

**Board Report**

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**File #:** 2018-0292, **File Type:** Plan**Agenda Number:** 13.

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**PLANNING AND PROGRAMMING COMMITTEE  
SEPTEMBER 19, 2018****SUBJECT: SHORT RANGE FINANCIAL FORECAST****ACTION: RECEIVE AND FILE****RECOMMENDATION**

RECEIVE AND FILE the Short Range Financial Forecast (Attachment A) and financial outlook.

**ISSUE**

The Financial Forecast is Metro's financial plan for capital and operating costs, which is updated and presented to the Board annually for approval of the "fund type assignments," or allocation of Metro funds among projects and programs. The Financial Forecast has historically been presented with a 20- to 40-year horizon. This Board report introduces the Short Range Financial Forecast (SRFF) as a focused plan for the first 10 years of the Financial Forecast (FY 2019 to FY 2028). Over the next 10 years, Metro has an ambitious \$71.1 billion transportation capital and operating program.

**BACKGROUND**

Metro maintains a 40-year long-range Financial Forecast, which is Metro's mechanism to identify funding for all Board-approved projects and programs. The Financial Forecast is a financial strategy for all capital and operating costs, and the fund assignments, or the allocation of funding among projects and programs. It determines the needed resources to deliver Metro's commitments on schedule and the direction for Metro staff to pursue the funding on the approved uses.

**DISCUSSION**

Metro staff last provided a Financial Forecast update to the Board in October 2017 and, prior to this, in June 2016 as part of the Board's consideration of the Measure M Ballot Measure. Metro staff now recommends the companion preparation of a SRFF which represents the first 10 years of the Financial Forecast. A 10-year forecast focuses on Metro's more refined financial estimates - the Metro annual budget, detailed project cost estimates, awarded grant receipts, and approved contract expenditures. Metro's longer term financial projections, although necessary for planning purposes, are subject to greater variability, which increases the longer the term of the projection. There is still a need for the 40-year forecast, as this supports Metro's LRTP and identifies a viable framework for funding Metro's long-term goals. The 40-year Financial Forecast will continue to be prepared by

Metro staff and presented to the Board as part of the next LRTP update.

The SRFF includes prior Board-approved spending that has been submitted in Metro's adopted transportation plans (LRTP and Short Range Transportation Plan), sales tax ordinance expenditure plans, annual budgets, capital life-of-project budgets and other Board actions. Operating costs for bus and rail are based on projections by Metro staff. Revenues from Metro's local sales tax measures, state and federal formula programs, and state and federal discretionary grants, are also based on Metro staff projections (which may rely on state, federal, or other third-party information). The SRFF includes state SB-1 grant awards that were announced in April and May 2018.

The SRFF, including the fund assignments, are provided in Attachment A. It presents the 10-year projections of sales tax, operating revenue, grant revenue, and debt financing; expenditures by major cost category; grant receipts by grant program and Metro project; Enterprise Fund cash flows; annual capital project expenditures; Metro subsidies to sub-recipients; and Metro fund balances. It thus provides a critical benchmark for identifying financial resources in aggregate, by fund type, for specific programs, projects and services. Funding actions such as grant applications, state and federal program development, and proposals for project acceleration should align with the SRFF to ensure funding decisions are sound, and their impacts sufficiently vetted. The recommended annual update of the SRFF will allow adjustments to be made over time as new financial information is available. Attachment B provides project profiles for key Metro projects.

### Financial Outlook

Metro's financial outlook benefits from continued robust sales tax receipts. Metro's relatively large capital program and bus and rail operations are primarily funded from the four existing 0.5% sales taxes. The FY 2019 budget has a 5.2% increase (Proposition A and C, Measure R) in comparison to the FY 2018 adopted budget, and should this growth occur, it will provide a higher base for future sales tax receipts. Metro's 2017 economic forecast (provided by UCLA) has an average 3.8% growth in taxable sales over the next 10 years. The strong sales tax growth is expected to fund its share of Metro's capital and operating commitments, as planned and on schedule.

Other Metro financial indicators also demonstrate a strong financial position. Cash balances are stable and increasing due to the recently implemented Measure M sales tax, and the amount of debt and debt service has been moderate over the most recent five years. Outside reviewers of Metro's financial condition - the bond rating agencies and the Federal Transit Administration (as part of Metro's grant applications) - continue to give the agency high marks. However, as Metro implements the Measure R and Measure M capital plans, the SRFF shows a growing issuance of debt and use of cash balances, which will reduce Metro's liquidity and perceived financial strength. In addition, Metro continues to experience cost pressures from higher bus and rail operating expenses, increases in the estimated cost of major capital projects, the acceleration of existing projects, and the addition of new projects, which all require additional funding resources.

