the Finance, Budget, and Audit Committee on November 21, 2024, centered on the recap and assessment of:

- FY24 Year End Preliminary Budget Results
- Metro Transit Cost Growth Drivers
- Transit Infrastructure Development (TID)
- Other Programs
- Revenues Assessment
- Next Steps in Budget Development 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 are authorized on a life of project basis. This month, staff will begin to provide a series of status updates on the FY26 Budget development process to the Board's Finance, Budget, and Audit Committee.

DISCUSSION

Near-Term Outlook Update and Challenges Ahead

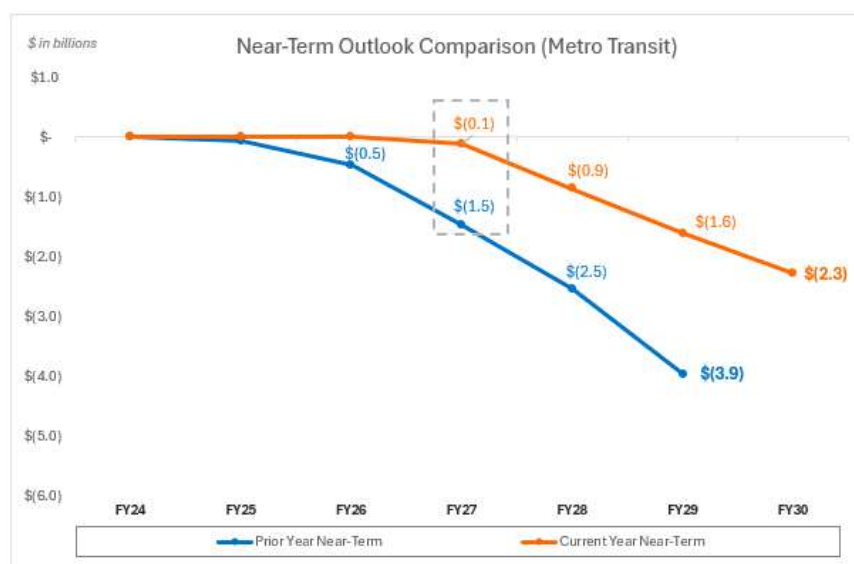
Metro consistently underscores the critical role of sound financial planning in effectively executing transit investments and operational strategies. The EZBB cycle begins with the Near-Term Outlook, which sets forth a five-year financial forecast grounded in a comprehensive evaluation of the economic landscape, revenue projections, ongoing programs, market cost escalations, Board-approved priorities, and the planning of major capital investments.

The Agency's Near-Term Outlook has improved from twelve months ago from \$1.5 billion deficit to \$0.1 billion in FY27 (Figure 1) due to:

- 1) Zero-Emissions Bus (ZEB) and infrastructure revised forecast as well as incremental grant revenues from SB125 ZETCP
- 2) Constrained and prioritized budgeting efforts through the EZBB process
- 3) Delayed spending on capital projects based on year-end actuals
- 4) Board approved policy changes to newly established Transit Community Public Safety Department (TCPSPD) is expected to result in gradual reductions in contract costs.

However, the Agency is committed to continuing its mitigation efforts as a cumulative financial gap of \$2.3 billion is anticipated by FY30 (Figure 1). The gap is comprised of \$1.3 billion for Metro Transit Operations & Maintenance (O&M) and \$1.0 billion in Metro Transit Capital Improvement Program (CIP) due to continued cost growth, increasing at a faster rate than projected sales tax and operating revenues.

Figure 1:



Major Cost Growth Drivers

As Metro advances its preparations for developing the FY26 Budget, staff has assessed the recent developments and expense outlook. This report outlines the key developments since the Special Board Workshop in March 2024, where Metro staff provided the Board with an in-depth analysis of the projected financial outlook for the Metro Transit program, facilitating a thorough assessment of the cost growth drivers and their implications for Metro's operational program delivery.