### *Ridership and Operating Expenses*

Ridership continued to decline in FY 2018 (down 3.1% for the period July 2017 through June 2018) which reduced Metro's operating revenue. Concurrently, Metro's budgeted operating costs increased

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by \$90.4 million (5.3%) in FY 2019 vs FY 2018. Both factors result in an increase in the sales tax subsidy - the amount of sales tax that funds bus and rail operations, in order to maintain current levels of service. Should this trend continue, operations will require an increasing share of Metro's funding resources that will leave less available for Metro's current commitments and any additional new projects and programs.

### *Capital Costs*

Metro experienced cost increases on two major transit projects in FY 2018 that each exceeded \$100 million. The higher costs will divert funding from other Metro uses and potentially require additional Metro debt financing. In addition, Metro is developing several other major transit and highway projects, and the ultimate cost for the projects may be higher than the planned cost and allocated funding in the LRTP, as updated. As Metro does not have unlimited financial capacity, it must responsibly plan within a funding envelope of reasonably available funds. Since Metro has allocated much of that funding for Board-approved projects and programs, future cost increases will similarly stress the funding envelope capacity and could result in additional debt financing that was not planned.

In addition to Board-approved projects and programs, Metro continues to identify new capital needs. These potential new capital projects may enhance the transportation system, address inadequate existing infrastructure, or be essential to our operations or regulatory compliance. Projects that have been identified in concept and may be presented to the Board for funding include: a re-scoped Division 20 turnback facility, electrification of the bus system, Link US, additional Tier 1 Express Lanes, Rail Operations Center (ROC) expansion, and I-210 Median Barrier. Metro has not allocated all funding for these projects in the LRTP, as updated, and the projects will require additional funding, which may be available from new or discretionary local, state, and federal sources, additional debt financing, or reprioritizing spending on other planned Metro projects.

### *State and Federal Grants*

Metro benefits from state and federal grant funding and has historically been successful in competing for the discretionary components of this funding. Metro received state and federal grant awards in April and May 2018 of \$1.7 billion through the SB-1 and INFRA grant programs. However, Metro does face a tenuous state and federal grant funding environment. The SRFF assumes ongoing receipts (of Metro's "fair share") over the next 10 years from the relatively new SB-1 grant programs and the longstanding federal New Starts programs. SB-1 is subject to a repeal vote in November and, if passed, would eliminate approximately \$4.9 billion of Metro grant receipts from the SRFF. The New Starts program does not currently have unanimous federal support, yet Metro anticipates \$1.3 billion of funding for Westside Purple Line Section 3. A loss of the New Starts funding will require supplemental funding, which may be available from new or discretionary local, state, and federal sources, additional debt financing, or reprioritizing spending on other planned Metro projects.

### Risk Assessment

Metro staff can quantify the impact of Metro's primary financial risks that would aid the Board's evaluation of future decisions, and prepare hypothetical scenarios of potential downside outcomes of our revenues and costs.

- If sales tax over the next 10 years falls by \$1.8 billion (which would occur if receipts in FY 2020 decreased by 1% in comparison to the prior year), this could delay the delivery of 10 capital projects up to 3 years, and require a diversion of sales tax for bus and rail operations.
- If our ridership or fare revenue does not improve from FY 2019 levels, and costs moderately increase over the next 10 years, Metro's operating subsidy from sales tax will increase by \$1.0 billion.
- If SB-1 grant programs are eliminated in FY 2019, Metro will forego \$4.9 billion of capital funding over the next 10 years, and this could delay the delivery of 10 to 12 major capital projects by 3 to 5 years.

Metro faces both revenue and cost risks that could have a significant impact on Metro's ability to deliver projects and operate the transit system. As a capital-intensive entity, Metro has the potential to address revenue and cost risks by deferring the delivery of projects or not implementing new projects, versus reduction in ongoing operations and administrative costs.

### **DETERMINATION OF SAFETY IMPACT**

Approval of this item will have no negative impact to the safety standards of Metro.

### **FINANCIAL IMPACT**

#### **Impact to Budget**

This item does not involve the expenditure of funds and has no impact to the FY 2019 budget. The SRFF fund assignments are generally consistent with the adopted FY 2019 budget.

### **IMPLEMENTATION OF STRATEGIC PLAN GOALS**

This item supports the adopted Metro Vision 2028 Strategic Plan Goal #5, which seeks to "Provide responsive, accountable, and trustworthy governance within the Metro organization." The SRFF helps ensure fiscal responsibility in how fund assignments are made and transparency in the agency's investment decisions.

### **NEXT STEPS**

The fund assignments in the SRFF will be the basis for grant funding to Metro projects and programs, and Metro staff will include the assignments in the federally-mandated Transportation Improvement Program (TIP). The projects must be included in the TIP to be eligible for federal grant assistance.


### **ATTACHMENTS**

Attachment A - Short Range Financial Forecast (FY 2019 to FY 2028)

Attachment B - Project Profiles

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