The Agency's Near-Term Outlook through FY30 includes continued cost growth in Metro Transit O&M and CIP in the following areas (Figure 2):

- Public Safety
- Cleanliness and Station Experience Expansion
- System Expansion
- Labor Costs
- Workers Compensation (WC), Personal Liability and Property Damage (PLPD) and Insurance Market Premiums
- Zero-Emissions Bus (ZEB) and Infrastructure
- Major Capital Project Risks

The cost growth drivers are presented in Figure 2, which highlights the anticipated growth rate of every cost driver in comparison to the prior year's projections. While every operational cost growth driver is anticipated to grow at a faster rate than projected sales tax revenues at 2.9%, there are a few areas where the growth has slowed:

- **Public Safety** due to Board Approval in establishing the Transit Community Public Safety Department (TCPSPD) which is expected to reduce contract costs over time.
- **Insurance/WC/PLPD** premiums by reinstating the Operations Safety Steering Committee

(OSSC), which meets quarterly to review risk exposure trends and evaluate mitigation measures

- **Zero-Emissions Bus (ZEB) & infrastructure** costs due to forecast revision

Figure 2:

5 Year Near-Term Outlook						
Cost Growth Drivers (in \$ Millions)	FY25		Current Near-Term Outlook		Avg Annual Growth Rate	Avg Annual Growth Rate (FY24-29)
	Adopted	FY30 Forecast	(FY25-30)		(FY25-30)	% Change
Labor Costs	\$ 1,188.5	\$ 1,559.1	\$ 8,148.0		5.6%	5.5% 0.1%
Parts, Fuel & Outside Services	714.1	961.4	5,019.4		6.1%	3.5% 2.6%
Public Safety	351.2	420.5	2,472.8		3.7%	6.2% -2.5%
Cleaning	248.0	347.5	1,794.1		7.0%	5.5% 1.5%
Insurance, WC, PL/PD	192.3	253.6	1,336.7		5.7%	11.1% -5.4%
System Expansion	15.2	113.0	457.2		7.0% *	7.2% -0.2%
TOTAL O&M	\$ 2,709.3	\$ 3,655.1	\$ 19,228.1		6.2%	6.5% -0.4%
ZEB and Infrastructure	\$ 107.8	\$ 436.9	\$ 2,133.3		32.3%	54.7% -22.4%

* System expansion growth based on total rail.

The remaining cost growth drivers remain relatively flat or continue to grow due to the Agency's continued investments:

- **Labor Costs** remain relatively flat even after incorporating the increases in the latest collective bargaining agreements starting in the current fiscal year and for the next five years
- **Parts, Fuel & Outside Services** growth driven by high inflation, propulsion power, utilities, other parts & supplies and professional services
- **Cleaning Costs** are driven by Metro's strategic investment in the expansion of its Station Experience initiatives and implementing technological innovations (i.e., Intelligent Cleaning Equipment (ICE) auto-scrubbers, Elevator Open Door Program, etc.)
- **System Expansion** remains relatively flat, with annual openings through FY30, which will strengthen connectivity and enhance integration across our transit network

Attachment A further outlines the updated assumptions in the latest Near-Term forecast surrounding the cost growth drivers.

Additional Risks and Challenges

As Metro works to mitigate the cost growth drivers, there are additional risks and challenges that have not been quantified in the current forecast, which may impact the Agency in the Near-Term. Some of the external risks include:

- Geopolitical uncertainty
- Potential increases in tariffs and their impact on Metro's purchase price
- Change in tax exemption status

- The availability and impact of traditional Federal programs and grants
- Ongoing inflationary pressures

Additionally, there are also internal factors that add financial pressure to the Agency:

- Operating Metro's system in the future with the expanding rail system will be more costly than operating the same level of service today. The average cost of running one hour of rail is 2.2 times more than operating one hour of bus service.
- The ongoing financial risks that stem from capital cost increases due to scope and project schedule changes may take away funding eligible for bus and rail operations if no alternative funding source is identified.
- Preparation for the 2028 Olympic and Paralympic Games in the absence of additional funding presents significant challenges.

FY26 Equitable Zero-Based Budget (EZBB) Process and Schedule

Metro is continuing to utilize the year-round EZBB process for its FY26 Budget development, starting with the five-year financial outlook followed by Capital Budgeting to anticipate project needs, while focusing on cost management and sustainability. Metro will continue its efforts to mitigate and defer the Near-Term deficit, managing through the economic slowdown that is expected to linger into FY26 while focusing on Agency priorities that require continuous investment.

The FY26 Budget will align with Metro's mission to enhance transit services, maintain infrastructure, and plan for regional projects, adhering to regulations and board-approved policies. Metro will continue collaborating with the Board of Directors with the goal of developing a balanced budget supported by monthly program reviews to reassess needs.

A schedule of budget updates will be presented, concluding with the Board's final adoption in May.

Month	Topic
February	Budget Development Process: • Updated Near-Term Financial Outlook & Cost Drivers • FY26 EZBB Development Process and Schedule • Public Outreach and Engagement 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 29, 2025 • Public Hearing on May 15, 2025 • Summary of Public Comment and Stakeholder Review • Final Board Adoption on May 22, 2025

Early and Expanded Public Outreach and Engagement

Metro remains dedicated to fostering transparency with riders, the public, and stakeholders. To uphold this commitment, the budget outreach process continues to engage the public through both traditional and new methods. This includes social media campaigns, stakeholder meetings, and outreach directly on the system with informational flyers. Updates on the budget outreach will be shared in the upcoming monthly reports.

FY26 My Metro Budget Activity

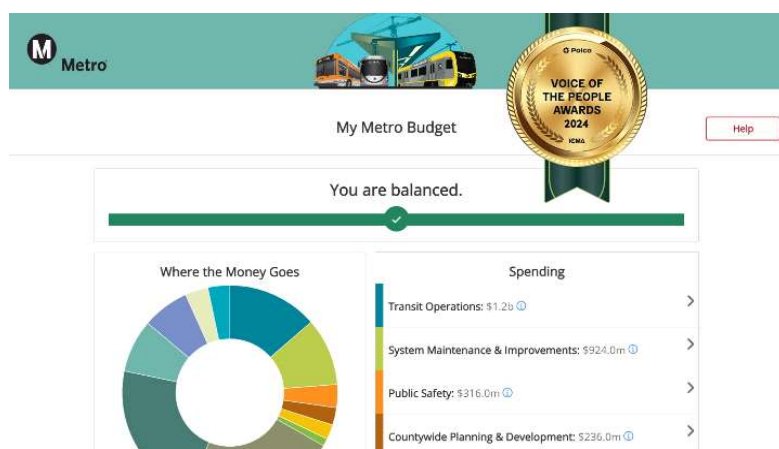
The My Metro Budget Activity, a national award-winning initiative, promotes education and transparency around Metro's budget. Recognized by the International City/County Management Association (ICMA) with the Voice of the People (VOP) Award for Excellence in Budget & Finance (Figure 3), the program highlights effective community feedback and data-driven decision-making.

Following previous years, a social media campaign is focused on engaging Spanish-speaking, female, and community college student riders, while Equity Focus Communities (EFCs) remain

central to the engagement efforts. Metro station staff and internal groups such as LIFE, Metro Micro, and the On the Move Riders Club are distributing information cards to engage underrepresented groups and riders.

The Fiscal Year 2026 (FY26) activity, launched in October 2024, can be accessed at mybudget.metro.net <<https://mybudget.metro.net/>>.

Figure 3:



New Tactics & Features

Metro continues to improve the budget activity based on feedback received and advancements in technology and incorporates the following new features and tactics:

- The activity includes over 90 unique categories for public comment
- Four new scenario questions
- Translations in nine languages to increase accessibility
- Metro is utilizing the new Community Based Organization (CBO) Database from the Office of Equity & Race for an informational campaign to increase participation of Youth Groups.
- Leveraging Artificial Intelligence (AI) to better analyze the written comments
 - o Categorization of comments for departments
 - o Summarization by topic
 - o Sentiment analysis

The feedback collected will be shared with Metro departments starting in January and will play a vital role in shaping the FY26 budget.

Future Initiatives and Staying Updated

A Budget Telephone Town Hall was held on Tuesday, February 4, 2025. This live, interactive forum is ideal for residents who cannot attend in-person meetings or participate online. Metro will request written comments in advance, with attendees also having the opportunity to ask questions and provide live feedback.

As the FY26 budget develops, further updates on outreach initiatives will be provided. Stay informed at the Budget Portal: <https://budget.metro.net>.

EQUITY PLATFORM

As we move forward with the development of the FY26 Budget, our commitment to equity will continue to guide our approach and decisions. While addressing public safety, cleanliness, system expansion, labor equity, and environmental sustainability, we strive to create a transit system that is not only efficient and safe but also inclusive and equitable for all Los Angeles residents and riders.

Additionally, Metro's EZBB processes will undergo enhancements following the recent awarding of a contract for an Agencywide Budget Equity Assessment. The assessment will refine Metro's budget tools and process to better incorporate both procedural and distributional equity considerations, extending beyond the analysis of impact or proximity to Equity Focus Communities (EFCs). Metro will continue to conduct the EFC Budget Assessment for FY24 Actuals and FY26 Proposed Budget and analyze the FY26 budget against budget equity principles as aligned with Metro's Equity Platform framework. However, the Agency will not be applying the Metro Budget Equity Assessment Tool (MBEAT) to the FY26 capital and operating budgets until the consultant's assessment is completed.

VEHICLE MILES TRAVELED (VMT) 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.

While this item does not directly encourage taking transit, sharing a ride, or using active transportation, it is a vital part of Metro operations, as it reflects the agency's commitment to fiscal discipline while making the investments needed to ensure a safe, clean, comfortable, reliable, and easy ride for all patrons. Because the Board has adopted an agency-wide VMT Reduction Target, and this item supports the overall function of the agency, this item is consistent with the goals of reducing VMT.

*Based on population estimates from the United States Census and VMT estimates from Caltrans' Highway Performance Monitoring System (HPMS) 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 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.

ATTACHMENTS

Attachment A - FY25 30 Near-Term Cost Growth Drivers

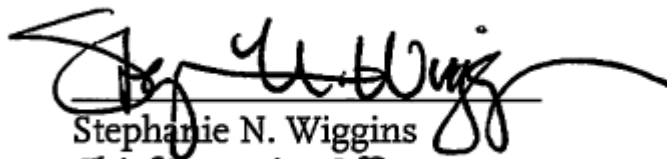
Prepared by:

Tina Panek, Sr. Director, Finance (213) 922-4530

Irene Fine, Sr. Executive Officer Finance, (213) 922-4420

Michelle Navarro, Sr. Executive Officer Finance, (213) 922-3056

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



Stephanie N. Wiggins
Chief Executive Officer

FISCAL YEAR 2026 BUDGET DEVELOPMENT PROCESS

Near-Term Forecast Update and Assumptions on Cost Growth Drivers

The Agency's Near-Term Outlook through FY30 includes continued cost growth in Metro Transit O&M and CIP in the following areas:

Public Safety

- In response to societal issues that have caused violence and criminal activity within the Metro bus and rail system—resulting in fatalities, injuries, and increased safety concerns for riders and frontline employees—the Metro Board of Directors took decisive action by introducing Metro Public Safety Surge Board Motion 31 on May 23, 2024.
- In June 2024, in line with the In-House Public Safety Implementation Plan Board Motion 21.1, the Metro Board approved the establishment of the Transit Community Public Safety Department (TCPSPD). With TCPSPD, law enforcement costs are trending down as a percentage of total public safety costs.
- In response to Board Motion 34.1, and ongoing commitment to enhancing public safety, Metro is expanding its strategies by investing in a new pilot for taller fare gates, expanding the current TAP-to-Exit pilot, and launching a pilot for concealed weapons detection system.

Cleanliness and Station Experience Expansion

- Metro remains steadfast in its commitment to upholding the highest standards of cleanliness and has made a substantial investment to bolster its cleaning operations, including the recruitment of custodial and facilities maintenance staff and increasing the frequency of cleanings.
- The Agency has expanded several of its Station Experience strategies and made several key enhancements including improvements in lighting, ventilation, fare gates, surveillance systems, elevators, escalators, and restroom facilities.
- Technological innovations are also implemented, including Intelligent Cleaning Equipment (ICE) auto-scrubbers, Elevator Open Door Program, classical music on platforms, testing commercial-grade vacuum cleaners for track maintenance, and piloting the use of bear-resistant trash receptacles.

System Expansion

- As part of Metro's growing system expansion, the LAX/Metro Transit Center is scheduled to open soon, offering customers transit access to LAX in two phases: (1) the launch of a new Aviation/Century station and (2) reconfiguration of the C Line and K Line. Additionally, a new security facility, Metro Center, is ramping up to be fully operational.

Attachment A

- At the July 2024 Board meeting, the Board approved amending the FY25 Budget to add Full-Time Equivalent (FTE) positions to support the LAX/Metro Transit Center and support the systemwide security services at Metro Center.
- Given the expanding system – at least one major rail opening annually leading up to the 2028 Games which assumes additional resources and staff will be needed to support these efforts.

Labor Costs

- Throughout 2024, staff facilitated workshops for Labor and Management to discuss mutual interests, foster collaboration, and engage in contract negotiations with four of the five unions (ATU, TCU, AFSCME and TEAMSTERS).
- As a result, the FY25 Budget was amended to reflect the finalized four collective bargaining agreements (CBAs), which includes an average annual salary increase of 4.4% over the five-year term, along with a 0.25% quarterly wage adjustment each year. Health and welfare benefit increases are also incorporated by the contract terms.

WC, PLPD and Insurance Market Premiums

- Workers' Compensation (WC) Division partnered with Bus Operations, Corporate Safety, and the Return-to-Work Program, prioritizing meetings with divisions experiencing high volume of claims, effective December 2023, highlighting discussions around claims investigations, Transitional Duty Program enhancement, and Safety Specialists' visibility at divisions.
- The Return-to-Work program has enhanced transitional duty opportunities. Corporate Safety has increased visibility at the divisions, is attending Local Safety Committees, and promotes a wide array of Safety programs, including de-escalation training and bus barrier retrofits.
- To mitigate the cost of insurance driven by the hard market, Metro has issued a Request for Proposal (RFP) for insurance services, allowing Metro to test the market to ensure it receives the most competitive rates.

Zero-Emissions Bus (ZEB) and Infrastructure

- Recently, Metro released a Request for Proposal (RFP) to procure 1,980 zero-emissions buses (ZEBs), marking the largest ZEB order in U.S. history. This initiative is a key component of Metro's goal to achieve a fully zero-emission fleet by 2035, which will require a minimum investment of \$2.1 billion in both buses and charging infrastructure over the next few years.
- New zero emission bus acquisitions and supporting infrastructure development will proceed as available industry infrastructure, manufacturing capacity, available technology, and funding permit.

Attachment A

- In response to the Zero Emission Buses Motion 31.1 Metro staff provides quarterly updates to the Board of Directors on electrification efforts with revised forecasts

Major Capital Project Risks

The Agency still faces ongoing cost escalations in its major capital projects with scope modifications, schedule changes and project close-out risks and will continue to conduct project reviews to mitigate these challenges. Due to these cost escalations with lower sales tax received vs. ordinance projections, we are seeing a financial gap in the Transit Infrastructure Development (TID) program. Metro may be able to mitigate a portion of the gap by issuing debt within debt capacity limits. However, there remains the risk of drawing down operational eligible funding which impacts bus and rail service.



FISCAL YEAR 2026 BUDGET DEVELOPMENT PROCESS – NEAR-TERM OUTLOOK AND ANTICIPATED CHALLENGES

February 2025 | Finance, Budget and Audit Committee





1. Near-Term Financial Outlook

- Near Term Outlook Deficit
- Cost Growth Drivers Summary

2. Additional Risks and Challenges

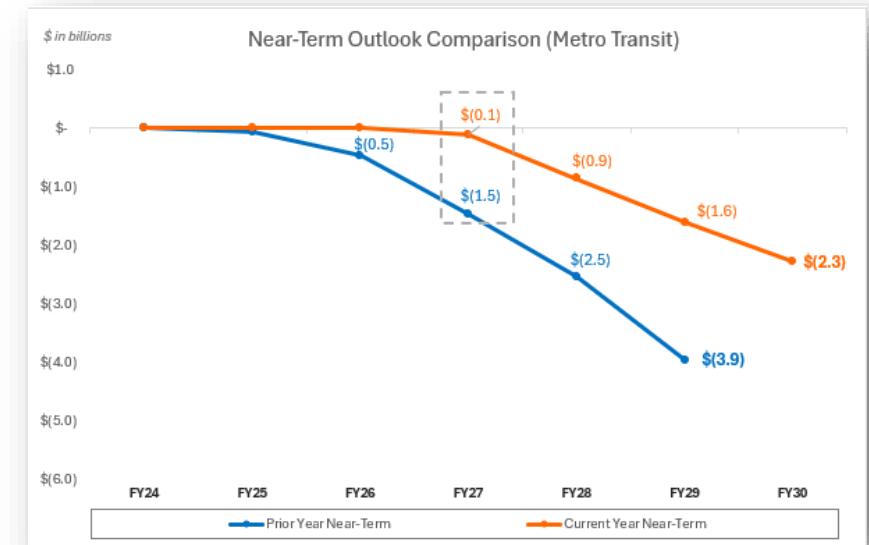
3. FY26 Equitable Zero-Based Budgeting (EZBB)

4. Next Steps



FOR INTERNAL USE ONLY

- The Agency has improved **prior year's Near-Term** cumulative gap of \$1.5 billion in FY27 to \$0.1 billion per **current year's Near-Term** outlook as a result of:
 - Zero-Emissions Bus (ZEB) & infrastructure revised forecast
 - Incremental grant revenues from SB125 ZETCP
 - Constrained and prioritized budgeting efforts through the Equitable Zero-Based Budgeting (EZBB) process
 - Delayed spending on capital projects based on year-end actuals
 - Board approved policy changes with newly established Transit Community Public Safety Department (TCPSP)
- However, a cumulative gap of \$900M remains by FY28 growing to \$2.3 billion by FY30 between the two programs:
 - Metro Transit Operations & Maintenance (O&M): cumulative \$1.3 billion deficit through FY30
 - Metro Transit Capital Improvement Program (CIP): cumulative deficit of \$1.0 billion through FY30



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

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5 Year Near-Term Outlook							
Cost Growth Drivers (in \$Millions)			Current Near-Term Outlook (FY25-30)	Avg Annual Growth Rate (FY25-30)	Avg Annual Growth Rate (FY24-29)		% Change
	FY25 Adopted	FY30 Forecast					
Labor Costs	\$ 1,188.5	\$ 1,559.1	\$ 8,148.0	5.6%	5.5%	0.1%	
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ZEB and Infrastructure	\$ 107.8	\$ 436.9	\$ 2,133.3	32.3%	54.7%	-22.4%	

* System expansion growth based on total rail.

- The remaining cost growth drivers are relatively flat or growing due to increased investments:
 - Labor Costs** remain relatively flat even after incorporating the increases in the latest collective bargaining agreements starting in the current fiscal year and for the next five years
 - Parts, Fuel & Outside Services** growth driven by high inflation, propulsion power, utilities, other parts & supplies and professional services
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 - System Expansion** remains relatively flat with annual openings through FY30, which will strengthen connectivity and enhance integration across our transit network



- As Metro works to mitigate the cost growth drivers presented in the Near-Term Outlook, there are additional risks and challenges that have not been quantified in the current forecast.
- These additional risks that may impact the Agency in the Near-Term include:
 - Geopolitical uncertainty
 - Potential increases on tariffs and impact to Metro's purchase price
 - Change in tax exemption status
 - The availability and impact of traditional Federal programs and grants
 - Ongoing inflationary pressures
- Internal factors that also add financial pressure to the Agency include:
 - Operating Metro's expanding rail system in the future will be more costly than operating the same level of service today
 - Ongoing financial risks that stem from capital cost increases which may impact operations eligible funding
 - Preparation for the 2028 Olympic and Paralympic Games in absence of additional funding presents significant challenges



- FY26 EZBB objectives:
 - Collaborate internally and with the Board of Directors to implement cost controls and develop a balanced budget with limited resources
 - Continue efforts to mitigate and defer the Near-Term deficit
 - Manage through economic slowdown that is expected to continue into the better part of FY26
 - Continue to invest in the major cost growth drivers
- Development of program budgets will consider:
 - Actual spending trends
 - Capital project cashflows based on phase and schedule
 - Sustaining levels of bus and rail service as well as adjusting for new rail openings
 - Agency priorities that require continuous investment





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.



FY26 Proposed Budget:

- Public Hearing and Board Adoption

May